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# The Strategic Role of Firm Legitimacy in Small and Medium Enterprises

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Customers' acceptance of a product or service is related to the customers' beliefs and perceptions. The acceptance and marketability of a product would be improved if customers had a good perception or legitimacy on a business firm. Legitimacy refers to the social justification of the organisational action which can be accepted and verified by social rules. The firm legitimacy process involves social accreditation of the organisational competency or the role played by the organisation in providing the product or service. This article discusses the types of legitimacy and its strategic roles in enhancing the small medium enterprises' competitiveness.

**Key words:** *SMEs Competitive Advantage, Firm Legitimacy, Strategic Legitimacy.*

## Introduction

Legitimacy is an aspect which should be focused on by any organisation, whether it is profit-oriented or otherwise. The organisation should acquire recognition or social acceptance from the environment in which it operates (Alam, Bhuiyan, Jani, & Wel, 2016; Mülazimoglu, 2017; Hasbani & Breton, 2013; Huybrechts & Nicholls, 2013; Massey, 2001; Middleton, 2013; Shoemaker, 1982; Voisey, Onkelinx, Sleuwaegen, & Buysse, 2010; Zimmerman & Zeitz, 2002). Legitimacy plays an important role in the market or industry acceptance of a firm or product. Small to medium enterprises (SMEs) need legitimacy to acquire and improve customers' acceptance of small, unknown companies and unfamiliar products ( Muhammad, 2016; Huybrechts & Nicholls, 2013; Meutia & Ismail, 2012; Middleton, 2013; Mort, Weerawardena, & Liesch, 2012).

Legitimacy is defined as the social evaluation of an organisation (Hasbani & Breton, 2013; Ivanova & Castellano, 2011), the environment's acceptance of the organisation (Hannan & Freeman, 1984; Meyer & Rowan, 1977) and the social justification of the organisational action which can be accepted and verified by social rules (Branco, Eugenio, & Ribeiro, 2008; Dacin, Oliver, & Roy, 2007; Johansen, 2012). The popular definition of legitimacy as used in the literature was introduced by Suchman (1995, p. 574) who defined it as: "the general perception and assumption that the organisation's action are correct, legitimate and relevant with the norms, values and beliefs in a social system". Briefly, legitimacy is a social contract between the firm and the community in its environment (Eugénio, 2013; Hooper, 2012), which allows the firm to function according to the community's norms and values (Farache & Perks, 2010; Mujtaba & Jamal 2018).

## Firm Legitimacy

### *Types of legitimacy*

Every firm will attempt to acquire legitimacy as a competitive edge to differentiate itself from other companies. As such, the legitimacy acquired by a firm is different from another as demonstrated by a social legitimacy process (Dacin et al., 2007). The social legitimacy process involves the firm's effort to acquire legitimacy, to maintain the current legitimacy level, or to improve on or to maintain the decreased legitimacy (O'Donovan, 2002, p. 349).

Suchman (1995) divides legitimacy into three types: pragmatic legitimacy, normative legitimacy and cognitive legitimacy. Zimmerman and Zeitz (2002) added another type of legitimacy which is industrial legitimacy. Pragmatic or regulative legitimacy is the firm's adherence to standard procedures like policy and regulations of the government, professional bodies and non-profit organisations (Deephouse & Carter, 2005; Zimmerman & Zeitz, 2002). Normative legitimacy shows how far the firm's actions are aligned with social norms and values (Deephouse & Carter, 2005; Zimmerman & Zeitz, 2002). Table 1 below presents the definitions for each type of legitimacy.

**Table 1**: Types Of Legitimacy

| Types | Definition |
|---|---|
| Regulative Legitimacy | Adherence to regulations, methods, standards, expectations of the government, credential bodies, and professional bodies |
| Normative Legitimacy | Adherence and alignment of the firm's actions with social norms and values inherent in the social system |
| Cognitive legitimacy | Alignment with the norms and usual forms of reference or existing definitions |
| Industrial Legitimacy | Adherence to the different industrial standards |

Source: Suchman (1995) and Zimmerman & Zeitz (2002).

Cognitive legitimacy refers to consumers' awareness of the existence of the firms or new enterprises (Drayer & Martin, 2010). It is acquired by adapting the customary situational definitions used in the industry (Ivanova & Castellano, 2011); for example, new firms or enterprises would adapt the existing forms, definitions, or social organisations' practices in the industry.

As for industrial legitimacy, this refers to the alignment of the practices in the industry, (Zimmerman & Zeitz, 2002). When firms manage to expand globally, there might be a difference between local standards and global standards in the industry. As such, the firm's industrial legitimacy presents a competitive edge which could be beneficial if the firm intends to expand globally.

***Strategic Role of Legitimacy***

Legitimacy could be utilised as a trading asset or something shared between firms. However, legitimacy is not a commodity or a source which can be moved or transferred in terms of ownership; it is a social accreditation and normative support of an organisation or firm (Voisey et al., 2010; Mujtaba, Jamal & Shaikh 2018). In an effort to remain competitive, SMEs not only require material resources and technical information, but they also have to acquire social acceptance and social credibility in the environment in which they operate (Scott, Ruef, Mendel, & Caronna, 2000).

As previously mentioned, limited resources would force SMEs to find external resources as well as make full use of existing resources (Mort et al., 2012). Legitimacy provides an opportunity for SMEs to access external resources and this contributes to performance improvement (Ivanova & Castellano, 2011). With legitimacy, a firm could attract or acquire capital resources, skilled manpower, and, most importantly, persuade customers to remain in the industry (Voisey et al., 2010). Dacin, Oliver, and Roy (2007) divide legitimacy into 5 types (as shown in Table 2) which could be acquired via a cooperative network or a strategic partnership.

**Table 2**: Roles Of Legitimacy From The Perspective Of Strategic Partnership

| Types | Definition | Source |
|---|---|---|
| Market Legitimacy | The right and qualification to conduct a business in certain markets | Legitimacy of the business partners in certain markets |
| Relationship Legitimacy | The belief and trust to become business partners | Relationship with all business partners |
| Social Legitimacy | The firm's adherence to social regulations and expectations | Social image of business partners |
| Investment Legitimacy | The legitimate business activity | Support and confidence of business partners in the business activity |
| Alliance Legitimacy | Legitimate and aligned strategic alliance | *Isomorphism :(similarity):* Sharing features/purpose with business partners though each has a different identity. |

Source: Dacin, M., Oliver, C., & Roy, J. (2007).

Expanding on previous studies (Aldrich & Fiol, 1994; Dacin et al., 2007; Deephouse & Carter, 2005; Hannan & Freeman, 1984; Meyer & Rowan, 1977; Suchman, 1995; Zimmerman & Zeitz, 2002), Ivanova and Castellano (2011) suggest two types of legitimacy especially for SMEs which are functional legitimacy and relationship legitimacy. These two types are suggested by taking into account the business environment which is ever-changing and volatile. These types of legitimacy should be developed by SMEs in order for them to compete in today's dynamic environment and also if SMEs wish to expand globally (Ivanova & Castellano, 2011; Sahid & Habidin, 2018).

Legitimacy provides a signal for current and future business partners about the firm's capability and competency. It functions to attract other firms to become the SMEs' business partners. The firm's capability consists of resources and competency (Johnson, Scholes, & Whittington, 2005); these two components are important factors for SMEs to advance, especially if they aim to be involved in the global market (Ivanova & Castellano, 2011).

The term 'resources' refers to the assets owned by the firm and includes tangible and intangible assets. Teece, Pisano, and Shuen (1997) explain competency as a routine activity or organisational process such as the firm's technical expertise. The processes inherent in the firm also include competencies and business processes defined as a "set of activities designed to achieve a specific aim for certain customers, whether external or internal" (Davenport, 2005, p. 105).

Relationship legitimacy refers to the legitimacy or value of the firm to become a business partner (Dacin et al., 2007; Ivanova & Castellano, 2011). This type of legitimacy is evaluated based on two elements: the relationship of business partners with other entities and specific features of the business partners themselves. A network with other business partners would provide an advantage to SMEs in terms of obtaining access to other firms. The firm's features would also attract other companies to form a partnership with it; each company would be able to observe the unique characteristics of the potential business partner. The similarities as well as differences would be the decisive factors in forming a partnership (Ivanova & Castellano, 2011; Mujtaba,et.al 2018; Sahid & Hamid, 2019).

## Conclusion and Suggestions

To conclude, legitimacy plays an important role for SMEs who face limited resources as well as those who have a tiny network of business partners. Legitimacy is a reflection of the relationship between an organisation and its environment. Legitimacy of SMEs would enable full utilisation of resources as well as providing access to the external resources of other firms who are also business partners with the SMEs. As such, SMEs should strive to acquire, expand, and maintain the legitimacy that they possess. Every action taken by the firm should consider the social and industrial environment factors which would be useful in evaluating the SMEs' legitimacy. Support for legitimacy would ensure the SMEs' success in remaining competitive in the industry. Therefore, studies on legitimacy in SMEs should focus on how these firms acquire legitimacy as well as strategies to develop and retain legitimacy as a competitive edge for SMEs.

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