

Analysis on the Mechanism of Improving Legitimization of Internet Companies

—From the Perspective of Stakeholders

Daming Huang*
School of Business Administration
Zhejiang Gongshang University
Hangzhou, China

Yueyi Xiang
Hangzhou Yunzhi Science and Technology Co, Ltd.
Hangzhou, China

Guopeng Xiang
School of Business Administration
Zhejiang Gongshang University
Hangzhou, China

Xingwu Luo
School of Business Administration
Zhejiang University of Finance and Economics
Hangzhou, China

Abstract—How to break through multiple legitimacy constraints to gain stakeholder recognition is a problem that every startup company must solve. From the perspective of stakeholders, this paper applies case study and grounded theory, reveals the inner mechanism of legitimacy formation and evolution of Giant Network and JD in the life cycles. Finally, we use grounded theory to build the mechanism of improving legitimization of Internet companies. The conclusions are as follows: during the process of improving legitimization of internet companies, the conformance strategy and manipulation strategy are mainly used to overcome the regulative legitimacy constraint and cognitive legitimacy constraint from competitors and customers in the startup and growth phases. Conformance strategy is the most commonly used one to overcome the regulative legitimacy constraint and normative legitimacy constraint from government, competitors and the public in the mature phase. Due to dynamic of legitimacy and the heterogeneity of stakeholders' legitimacy judgment, enterprises should adopt different legitimate strategies based on the different stakeholders at different phases.

Keywords—stakeholders; legitimacy constraint; legitimate strategy; Internet company; improving legitimization

I. INTRODUCTION

From the inception of the reform of economic system in 1978, China's economy has entered a new stage--economic transformation period. China's Internet industry was born in such a period of opportunities and challenges in which it not only suits to the circumstances for survival and development, but also obtains necessary resources for companies' proactiveness and innovation through institutional innovation--organizational legitimacy. The issue of organizational legitimacy has caused "double-edged sword" effect on Internet companies: on the one hand, legitimacy is conducive to gain scarce resources for startup companies from stakeholders [1];

on the other hand, the legitimacy threshold hinders the growth of startup companies [2]. Under the same legitimacy constraints, some Internet companies only last briefly, but others can break through legitimacy constraints to develop and grow. For example, Alibaba successfully launched B2B e-commerce model; Giant Network broke the older pattern that "Pay to Play"; and JD created new e-commerce model by strengthening self-built logistics system and self-run logistic mode, thus standing out from competitions.

These Internet companies face multiple legitimacy constraints in the process of legitimization which in nature have a relationship with the legitimacy evaluators that are stakeholders. Therefore, this raises the following questions: 1. Who are the stakeholders involved in the legitimization of Giant Network, JD and other Internet companies? 2. Which legitimate strategies are likely to be adopted based on different stakeholders? 3. Legitimacy can be divided into regulative legitimacy, normative legitimacy and cognitive legitimacy. Which kind of legitimacy will Internet companies ultimately acquire for improving legitimization? 4. If the process of legitimization in Internet companies can be divided into different phases, then whether the above-mentioned questions are different in different phases?

Therefore, this paper takes Giant Network and JD as research objects to analyze the stakeholders that Internet companies face in each phase in the life cycle by using stakeholder theory, legitimacy theory and enterprise life cycle theory and to build general model of the mechanism of improving legitimization of Internet companies based on the legitimate strategies and legitimization which different stakeholders have adopted.

II. LITERATURE REVIEW

A. Improving legitimization

From the viewpoint of new institutionalism in organizational sociology, the legitimacy of an organization lies

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in the consistency between organizational behavior and its institutional environment [3]. In a sense, we can equate the legitimacy of an organization with the institutional entrepreneurship. In the entrepreneurship research of new institutionalism, field acts as unit of analysis and is at the core status. Field can be divided into emerging field and mature field. In the emerging field, regulations and relational structure have yet to define, having higher uncertainty and lower structuration. In the mature field, regulations and relational structure have already formed, having higher certainty and structuration [4]. Thus, the entrepreneurship research varies in different field. As an emerging economy in transformation period, China's market economic system is not sound and institutional environment is volatile, which provides suitable environment for the research of legitimacy in the emerging field [5]. Meanwhile, legitimization can be divided into two categories based on the incompleteness and vacancy in the evolution progress of emerging field: improving legitimization and exploiting legitimization, among which improving legitimization refers to the process of legitimization by innovation and perfection of original institution and exploiting legitimization refers to the process of legitimization by creating a new institution. This paper chooses improving legitimization as its research object. Some scholars [6] had analyzed how to coordinate and satisfy interest appeals of different stakeholders among AIDS patients, pharmaceutical companies and government in the constructive process of AIDS Treatment Committee in Canada which is in fact a typical case of improving legitimization. With the Canada's top five accounting firms as an example, some researchers [7] studied how new form of organization break through legitimacy constraints to successfully merge between acquired law consulting company and original accounting service and ultimately gain recognition from stakeholders. However, scholars does not analyze the mechanism of legitimization and explain the characteristics of improving legitimization well, especially in the new form of economy of "Internet plus" in which plenty of traditional industries begin to transform and upgrade. Therefore, it is of great significance to analyze the mechanism of improving legitimization of Internet companies.

B. Stakeholders and legitimacy

Legitimacy is defined as "generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" [8]. This definition is widely cited in the later study. Legitimacy can be understood as behavioral outcome perceived and evaluated by stakeholders, which means to what extent stakeholders accept organizational behavior. In addition, Scholars [9] come up with legitimacy-as-perception in a review article about legitimacy in *Academy of Management Annuals* which also emphasized the perception of legitimacy and the component of subjective evaluation. They suggest that it is the individual perception of the organization (or other social entities) that cause their evaluation on legitimacy [10] and generate corresponding behavior on the basis of these evaluations, thus triggering a series of consequences [11].

However, existing researches assumes that stakeholders have homogeneity in the evaluation process of legitimacy in

startup companies [12]. However, the resources startup companies need comes from many different stakeholders which always have different norms, religions, regulations and procedures to evaluate a company. The conformance, selection, manipulation and creating strategies can be adopted based on different stakeholders. The objects studied in this paper are Internet companies, which are technology-based companies. They can be defined as high-tech companies, the stakeholders of which can be divided into the following six categories; government, customers, employees, the public, suppliers and competitors. The acquisition of legitimacy can provide key resources for the development of companies. Conversely, the recognition and support from stakeholders will reduce. This, to a large extent, makes the survival and development of companies to be constrained by legitimacy which has multiple dimensions. According to the most cited classification of legitimacy [13], legitimacy constraints can be divided into regulative legitimacy constraint, normative legitimacy constraint and cognitive legitimacy constraint. Regulative legitimacy constraint refers to the constraint on companies' behavior from rules and laws enacted by government and conventions and regulations in industry; normative legitimacy constraint refers to the constraint on companies' behavior from social code of conduct and value; cognitive legitimacy constraint refers to the constraint on companies' behavior from their popularity in public.

C. Enterprise life cycle theory

The legitimacy that organizations acquire and the subject that gives the legitimacy are all dynamic and changing, which creates opportunities and challenges for organizational administrators in cultural environment to acquire legitimacy with limited resources. The existing literatures mainly focus on the relationship between legitimacy and startup companies and innovation, most of which examine the mechanism of legitimacy in the companies' behavior from a static and holistic perspective instead from the perspective of process. Therefore, it is of great significance to introduce enterprise life cycle theory to study the acquisition of legitimacy. Enterprise life cycle theory dates back to the middle of twentieth century. Some scholars [14] first come up with the view of "life cycle", which means that the method and principles of bionics are adopted to study enterprises issue. Some researchers [15] held in his book *Enterprise Life Cycle* that enterprises, like organism, also experience the process from birth to death and from prosperity to decline. One of the most representative views [16] put forward is the four-phase model: startup phase, growth phase, mature phase and decline phase. Similarly, companies' legitimacy varies dynamically with the change of stakeholders' needs. Some scholars [8] conducted dynamic researches on the process of legitimacy from the acquisition, maintenance and restoration of legitimacy. By combining with different phases of enterprise life cycle, the changes of legitimacy constraint in the process of legitimization of Internet companies is explored and the relationship between stakeholders and legitimate strategies is analyzed, which is conducive to reveal the mechanism of improving legitimization of Internet companies.

III. RESEARCH DESIGN

A. Research method

Cases study is particularly suitable for new fields researches and fields with inadequate researches. The case study in this paper is exploratory case study which can be applied to the "why" and "how" questions. In addition, this paper introduces other analytical methods or tools to make up for the deficiency of case study, but only being the tools to analyze case data: firstly, timing analysis is adopted to divide the life cycle of two companies. Based on theories review and taking business growth and key events as reference, the life cycle of two Internet companies can be divided into three phases: startup phase, growth phase and mature phase. Taking the birth of Chinese online games in 2000, independent research and development of online game Journey in November 2004 and the official version of Journey in July 2007 as key dates, the startup phase of Giant Network started from the year of 2000 to November of 2004, the growth phase from November of 2004 to August of 2008 and the mature phase from August of 2008 up to now. Taking the establishment of JD in 1998, 500 daily order processing number in multimedia network of JD in November 2005 and the construction of 3C products in the whole lines in 10th anniversary of JD in June 2008 as key dates, the startup phase of JD started from the year 1998 to November of 2005, the growth phase from November of 2005 to June of 2008 and the mature phase from June of 2008 up to now. Secondly, content analysis method is adopted to encode legitimacy constraints, stakeholders and legitimate strategies.

B. Cases selection and data collection

This paper abides by the following 3 standards in the selection of cases: first, consistency with research topic. Both of these two Internet companies break through legitimacy constraint and innovate and perfect the existing regulations in industry, belonging to the improving legitimization. Additionally, these two companies adopt legitimate strategies to acquire the recognition from stakeholders and have relatively complete process of legitimization. Second, typical cases. Giant Network breaks traditional "Pay to Play" model and launches "Free to Play" model to enter into online game industry, becoming the leading company in industry. JD breaks the B2B e-commerce regulations established by Alibaba to build new B2C e-commerce regulations, thus laying a leading foundation in B2C field. Thirdly, detailed information on cases. These two Internet companies are both leading ones in their own fields and have a history of more than a decade from their foundation. There are abundant academic research literatures, publications and news report about these two companies, so it is adequate to study these two companies by analyzing second-hand data. Therefore, this paper chooses Giant Network and JD these two Internet companies as samples.

The evidence for cases study can be obtained through different channels. There are six sources of evidence for cases study: document, archival record, interview, direct observation, participatory observation and physical evidence. Furthermore, many scholars conduct cases study based on second-hand date. Because the selected Internet companies are highly popular and

there are abundant academic literatures, publications and news report about these two Internet companies, it is adequate for this paper to research based on second-hand data. This paper follows three principles in data collection: evidence from multiple sources; the database of cases study is built to form a series of evidence chain; cross validation of data is realized to enhance the reliability of second-hand date. And this paper adopts seven different methods to collect data: (1) important articles and news report related with these two Internet companies in the website of China Academic Journal Net; (2) the official websites of these two Internet companies; (3) related industrial analysis and cases study in institutions of higher learning; (4) news report in authoritative portal websites such as Netease, Sina; (5) related books of two Internet companies; (6) comprehensive websites such as China Business Journal, China Management Communicating, 21 manager, etc.; (7) applied journals and industrial reference data.

Through the sorting out of the collected data, 3 sub-databases are established in accordance with the difference of contents: database of legitimacy constraints, database of stakeholders and database of legitimate strategies. Grounded theory is adopted in this paper to encode. The encoding group includes 1 host and 2 coders whose research fields are institutional entrepreneurship and legitimacy respectively, which is helpful to decrease comprehension deviation on coding variables. In addition to this, this study guarantees the consistency and reliability of coding results from three aspects: first, trainings are organized for the coding team members to explain the relevant concepts in the articles and ensure that the coders are familiar with the relevant operation contents and procedures; second, the relevant concepts are printed out so that the coding results are not affected by coders' confusion or ambiguity on the concept; third, coding members are arranged to tentatively do coding task, consult with the tutor and the field experts on the differences in the coding process, and reach consensus.

IV. CASES ANALYSIS

A. Legitimacy constraint

Both of these two companies face regulative legitimacy constraint in life cycle and the components of legitimacy constraints are different in different phases. In the startup and growth phases, regulative legitimacy constraint and cognitive legitimacy constraint are the main legitimacy constraints of two companies. In the mature phase, the regulative legitimacy constraint and normative legitimacy constraint become the main legitimacy constraints of these two companies. In the startup and growth phases, Giant Network, as a new beginner, not only observes widely-recognized regulations and rules in industry, but also is in urgent need to improves its popularity. Therefore, the legitimacy constraint of Giant Network is mainly the regulative legitimacy constraint and cognitive legitimacy constraint. In the mature phase, such problems as violent scene in online game Journey and teenager's addiction to games triggered the attention of public opinion and supervision departments to intervene for investigation. So, the legitimacy constraint for Giant Network in the mature phase is regulative legitimacy constraint and normative legitimacy

constraint. B2C mode of JD and B2B mode of Alibaba are different, but owing to Alibaba's prevalence of e-commerce, the regulative legitimacy constraint JD faces is not very high. Furthermore, it was in the accidental circumstance of SARS that JD transformed from traditional retail into e-commerce, which makes the cognitive legitimacy constraint and regulative legitimacy constraint the main constraints in its startup and growth phases. However, in the mature phase, the continuous price war in industry causes the regulative legitimacy constraint and normative legitimacy constraint the major constraints for JD in this phase.

B. Stakeholders

During each step of this life cycle, the two companies should have different stakeholders. In the startup and growth phase, Giant Network replaces "Pay to Play" model formulated by competitors by "Free to Play" model and overthrows the habit of charge for online game players, thus its stakeholder are mainly competitors and customers. In the mature phase, the increasing reports on teenage addiction on online games attracted attention from the public and supervision department, so its stakeholders are mainly the government and the public. The stakeholders of JD in its startup phase are mainly the public, customers, employees and competitors. In the growth phase, the stakeholders are suppliers, the public and competitors. In the mature phase, the stakeholders are competitors, suppliers and the government. Because Giant Network sells virtual products, competitors are greatly influenced by the resources associating with existing mode of game products. All the key supply chain resources JD needed are at suppliers' disposal: (1) JD was forced to transform from traditional retail into e-commerce due to the bursting of SARS. And at that time, the popularity of Internet in China was relatively low and employees boycotted transformation; (2) In the growth phase, low price strategy of JD not only impaired the interests of suppliers and competitors, but also raised the public doubts about the authenticity of the promotion; (3) In the mature phase, the price battle became more and more intense between JD and traditional retails and other competitors. Meanwhile, suppliers cancelled the cooperation with JD under the disguise of refusing to open API to JD, thus causing supervision department to intervene for investigation.

C. Legitimate strategies

During each step of this life cycle, Giant Network and JD adopted different legitimate strategies in different phases. In the startup phase and growth phase, because competitors and players were accustomed to traditional "Pay to Play" model, Giant Network chose the following manipulation strategies: 1. advertisement on CCTV; 2. A lot of salesmen were sent to Internet bars in second- and third-tier cities to book a whole bars to have players experience Journey with no charge. In the mature phase, supervision department enacted a series of official standardization documents such as "anti-addiction" and "opening boxes" which greatly influenced Giant Network. At this moment, Giant Network adopted conformance strategy to response to the government call, decrease the number of "boxes" and launch "trade tax" as its new method of earning profits, thus successfully overcoming the hardship and difficulties. JD was transformed into B2C model in its startup

phase which not only cannot be understood by customers and the public, but also experienced the boycott from employees. Therefore, there was no intense conflict with existing environment by adopting conformance strategy and it was easier to gain the recognition from stakeholders. In the growth phase, JD mainly adopted manipulation strategy and invested the capital financed in the third time into self-built logistics to strengthen the manipulation of suppliers. In the mature phase, JD was under the regulative legitimacy constraint of "third part logistics" and the license of "home appliances for rural areas", so it mainly adopted conformance strategy and gain the recognition and permission from relevant government departments by allying with key stakeholders.

Through above analysis, this article builds the general model of the mechanism of improving legitimization of Internet companies. But there are following two aspects needed to explain: first, although enterprise life cycle is introduced to divide the process of legitimization, there is no distinct boundary in each phase of life cycle and companies also adopt various legitimate strategies on stakeholders; second, Internet companies may face multiple legitimacy constraints in different phase and adopt multiple legitimate strategies based on different stakeholders, but what the model presents are the major legitimacy strategies, stakeholders and legitimacy constraints.

V. CONCLUSION

A. Research conclusion

The research conclusions include the following aspects: (1) with regard to legitimacy constraint, regulative legitimacy constraint is the major constraint Internet companies face. Due to ingrained existing regulations in industry, regulative legitimacy is hard to be acquired in one step and need to conform to the environment to gain it gradually. In the startup phase and growth phase, the legitimacy constraints of Internet companies are regulative legitimacy constraint and cognitive legitimacy constraint. There is upward trend for normative legitimacy and downward trend for cognitive legitimacy constraint in enterprise life cycle. In the mature phase, regulative legitimacy constraint and normative legitimacy constraint become the major legitimacy constraints Internet companies face. (2) with respect to stakeholders, the most critical stakeholders are competitors. Due to ingrained regulations in industry, the popularity and market share that startup companies need are manipulated by dominant companies. In the startup phase and growth phase, competitors and customers are the main stakeholders of Internet companies for the acquisition of market share in this phase. While in the mature phase, in order to standardize industrial competitiveness and protect public interest, government, competitors and the public become the main stakeholders. (3) As for legitimate strategies, the conformance strategy is the most used strategy. In the startup phase, companies are not equipped with adequate resources and abilities, thus the conformance strategy is used to adapt to the environment for the development and growth. While in the growth phase, after having built up some legitimacy, companies begin to use manipulation strategy to promote and implement new system in an all-round way. In the

mature phase, companies need to adopt conformance strategy to improve new system and standardize industrial development together with competitors and government.

B. Theoretical contribution and practical implication

The theoretical contribution reflects in the following aspects: (1) The formation and the mechanism of evolution of legitimacy in Internet field are researched. In the past, most researches focus on the source of legitimacy of traditional companies and legitimate strategy [17] and few researches examine the type of legitimacy and the legitimate strategies of Internet companies in different phases from the vertical perspective. This paper has an in-depth analysis on the inner mechanism of legitimacy by studying the process of improving legitimization of Giant Network and JD. (2) We contribute to the legitimacy and entrepreneurship literature by explicitly linking legitimacy criteria to systemic changes in the stakeholders, thus building a richer, more nuanced, and comprehensive perspective of legitimacy. In the past research, legitimacy was defined as two kinds of nature variable "legitimacy" and "illegitimacy" for the convenience of measurement and it would not be taken into consideration any more once it was acquired, which restricts the development of

legitimacy theory [18]. Although some scholars begin to pay attention to taking legitimacy as the existence of continuous variables, it has not been proved. This paper analyzes the dynamic change of legitimacy in different phases of life cycle based on two examples from the vertical perspective. (3) The heterogeneity of stakeholders in the evaluation process of legitimacy is confirmed. In the past, researches assumed that stakeholders have homogeneity in the evaluation process of legitimacy, but as a matter of fact, the standard of evaluation is different for different stakeholders [19]. By analyzing the change of stakeholders and legitimate strategies in different phases of life cycle, this paper further proves such conclusions.

This paper provides reference for the legitimization of Internet companies similar with Giant Network and JD: first, there is a trade-off for the acquisition of legitimacy in different phases of life cycle. And it should properly allocate limited resources step by step to acquire legitimacy. Second, since the legitimacy that organizations acquire and stakeholders who give the legitimacy are all dynamic and changing, it requires Internet companies to adopt legitimate strategies based on key stakeholders.

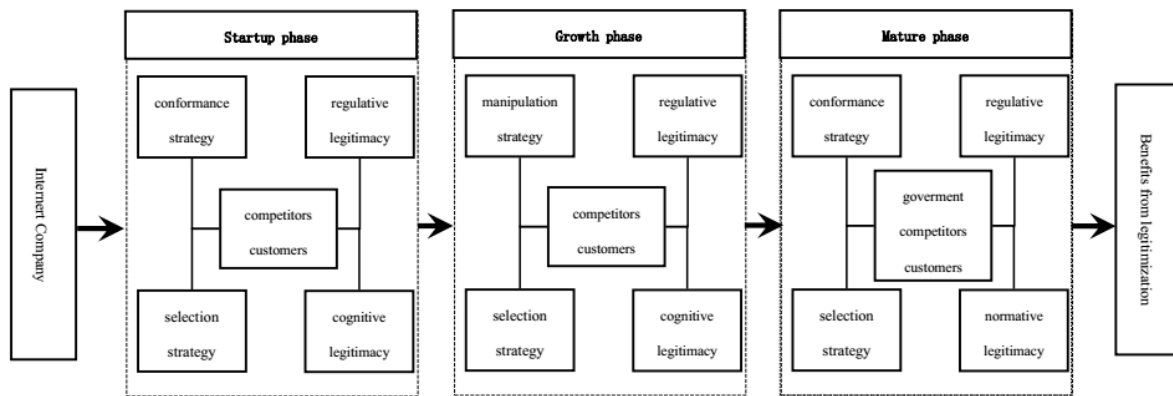


Fig. 1. The general model of the Mechanism of Improving Legitimation of Internet Companies

C. Research limitation and future research direction

There exist the following deficiencies in this research: the second-hand data are used to analyze the cases and the first-hand data are inadequate. Only two Internet companies are chosen to generalize the mechanism of improving legitimization. The universality of this conclusion has yet to be further proved. In the future, the research can be conducted from the following aspects: quantitative research of legitimacy from the perspective of stakeholders; role shift of legitimacy theory: from "leading role" into "supporting role"; to strengthen the analysis on industrial background and to testify companies in different emerging economies.

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