Strategic Management Journal
Strut. Mgmt. J., 28: 169-187 (2007)
Published online in Wiley InterScience (www.interscience.wiley.com) DO1: 10.1002/smj.577
Received 9 June 2003; Final revision received 26 June 2006

THE LEGITIMACY OF STRATEGIC ALLIANCES: AN INSTITUTIONAL PERSPECTIVE

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Drawing on an institutional perspective, this paper suggests that strategic alliances serve an important legitimating function for firms and that this role, mediated by alliance governance structure and partner selection preferences, has a significant influence on firm and alliance performance. A theoretical framework is proposed that identifies five types of legitimacy associated with strategic alliances and the specific conditions under which legitimation may be an important outcome of strategic alliances. Propositions are developed to explain when firms are most likely to enter into alliances for legitimacy purposes and how the legitimating role of strategic alliances contributes to firm and alliance performance. The paper concludes with a summary and implications of a legitimacy-based view of alliances. Copyright © 2007 John Wiley & Sons, Ltd.

Strategic alliances continue to grow in popularity (Dyer, Kale, and Singh, 2001), and recent years have witnessed a burgeoning interest in the functions and advantages of strategic alliance formation. The key advantages that have been attributed to the establishment of strategic alliances include entry into new markets (Garcia-Canal *et al.,* 2002), increased market power (Eisenhardt and Schoonhoven, 1996; Kogut, 1988), the acquisition and exchange of skills (Hamel, 1991; Kogut, 1991; Mowery, Oxley, and Silverman, 1996), strategic renewal (Borys and Jemison, 1989), risk and investment sharing (Anderson, 1990; Ring and Van de Ven, 1992), economies of scale and scope (Contractor and Lorange, 1988; Mohr and Spekman, 1994), reductions in liabilities of foreignness (Mezias, 2002; Zaheer, 1995) and government or trade barriers (Contractor and Lorange, 1988; Hagedoorn, 1993), and the acquisition of institutional legitimacy (Baum and Oliver, 1991).

Although interest in the drivers of strategic partnering has revealed a significant number of strategic benefits from collaboration among firms, the broad literature on strategic alliances pays scant attention to the legitimacy-based function of alliances. While different theories, such as transaction cost theory (Barney and Hesterly, 1996; Ireland, Hitt, and Vaidyanath, 2002), the resource-based view (Chung, Singh, and Lee, 2000; Eisenhardt and Schoonhoven, 1996), organizational learning theory (Kale, Singh, and Perlmutter, 2000; Khanna, Gulati, and Nohria, 1998), and social network theory (Ahuja, 2000; Gulati, 1999; Kenis and Knoke, - 2002) have been used to derive theoretical rationales for alliance formation, the acquisition or enhancement of legitimacy has been largely overlooked as a specific benefit of alliance formation. In addition to limited attention given to the legitimating role played by alliances in contributing to firm and

Keywords: alliances; legitimacy; institutional
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partnership success, research to date has failed to explain how this legitimating role might influence alliance governance structure and alliance partner preferences.

This paper attempts to extend our understanding of strategic alliances by examining the legitimating aspects of strategic alliances. Drawing on an institutional perspective, we will argue that the social, symbolic, and signaling characteristics of alliances may serve as a source of legitimacy for partnering firms, and that this legitimacy itself is a strategic resource with the potential to yield significant economic and competitive (i.e., technical) benefits for firms. For this reason, firms will often be driven to achieve legitimacy. Accordingly, we suggest that legitimacy serves as a means to achieve competitive or technical ends rather than an end in itself in firms' decisions to establish alliances. Based on these arguments, this paper develops a theoretical framework that identifies the specific conditions under which firms are likely to enter into strategic alliances to meet legitimacy needs, and what factors will mediate the likelihood that fulfillment of these needs will lead to improved firm and alliance performance. This framework suggests that there are five types of legitimacy needs, that there are identifiable conditions under which firms need legitimacy and that the extent to which fulfillment of these legitimacy needs enhances firm and alliance performance will be dependent upon the establishment of an appropriate alliance governance structure and the selection of an appropriate partner. Our purpose is not to supplant strategic and operational explanations of alliances, but rather to extend recent efforts to synthesize strategic and institutional perspectives (e.g., Lounsbury and Glynn, 2001; Oliver, 1997; Rao, 1994) by suggesting that they complement rather than compete with a legitimacy explanation of firm and strategic alliance performance.

The paper begins by defining key terms and reviewing the literature relevant to a legitimacy-based view of strategic alliances. The five legitimating functions of alliances are then proposed and a theoretical framework is introduced to explain the rationale, sources, targets, and outcomes of these roles, as well as the environmental and firm characteristics driving the specific legitimacy needs. Propositions are then advanced to suggest how a firm's need for legitimacy may influence its strategic alliance governance structure and partner preferences, and how these, in turn, are likely to influence firm and alliance performance. The paper concludes with a summary and implications of a legitimacy-based view of alliances.

CONCEPTUAL BACKGROUND

Strategic alliances and legitimacy: Basic definitions

Strategic alliances are commonly defined as shorter long-term voluntary relations between organizations concerning one or more areas of activity— such as market entry, skill acquisition, or technological exchange—in which both parties regulate their future conduct *ex ante* by means of mutual forbearance and more or less formally specified contractual mechanisms (e.g., licenses, outsourcing agreements, joint manufacturing agreements) (Buckley and Casson, 1988; Gulati, 1998). A variety of alliance types, distinguished by varying contractual mechanisms that dictate their governance structure (i.e., control and coordination features), have been identified by prior research (e.g., Gulati, 1995b; Pisano, 1989; Pisano, Russo, and Teece, 1988). The various types may be categorized as equity agreements (e.g., joint venture, minority equity positions, and equity swaps) and non-equity agreements (e.g., joint R&D, long-term sourcing agreements, reciprocal distribution, and less than arm's length franchising and licensing relationships). Joint ventures, which involve partners creating a new entity in which they share equity and most closely replicate the hierarchical control features of organizations, fall at one end of the spectrum, while less than arm's length contracts, such as licensing agreements with no sharing of equity that have few hierarchical controls built into them, anchor the other end of the spectrum (Gulati, 1995b; Gulati and Singh, 1998). Existing typologies of strategic alliances do not typically include mergers and acquisitions, wholly-owned subsidiaries, exporting, or arm's-length transactions carried out in spot markets.

Legitimation refers to the social justification of an actor or activity, such that the actor or activity is publicly validated or endorsed (Perrow, 1961). The process of social validation involves recognition of a distinctive competency possessed or role-played by the organization in providing a good or service. According to Selznick (1957), an organization and its leaders will attempt to market

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this competency to relevant constituents. Following Suchman (1995: 574), legitimacy is defined as 'a 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.' Legitimacy varies across firms and is bestowed discriminately through a process of social endorsement. Legitimacy is transacted or exchanged between parties (Pfeffer and Salancik, 1978). An organization's need for legitimacy is driven by a combination of the, characteristics of the organization as well as its context. The concept of legitimacy is akin to, but distinct from, the concepts of reputation and prestige. Reputation has been described as representing the affective or emotional reaction to a firm and is defined as the overall emotive estimation of a firm by its constituents (Fombrun, 1996: 37). Organizational prestige refers to the acquisition of a favorable public image that involves recognition of distinctive competencies or roles (Perrow, 1961: 335). In our view, legitimacy is a broader concept that pertains to the extent to which a firm's structures and activities appear to conform with social norms, values, and expectations of the firm's economic and social environment. We acknowledge, therefore, both the strategic and institutional functions of legitimacy.

Strategic alliances: An institutional view

Institutional theorists (DiMaggio and Powell, 1983; Scott, 1995) propose that organizational actions are driven by social justification, that is, by the desire of organizational actors to give a plausible and meaningful account of their actions. From this perspective, strategic activities are socially and normatively defined because their motives derive from an actor's propensity to legitimate or account rationally for such activities, and their effectiveness is judged by a range of constituents (e.g., shareholders, customers, governments, public interest groups) who assess the appropriateness or legitimacy of strategic activities from their own perspective. According to institutional theory, strategic and economic activity is embedded in a social and normative context and this context motivates economic actors to seek legitimacy or approval for their actions, particularly from those constituents on whom the actors depend for physical, human, financial, or reputational capital (Amburgey, Dacin, and Singh, 1996; Oliver, 1996). Institutional theory also suggests that the institutional environment (e.g., government, society, community groups) imposes significant pressures on organizations to justify their strategic actions and outputs. These pressures, in turn, motivate organizations to increase their legitimacy with respect to institutional constituents and to conform with institutional rules, regulations, norms, and expectations (Dacin, 1997; Dacin, Ventresca, and Beal, 1999; Scott, 1995).

In this paper, it is proposed that the capacity to meet specific legitimacy needs inherent in strategic alliances yields a variety of technical benefits (e.g., increased access to markets, the ability to attract resources or high quality alliance partners). That is, legitimation is an important means by which technical benefits can be realized and firm and alliance performance can be enhanced. Thus, firms are driven to acquire and maintain legitimacy, and in doing so are able to gain access to strategic and technical benefits such as support and resources from key constituents.

These arguments build on recent work that has begun to examine firms' efforts to establish and maintain interorganizational ties to prominent and legitimate actors and institutions as a means of gaining economic and competitive advantage (Podolny, 1994; Pollock, Gulati, and Sadler, 2002). Although theoretical and empirical attention to the potential link between legitimation and interorganizational relations is limited, a body of work has been developed that demonstrates how ties to actors with substantial reputations and social status can provide a number of organizational benefits. For example, Wiewel and Hunter (1985) found that new organizations were able to increase their legitimacy and longevity as a function of their ability to invoke affiliations with reputable organizations. In this case, legitimacy proved to be an efficient means of maintaining ties with loyal customers. The findings of Sharfman, Gray, and Yan's (1991) investigation of interorganizational collaboration in the garment industry showed that collaboration increased the 'collective legitimacy' of the industry. In a study of public and private day care centers, Baum and Oliver (1991) found that those day care centers that established legitimating interorganizational linkages to well-respected community and state organizations had significantly higher survival rates. Larson (1992) examined the role of reputation as a form of social control and found that reputation influenced both the initiation

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and nature of alliances. Uzzi's (1996) research on interorganizational ties among New York apparel firms revealed that firms embedded in networks tended to have higher survival chances up to some threshold, relative to arm's length market relationships, beyond which the advantages of embeddedness tended to reduce the adaptive capacity of particular firms.

These studies suggest that the legitimacy of relations between firms may influence alliance performance as well as the performance of firms by generating- support for the interorganizational relationship and enhancing the firm's reputation, thereby increasing the firm's survival chances and its ability to procure critical resources or strategic advantages. Due to the transactional and social nature of alliances, it is especially appropriate to examine legitimacy within an alliance context. Alliance activity involves the capture and sharing of risks as well as a variety of tangible and intangible resources (individual skills, knowledge, and contacts). We propose that there are five distinct types of legitimacy needs in alliance formation, and that these play an important role in yielding significant technical benefits for firms and their alliances.

THE LEGITIMACY OF STRATEGIC ALLIANCES: A PROPOSED FRAMEWORK

The type of legitimacy needed by a firm and in turn, the specific targets or constituents to which a firm must appear legitimate, will be driven by the firm's objectives in a particular context, the characteristics of that environment, and the firm's characteristics. Thus, as illustrated in Figure 1, we propose that strategic alliances may provide one or more of five types of legitimacy for a focal firm, which are distinguishable on the basis of these drivers. More specifically, we propose that these determinants may encourage a firm to enter into a strategic alliance to gain market legitimacy, relational legitimacy, social legitimacy, investment legitimacy or alliance legitimacy. While these forms of legitimacy are distinct, a firm may enter into alliances for multiple legitimacy needs. For example, a single alliance may offer the benefit of providing multiple legitimating benefits, and firms may also enter into multiple alliances simultaneously, each of which may fulfill a separate legitimacy function.

The proposed framework outlining the five different types of legitimacy associated with strategic alliances is provided in Table 1 and elaborated below. These five types of legitimacy are differentiated and compared in the table according to the environmental and firm characteristics that drive their need, the targets of the legitimating effort, the source of the legitimacy, and the economic and competitive benefits that result from these legitimating roles of strategic alliances. Given that firms enter into alliances under conditions of multiple motives and benefits, we acknowledge the possibility for interaction and overlap across these proposed types.

Strategic alliances: Market legitimacy

A firm may enter into an alliance primarily to establish or maintain its rights or qualifications to operate in a specific market (i.e., market legitimacy). When a firm has the objective of entering into or continuing its existence in a market, it will often seek out an alliance with a legitimate firm in

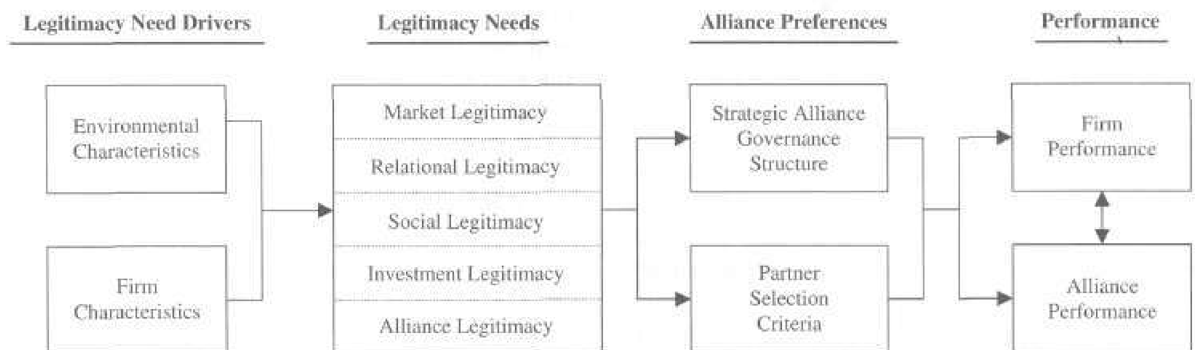

Figure 1. The legitimating roles of strategic alliances and their impact on performance

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Table 1. The legitimating roles of strategic alliances: a proposed framework

	Market legitimacy	Relational legitimacy	Social legitimacy	Investment legitimacy	Alliance legitimacy
Definition	Rights and qualifications to conduct business in a particular market.	Worthiness to be a partner.	Conformity of the firm to societal rules and expectations.	Worthiness of the business activity.	Validity or appropriateness of strategic alliances.
Environmental characteristics driving need for legitimacy	Dependence on government authority and endorsement for market entry and existence.	Competition for attractive partners; Necessity of additional ties in the future.	Monitoring of firm compliance with societal rules and expectations; Importance of socially responsible image to firm survival.	Adoption of the activity by other organizations; Promotion by legitimate entities.	Acceptance of the alliance form in the market.
Firm characteristics driving need for legitimacy	Market experience; Reputation in the market; Past performance in the market; Government endorsement.	Alliance history; Partner image; Dependency of firm business on partnering.	Visibility of firm activity or output; Social impact of firm activity or output; Image of firm's social responsibility.	Past adoption of the activity; Internal proponents of the activity; Duration and intensity of required resource investment in the activity.	Importance of alliance form acceptance for market access and firm success; Acceptance of alliance, form by parent firms.
Motive for entering a strategic alliance	To increase one's legitimacy in a geographical or product market.	To increase one's legitimacy as a good partner.	To increase one's legitimacy as a socially responsible firm.	To increase the legitimacy of the business activity.	To legitimate alliance use.
Legitimacy source(s)	Partner's legitimacy in the market.	Relationship with partner.	Partner's social image.	Partner's support and confidence in the business activity.	Isomorphism.
Target(s)	Governments; Suppliers; Customers.	Potential ties.	Public interest groups; Local communities; Customers.	Board of directors; Corporate executives; Venture Capitalists; Shareholders.	Other organizations; Parent firms.
Economic or competitive benefit(s)	Entrance into or continued existence in a market.	Development of additional interorganizational ties.	Possession of a socially responsible firm image.	Internal endorsement of the business activity.	Social acceptance of the alliance form in the market or by parents.

that market to ensure endorsement and receptiveness by government, suppliers, or customers. For example, Provan (1982) describes agency affiliation with the United Way as a means of helping the agency legitimize its rights to serve in a particular domain. Organizations can also identify with already legitimate practices, symbols, or values that are salient for target market constituents in order to enhance their legitimacy (Bianchi, 2002; Miles, 1982).

The need for such market legitimacy is particularly " relevant when government authority over business is great and government endorsement is essential for existence in a particular market. For example, in many transitional economies, such as China, a firm's right to operate freely in the local market does not necessarily occur automatically. Such markets can prove to be both an expensive and intractable environment in which to operate for firms that have not established sufficient market legitimacy to ensure entry (Peng, 2000). General Motors (Kraar, 1999) and Manulife (International) Ltd (AP Dow Jones, 1996) have successfully entered and maintained their businesses within the Chinese market because they formed alliances with local Chinese firms that served specifically to establish their rights and qualifications to conduct business (e.g., satisfied government equity ownership stipulations) in that Chinese market. Yiu and Makino (2002) demonstrated that such regulative institutional forces that emanate from government and are codified in formal legal restrictions and sanctions can drive a multinational firm to adopt a joint-venture, rather than wholly-owned-subsidiary, mode of market entry.

The need for market legitimacy is also great when a firm lacks the characteristics that contribute to the target's market legitimacy perceptions of the firm, such as experience, a positive reputation, success, or government approval in the market. This 'liability of foreignness' is a critical hurdle for firms as they attempt to compete in new markets (Zaheer, 1995; Zaheer and Mosakowski, 1997). Cargill, Inc., one of the world's largest private agricultural companies, illustrates the critical importance of establishing and maintaining market legitimacy. Lacking experience, a positive reputation, success, and government approval in the Indian market, Cargill encountered substantial resistance from local farmers and eventual failure when influential local politicians and intellectuals opposed their efforts to enter India (Dewan, 1994). More recently, Bianchi (2002) conducted a case study of Home Depot's entry into the Chilean market and demonstrated that successful entry into foreign markets is largely determined by the extent to which a firm's activities in that market are deemed institutionally appropriate and salient *vis a vis* local retailing norms and expectations.

Market legitimacy is also critical for new firms. Lacking much-needed resource endowments, establishing legitimacy is a critical activity for young firms entering new markets. Such firms experience liabilities of newness (Stinchcombe, 1965) as well as liabilities of foreignness (Zaheer, 1995; Zaheer and Mosakowski, 1997). The acquisition of market legitimacy can help to attenuate these critical liabilities by reducing uncertainty in these markets (Larson, 1991). In sum, firms are most likely to need to establish their rights and qualifications to conduct business in a market (i.e., market legitimacy) when government authority or public endorsement is lacking and when firms are perceived to lack sufficient experience to enter into the intended market. Firms that gain market legitimacy develop or enhance their perceived appropriateness among local business and government constituents to conduct business in that market, thereby increasing their likelihood of success in that market.

Proposition 1: A firm will be more likely to enter a strategic alliance to gain market legitimacy when (a) market entry and existence depend on the authority and endorsement of governments and other key actors, and (b) the firm lacks market experience and a positive reputation within that market.

Strategic alliances: Relational legitimacy

Sometimes a firm is motivated, in 'part, to form and perpetuate an alliance to enhance its relational legitimacy, that is, its perceived worthiness as an attractive alliance partner. The literature on interorganizational relations increasingly emphasizes the usefulness of alliances as a means to address problems that range from deregulation, to globalization, to sustainable development (e.g., Bresser, 1988; Bresser and Harl, 1986; Kanter, 1989). Firms have recognized that the collaborative pooling of expertise and resources can solve intractable problems, reduce

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risk, or enhance firm performance in ways that confrontation or competition cannot (Child and Faulkner, 1998). This recognition is reflected in the annual worldwide growth rate of 25 percent among strategic alliances between 1987 and 1997 (Harbison and Pekar, 1998). Along with such recognition has come an increase in the competition for worthy partners, and the pool for such high-quality alliance partners is not infinite, especially in more challenging industries, such as pharmaceuticals, computers, and biotechnology. Thus, N the need for relational legitimacy will be particularly important for firms in environments where competition for attractive partners is intense. Relational legitimacy permits firms to enjoy greater discretion and a wider set of partner choices in making partner selection decisions in alliances. For example, Mips Computer Systems, operating in the high-technology industry where competition for partners is especially severe, formed a coveted alliance with DEC, which provided it with the necessary relational legitimacy to attract other partners such as NEC and Siemens (Gomes-Casseres, 1996). As Gomes-Casseres (1996: 103) noted, 'the credibility that DEC provided to Mips was important in attracting other allies.'

A firm's attractiveness as a partner is defined by its perceived complementarity in providing skills or know-how, expertise in the area or activity sought by the alliance, receptiveness to knowledge trading, as well as trustworthiness, and integrity established from prior experience and/or referrals. When competition for partners is high, it will be important for firms to provide external signals of its worthiness. Firms that demonstrate a propensity to forbear from excessive opportunism (Buckley and Casson, 1988) and that exhibit norms of equity, trust, and an orientation toward mutual gain (Borys and Jemison, 1989; Ring and Van de Yen, 1992, 1994) will tend to be viewed as particularly attractive alliance partners. Trustworthiness has been established as integral to a firm's attractiveness as a potential collaborator (Barney and Hansen, 1994; Gulati and Singh, 1998; Ring and Van de Ven, 1992). Through their prior alliance activities, firms develop alliance 'histories' (Gomes-Casseres, 1996; Gulati, 1995a; Larson, 1992) with respect to their 'relational quality,' which is the 'extent to which partners feel comfortable and are willing to rely on trust in dealing with one another' (Arino, de la Torre, and Ring, 2001: 111). The concept of relational quality captures elements of the firm's characteristics such as its reputation as well as its prior experience.

From a game-theoretic view, firms develop reputations that enable other firms to formulate expectations regarding future behavior (Axelrod, 1984). Powell and Smith-Doerr (1994: 390) have suggested that alliance partners 'may develop reputations as reliable partners' after alliance success is realized; further alliances with the same partner become easier and options for other partners emerge as partners become better skilled or increasingly competent at learning through alliances. Firms that are perceived as attractive and capable partners accrue relational legitimacy, which enables them to demonstrate their viability and predictability as alliance partners, and potentially enhances their access to, and ability to select from, a greater pool of high-quality alliance partners. Relational legitimacy enhances discretion in the partner selection process. As such, relational legitimacy is efficient in that firms are able to reduce search costs for partners as their own partner attractiveness (relational legitimacy) serves to draw in prospective partners. For example, Corning Inc. has developed a high degree of relational legitimacy over time by being perceived as trustworthy and capable in managing its collaborative ventures (Hitt, Ireland, and Hoskisson, 1997). In seeking a partner, potential collaborators anticipate a high likelihood of success in venturing with Corning given their relational legitimacy, and Coming's relational legitimacy has enabled it to be selective in choosing among a range of interested partners that approach Corning to be their partner of choice. This points to the ability of firms to leverage their collaborative capabilities to facilitate further partnerships and increase their legitimacy as good alliance partners. The need for relational legitimacy will be especially pronounced for firms that lack a positive alliance history as an attractive partner, and that depend on partnering for their business success, due to a lack of key competencies or resources.

Therefore, firms that wish to develop additional interorganizational relationships will need to establish their worthiness to be a partner (i.e., relational legitimacy), and this need for relational legitimacy will be dictated by the intensity of competition for attractive partners in the environment, the firm's alliance history and partner image, the dependency of the firm's business on partnering, and the likelihood that the firm will need to attract alliance

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partners in the future to achieve its goals and objectives.

Proposition 2: A firm will be more likely to enter a strategic alliance to gain relational legitimacy when (a) competition for attractive partners is intense, (b) there is a necessity for additional future ties, and (c) the focal firm lacks a positive alliance history or a positive reputation as a partner.

Strategic alliances: Social legitimacy

Strategic alliances can also serve a crucial legitimating function in a firm's social or institutional environment (e.g., consumer advocacy groups, community organizations, professional associations). From the early works of Bowen (1948, 1953) to more recent studies (Andrews, 1987; Thomas, Litschert, and Ramaswamy, 1991), social responsiveness and corporate social responsibility have been linked to corporate strategy (Deniz-Deniz and Garcia-Falcon, 2002; Kostova and Zaheer, 1999; Meznar, Chrisman, and Carroll, 1990). All economic activity is embedded within a broader social or institutional context of societal norms, rules and expectations which defines socially acceptable economic behavior (Zukin and DiMaggio, 1990). Public interest groups, local communities, and occupational and professional associations are constituents of the institutional environment that define, diffuse, or enforce prevailing norms and requirements of acceptable firm conduct (DiMaggio and Powell, 1983; Meyer and Rowan, 1977; Oliver, 1996). Firms are expected to conform to societal rules and expectations of appropriate business behavior, and the monitoring efforts of these institutional constituents urge firms to behave as socially responsible entities. Research in international business has also found that globalization often increases institutional and customer pressures on firms to surpass local social responsibility requirements, even when they may be tempted by lax regulations and enforcement in local institutional contexts (Christmann and Taylor, 2001). Firms that lack the social endorsement of the public and society may face boycotts, sanctions, loss of opportunities for state contracts and subsidies, or a deterioration in consumer and community support. One important avenue available to a firm for satisfying pressures for social legitimacy is the establishment of an alliance with a partner perceived to be socially responsible.

The need for social legitimacy will be particularly significant in institutional environments that are characterized by constituents who closely monitor firm compliance with societal rules and expectations, and in environments where a socially responsible image is vital for firm survival. For example, firms that fall under the watchful eye of authoritative transnational public interest groups, such as Transparency International or Greenpeace, will have a greater need for social legitimacy, given the ability of these groups to 'make rules, set standards, propagate principles, and broadly represent "humanity" *vis-a-vis* states and other actors' (Boli and Thomas, 1997: 172). Furthermore, firm characteristics such as the visibility and social impact of a firm's activity or output, and a firm's image of social responsibility, will also dictate the need for social legitimacy. The news reports of the last decade associated with the Gap, Nike, and Liz Claiborne illustrate the deleterious effects on firms when their institutional constituents learn that they are involved in highly visible, social damaging activities (Dexter and Bernstein, 2000; Greathead, 2002). The demands exerted by public interest groups and consumers in the form of consumer boycotts, lobbying efforts, and the further tarnishing of the firms' reputations illustrate how social illegitimacy can compromise firm performance and success.

In order to enhance their social legitimacy, organizations often form partnerships with government and community organizations. For example, a variety of auto manufacturers (including DaimlerChrysler, GM, Mitsubishi) partner with action groups such as MADD (Mothers Against Drunk Driving) to formulate strategies and campaigns targeted at specific communities. In fact, a recent article claims that the partnerships between corporations and MADD have a significant bottom-line impact by allowing the firm to position itself as a good corporate citizen and enhancing its brand loyalty with consumers (Kingsriter, 1999). In turn, Kingsriter (1999) also notes that MADD's strategic alliances with its corporate partners account for a significant portion of its revenues, well above the national average for non-profits. It holds regular partner summits to find innovative ways to share knowledge with its corporate alliance partners. These kinds of activities allow organizations to make claims of promoting public good, thereby

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enhancing their social legitimacy. The benefits of social legitimacy are both social and technical. The challenges to their legitimacy decline and they have access to the support of important constituencies leading to enhancement of social legitimacy.

To summarize, firms may be driven to enter into a strategic alliance for social legitimacy reasons to develop or enhance their legitimacy with government agencies, local communities, public interest groups, or customers. This will be especially likely to occur when constituents of the firm's environment are vigilant in monitoring business behavior and when firms operate in industries where social and public issues are especially salient. Firms that are highly visible, due to size and potential impact on public goods, and that tend to lack a socially responsible image or set of behaviors, are also more likely to need social legitimacy to enhance firm performance and success.

Proposition 3: A firm will be more likely to enter a strategic alliance to gain social legitimacy when it (a) is closely monitored by institutional constituents, (b) depends on a socially responsible image for success, (c) engages in activities or produces outputs that are highly visible and controversial, and (d) lacks a socially responsible image.

Strategic alliances: Investment legitimacy

Investment legitimacy refers to the role an alliance serves to legitimate the worthiness of a firm's business activities in the eyes of corporate insiders, such as the parent firms' board of directors, executives, venture capitalists and shareholders. These are the investors in the alliance who risk reputational or economic loss if the alliance fails. Bounded rationality and uncertainty are chronic conditions in business organizations, and corporate insiders often lack clear or complete evidence that a given business activity will contribute positively to their firm. Thus, an organization that is interested in obtaining the internal endorsement of a business activity, and perhaps its permanent internalization within corporate operations, may form an alliance which allows the activity to make a transition from being non-legitimate to legitimate. Kogut (1991) and Reuer (1999), for example, note that alliances often serve as platforms for future investment, internalization or acquisitions. The need for such investment legitimacy is likely to be greater when the business activity has not been successfully adopted by other organizations or promoted by key entities in the firm's environment. The need for investment legitimacy is also likely to be more crucial when an activity has not been successfully adopted in the past, lacks internal proponents, and requires lengthy and intense resource investment. These environmental and firm characteristics suggest that novel types of business initiatives by newer firms may be especially likely to lack investment legitimacy given that there is limited previous performance on which corporate insiders and investors can economically and rationally judge them. However, investor confidence in a novel or seemingly risky initiative may be secured by entering into a strategic alliance with a partner who exhibits strong support, experience, and confidence for the uncertain business activity by its willingness to share risk in the investment.

In sum, a firm will be driven to seek internal endorsement of a business activity (i.e., investment legitimacy), when the activity is novel, relative to other firms in the environment and the firm's own history, when the proposed activity lacks strong internal advocates or support, and when the resource investment is likely to be significant or lengthy. Under these conditions, alliance success will depend on the alliance participants' abilities to generate sufficient confidence among the board of directors, corporate executives, venture capitalists, and/or shareholders that the initiative for which the alliance has been established is indeed legitimate and therefore likely to provide resource benefits or performance advantages to the firm.

Proposition 4: A firm will be more likely to enter a strategic alliance to gain investment legitimacy when its business activity (a) has not been successfully adopted by other firms, (b) has not been successfully adopted by the focal firm in the past, (c) lacks internal champions, and (d) requires lengthy or intense resource investment.

Strategic alliances: Alliance legitimacy

Under certain conditions, the validity or appropriateness of strategic alliances as a form of business transaction (i.e., alliance legitimacy) needs to be established to ensure business success. Unlike investment legitimacy, which seeks to persuade internal constituents and investors of the economic

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viability of developing a firm's business activity, alliance legitimacy seeks to establish endorsement for the alliance form itself. This occurs in industries that lack a history of using alliances and that have always limited their form of business activity to pure competition, acquisition, or diversification.

The use of a strategic alliance, as an organizational form, can signal its validity or appropriateness as a mechanism for market entry or organizational learning, and thus may be employed by firms motivated to establish the viability of this form as a means of obtaining economic goals and objectives. Early alliances among competing automotive manufacturers validated the use of strategic alliances as a mode of joint learning. In this way, the use of a strategic alliance served to validate or legitimate its viability as a form of business activity and demonstrated to future attractive business partners that such a form is a feasible way to exchange know-how, gain new competencies, or move into new markets. Yiu and Makino (2002), for example, found that the cognitive mindsets of multinationals were bounded by their counterparts' entry patterns when making foreign entry-mode choices. Mimetic isomorphism and historical norms influence entry-mode choices. Thus, the need for alliance legitimacy will be especially significant when the alliance form is not accepted in the current market.

In addition, alliances are often established by parent firms as short-term experiments or investigative trials for exploring the feasibility of longer-term resource commitments (e.g., experimental manufacturing facilities, product tests in new markets) through the alliance form. Parent firms, especially those lacking experience and understanding of the strategic alliance form, may not be able to adequately gauge whether they should employ an arm's length, strategic-alliance or wholly-owned-subsidiary approach to a business venture (Almeida, Song, and Grant, 2002). Many alliances are developed as learning experiments (Ciborra, 1991) through which the parent firms test the validity or appropriateness of a longer-term commitment to the business activity involved in the alliance. The need for alliance legitimacy will be especially significant when the alliance form has not been tested by the firm in the past (Osborn *et al,* 1998).

In sum, firms that wish to establish the validity of using an alliance form, as opposed to an acquisition, for example, will need to ensure that strategic alliances are considered valid or appropriate (i.e., possess alliance legitimacy), and this alliance legitimacy need will be dictated by environmental characteristics (e.g., the novelty or lack of acceptance of the alliance form in the market) and firm characteristics (e.g., the importance to the firm of endorsing the alliance form). Alliance legitimacy can also be crucial to the firm's ability to secure other types of legitimacy. That is, it may not be possible to convince investors of the value of the business activity anticipated through an alliance (investment legitimacy) until the firm is first able to convince investors that the alliance form itself (i.e., alliance legitimacy), as opposed to a diversification strategy, for example, is a viable means of achieving economic gain or competitive advantage. Similarly, it may first be necessary to convince the government or competitors of a foreign market that strategic alliances are an acceptable way to do business (alliance legitimacy) before a firm can establish its rights and qualifications to conduct business in that market (market legitimacy).

In this way, alliance legitimacy may not only be an end in itself but may also interact with the need for market, relational, social, and investment legitimacy to achieve future economic objectives.

Proposition 5: A firm will be more likely to enter a strategic alliance to gain alliance legitimacy when (a) use of the strategic alliance form is novel to the industry or firm, and (b) acceptance of the alliance form is important for achieving other types of legitimacy (market, relational, social or investment legitimacy).

Legitimacy need, governance structure, and partner selection

Our discussion thus far has demonstrated that a number of different legitimacy needs may drive firms to enter into strategic alliances. While some firms, such as highly established organizations whose past performance provides legitimacy and access to resources, will have few or no legitimacy needs, many others will have a significant need for market, relational, social, investment, and/or alliance legitimacy. The preceding propositions have identified the environmental and firm characteristics that tend to determine when a firm will be likely to need each of the five types of legitimacy proposed above. By identifying the

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specific environmental and firm conditions under which each of the legitimacy needs will be important, these propositions therefore indicate that firms are likely to vary in the magnitude and type(s) of legitimacy that is needed.

All other things equal, we can assume that firms possessing a high level of legitimacy through formation of strategic alliances will have higher firm and alliance performance. However, we argue that the type of alliance a firm establishes (alliance governance structure) and whom a firm selects as an alliance partner (partner selection criteria) will serve as the key mediators in determining the impact of legitimacy on firm and alliance performance. We also argue that the intensity of overall legitimacy needs will influence the choice of governance structure and partner.

Alliance governance structure

Prior research has differentiated governance structures based on an obligation dimension, that is, a reciprocally or contractually based dimension that defines the profit allocation structure and the extent of rights and other obligations. Based on this differentiation, the literature suggests that the most important distinction in alliance governance structure is whether it has an equity or non-equity (contractual) base (Gulati and Singh, 1998; Wright, 1981). Equity-based alliances tend to represent a higher level of internalization and interorganizational interdependence than non-equity agreements. Equity alliances are tightly coupled forms of organizing in which the participants are linked together by formal structures and may involve joint ownership. Given that alliances, to a large extent, are incomplete contracts, equity investments are important to mitigate risk (Pisano, 1989). In equity alliances, profit or benefit allocation (and usually decision-making control) are distributed in accordance with equity shares, and they tend to be much more complex alliance forms to administer and control. Furthermore, equity alliances tend to take longer to establish and dissolve (Harrigan, 1988). In contrast, non-equity alliances tend to be loosely coupled forms of organizing which involve less structure and joint ownership. Non-equity alliances embody fewer hierarchical elements and less replication of organizational control and coordination features than equity alliances (Gulati, 1995b; Pisano, 1989; Pisano *et al.,* 1988). These contractual agreements provide greater flexibility for the partnering firms (Osborn and Baughn, 1990), including ease of relationship termination. Taken together, non-equity alliances are less demanding and pose fewer risks to the partnering firms.

The traditional literature on strategic alliances is dominated by transaction cost theory and the resource-based view, both of which offer powerful explanations as to the choice of strategic alliance governance structure as alternatives to market or hierarchy. The transaction cost perspective holds that alliance governance structure is determined by the nature of the transactions to be performed, as defined by coordination and appropriation costs (e.g., Gulati and Singh, 1998), whereas the resource-based view emphasizes the significant role of a partner's resource alignment in determining the governance structure of a strategic alliance (e.g., Chen and Chen, 2003; Das and Teng, 2000). Based on the distinctions between equity and non-equity strategic alliances, we reason that the choice of governance structure will vary with the magnitude of a firm's need for legitimacy. The higher level of internalization and interorganizational interdependence inherent in equity structures indicates to constituents a greater sense of commitment and confidence on the part of a partner By the same token, the greater the need for legitimacy, the more involvement the focal firm is likely to desire from the partner because a more intense level of commitment is more likely to secure the focal firm's legitimacy needs. Past research has found that company's ability to transfer resources such as legitimacy, for example, varies according to the organizational form of the alliance, with equity alliances facilitating transfers (Hagedoorn and Narula, 1996; Osborn and Baughn, 1990). Furthermore, a focal firm that has a substantial legitimacy deficit may be more inclined to endure the flexibility and resource sacrifices demanded by an equity venture in order to gain the needed legitimacy, and thus be more willing to pursue an equity alliance form than a firm with a relatively minor legitimacy need. Thus, we propose that the magnitude of the legitimacy need will be positively related to a preference for equity-based strategic alliances.

Proposition 6: The magnitude of a firm's legitimacy need will be positively related to a preference for equity-based strategic alliances rather than non-equity-based strategic alliances.

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Alliance partner selection

A firm's selection of an appropriate strategic alliance partner is a critical decision (Hitt *et al,* 1995). Partner selection determines a strategic alliance's mix of skills, knowledge, and resources, its operating policies and procedures, and its vulnerability to indigenous conditions, structures, and institutional changes (Child and Faulkner, 1998). Research to date has demonstrated that partner selection is a consciously strategic and specific decision in the creation of a strategic alliance, and that 'the importance and variation of the criteria used by a firm in selecting a partner are reflective of a wide range of factors, many of which derive from a firm's needs (Dacin, Hitt, and Levitas, 1997; Hitt *et al.,* 2000). Thus, firms possessing a need for legitimacy will be driven to select a partner that enables the satisfaction of that need, particularly when outcomes associated with the satisfaction of the given need are salient to the focal firm (e.g., where the relational legitimacy gained through partnering with a highly prestigious firm is certain to attract additional customers and partners). Because firms have different legitimacy needs, it is not enough to say that firms look for an attractive partner in strategic alliances. Rather, firms forming alliances to increase market, relational, social, investment, or alliance legitimacy will be inclined to select partners that fit their partner selection criteria which would satisfy their specific type of legitimacy need(s) and, in turn, will be highly likely to enhance firm or alliance performance.

Proposition 7: Partner selection criteria are likely to be positively associated with specific legitimacy needs of the focal firm. Focal firms prefer to select strategic alliance partners that most effectively satisfy their legitimacy needs.

Given the fairly obvious likelihood that focal firms will use partner selection criteria that most effectively satisfy their legitimacy needs, it is important to identify how different legitimacy needs may lead firms to emphasize different criteria when selecting a partner. A firm with a need for market legitimacy will be likely to emphasize experience and success in the intended market. That is, a firm will emphasize selection criteria that relate to a partner's abilities and competencies to do business in the intended geographical or product market and evidence that the partner already possesses valuable links within that market. In contrast, a firm with a relational legitimacy deficit will prefer a partner that has a very rich alliance history and is considered to be very selective when choosing potential ties. A selective partner with an impressive partnering history impresses upon a focal firm's constituents the firm's worthiness to serve as a partner. A firm lacking social legitimacy will likely focus on selecting a partner who conforms to societal rules and expectations of appropriate business behavior, and who is perceived to be socially responsible by those institutional constituents on whom the firm depends for social and resource support. A firm lacking investment legitimacy will likely focus on selecting a partner who is reputed to be an investor who contributes resources to ventures of the highest potential. The confidence of such prudent partners in a business venture would likely serve to legitimate the worthiness of a firm's business activities in the eyes of corporate insiders by reassuring these insiders that the business activities will contribute positively to their firm. Lastly, partner selection criteria for alliance legitimacy are likely to revolve around issues of trust, complementarity of assets, and a joint willingness to undertake the risk of being a first mover in using the alliance form in a given industry context. Thus, we contend that when selecting an alliance partner a focal firm will likely consider the extent to which a potential partner satisfies their legitimacy needs, and that these criteria will differ depending on the type of legitimacy need.

Legitimacy, firm performance, and alliance performance

A key premise of this paper is that legitimacy derived through participation in a strategic alliance is a means to an economic or competitive end. Legitimacy plays a key role in allowing firms to access critical resources, such as technology, economic and social capital, markets, partners, and customers (Aldrich and Fiol, 1994; Zucker, 1987). Furthermore, it has been proposed that the alliance governance structure a firm chooses (i.e., what type of alliance it establishes) and its partner selection criteria (i.e., who it chooses as a partner) play the most crucial roles in determining whether the formation of alliances leads to higher firm and alliance performance. These arguments

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are captured in Figure 1 and in the following propositions.

Proposition 8: Firm performance is dependent upon the selection of the alliance governance structure and partner that satisfies a focal firm's legitimacy needs.

Proposition 9: Alliance performance is dependent upon the selection of the alliance governance structure and partner that appropriately satisfies a focal firm's legitimacy needs.

Given these propositions, what are the economic and competitive benefits that result from each type of legitimation? A wealth of literature exists on the performance of firms and alliances, much of which highlights the complexity of identifying and measuring performance factors. Gulati (1998: 309), for example, portrays the problem of understanding the factors influencing alliance performance as 'one of the most interesting and also one of the most vexing questions' on the research agenda. Both firm and alliance performance has been examined through the lens of various perspectives, including transaction cost theory (Balakrishnan and Koza, 1993; Hennart and Reddy, 1997), real options theory (Kogut, 1991), agency theory (Dalton *et al.,* 2003; Reuer and Miller, 1997), evolutionary economics (Zollo, Reuer, and Singh, 2002) and organizational learning theory (Barkema *et al.,* 1997; Sorensen, 2002). Very little work exists, however, on firm and alliance performance from a legitimacy perspective. Below we suggest the economic or competitive benefits associated with different types of legitimacy derived through alliance participation that tend to enhance firm and alliance performance. These are summarized in Table 1 and outlined briefly below.

Market legitimacy

Increases in the market legitimacy of a firm lead to enhanced access to new geographical and product markets, and therefore access to resources and competencies that might otherwise be denied to a firm. This enhanced access, in turn, increases the potential for higher firm performance. For example, take the case of U.S. telecommunications providers seeking to expand in the Mexican market during the mid 1990s. By partnering with U.S.-based Sprint, Telmex (Mexico's largest communications provider and former government entity) was able to expand its services and product development to the U.S. market and beyond while providing Sprint with enhanced access to the Mexican market (Charytan and Ruff, 1998). Telmex benefited from access to global markets and Sprint's existing partner base in Europe and Canada.

Relational legitimacy

Firms that succeed in increasing their relational legitimacy are able to attract high-quality partners, which increases the focal firm's access to valued expertise in other firms, and reduces the transaction costs of dealing with less legitimate and less trustworthy partners, thereby increasing the efficiency of alliance performance and the opportunity to increase market share through use of the competencies possessed by the partnering firm. As a firm forms ties with high-quality partners, this also increases its chances of forming advantageous alliances in the future, thus enhancing the firm's future competitive potential.

Social legitimacy

Social legitimacy bestows approval on firms from constituents who often possess the power to increase firm resources or resource access (e.g., government grants or contracts). Social legitimacy also increases a firm's profit potential by neutralizing opposition from publics with the power to withhold funding, boycott products, or jeopardize the firm's reputation (e.g., consumer advocacy groups). For example, in order to enhance their social legitimacy, Phillip Morris International, the world's largest manufacturer of tobacco products, engages in a variety of partnerships in its existing and emerging markets. These range from sponsorship of local arts and cultural events to ongoing partnerships with- local community organizations and non-profit groups such as AmeriCares and the United Way to address youth smoking, hunger, and disaster relief (Davies, 2002). Social legitimacy is critical for companies such as Phillip Morris, whose products and strategies are frequently called into question.

Investment legitimacy

By increasing the investment legitimacy of a firm's business activity formed through an alliance,

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shareholders, investors, or top-management-team decision-makers are more likely to support the establishment and proposed duration of the alliance, thus making it more feasible to accomplish the alliance's goals, obtain extra funding or investment for the alliance's purposes, and therefore increase the likelihood of alliance success. By increasing investment legitimacy, investors are more likely to support the continuation of the business activity, thus making it more feasible to accomplish the firm's future goals, obtain extra funding or investment for the firm's purposes, and therefore increase the likelihood of success.

Alliance legitimacy

Alliance legitimacy increases alliances' performance by legitimating the alliance form itself. In some cases, being a first-mover in the formation of an alliance in an industry may be advantageous to the first-mover firm. For example, if a focal firm is the first in an industry or market to establish and legitimize an alliance, that firm will then gain an advantage over its competitors by being the first to possess alliance experience, thereby allowing it to be first in developing or enhancing other types of legitimacy, such as market legitimacy and relational legitimacy. In addition, this enhances the likelihood that the focal firm would be able to establish subsequent alliances in that industry and gain further technical and competitive benefits.

Therefore, while any one or all of the five types of legitimacy proposed in this paper do not ensure firm and alliance success, legitimacy is a critical yet largely neglected aspect of alliances that may serve as a crucial means or mediating factor in obtaining economic and competitive advantages, thereby increasing both firm and alliance performance.

As a final note, it is important to acknowledge the link between firm and strategic alliance performance that is portrayed in the relationships underlying the legitimating role of strategic alliances. Clearly, firm and strategic alliance performance are closely tied to each other in that performance alterations that derive from legitimacy gains or losses by the firm will tend to spill over to the strategic alliance, and vice versa. As the preceding discussion of benefits reveals, legitimacy tends to influence both firm and alliance performance and these two phenomena are highly interrelated.

CONCLUSIONS

Although it is well understood that strategic alliances are established for the purpose of resource sharing, competency development and competitive advantage, the strategic and economic value of the legitimacy that is associated with strategic alliances has tended to be overlooked by researchers. Yet, as this paper argues, legitimacy gained though the participation in a strategic alliance can have a profound impact on economic and competitive success. Firms that lack market, relational, social, investment and alliance legitimacy, respectively, may be denied access to crucial markets, needed partners to conduct joint projects or share risks and costs, government funding and customer support, critical sources of investment and top management support, and novel opportunities to innovate or act as a first-mover in alliance formation, thus jeopardizing the potential for competitive advantage. Based on an institutional perspective, a typology of legitimacy functions was proposed that identifies the specific conditions under which legitimacy may serve an important role in strategic alliances. Propositions were developed to explain the mediating role of alliance governance structure and partner selection criteria in determining the effects of legitimacy on firm and alliance performance, and specific partner selection criteria were suggested for each type of legitimacy. This paper, therefore, argues that the legitimating role of strategic alliances may be a critical source of competitive advantage (Oliver, 1990, 1997). This work also extends recent efforts to synthesize strategic and institutional perspectives (Lounsbury and Glynn, 2001; Rao, 1994) by suggesting that strategic and operational explanations of alliances complement a legitimacy explanation of the strategic alliance phenomenon.

Future research needs to examine more extensively the factors that contribute to firm and alliance performance in the context of multiple and potentially conflicting demands from customers, suppliers, parent companies, local community, host governments, investors, corporate insiders, and public interest groups. Accordingly, research into the embeddedness of strategic alliances in an institutional context constituted of multiple demands and expectations may illuminate the broader role of strategic alliances in a societal context and the ways in which alliance managers might balance conflicting alliance objectives and expectations.

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Another avenue for future research concerns the degree to which the need for legitimacy applies in different empirical settings. We have argued that firms' legitimacy needs will vary and that some firms may have few or no legitimacy needs to fulfill. In addition, research by Kraatz and Zajac (1996) has demonstrated that legitimacy may have a negligible influence on firm actions in some strongly institutional and technical environments. Therefore, it may be useful to examine how legitimacy needs vary systematically by industry or organizational context.

Another possible extension would be to consider the temporal embeddedness of legitimacy benefits afforded by alliance strategies, more generally. Research has demonstrated that institutional and technical benefits vary over time as an innovation becomes increasingly institutionalized (Westphal, Gulati, and Shortell, 1997). In other words, to what extent do the legitimacy benefits of alliance strategies change over time as alliances become increasingly diffused across a variety of contexts?

Future research also needs to examine the ongoing process of legitimacy management, which involves maintaining and in some cases regaining legitimacy for the firm. If a firm is able to gain legitimacy through participation in a strategic alliance, it may need to commit additional resources to maintain that legitimacy. At the same time, symbolic decoupling or mere ceremonial conformity is sometimes an alternative route for sustaining legitimacy benefits (Zajac and Westphal, 2001), and such symbolic approaches may be less resource intensive. Therefore, the costs associated with obtaining legitimacy need to be balanced against the expected technical benefits. In addition, a firm's institutional constituents are varied and changing, and continuing to meet the legitimacy demands of these various targets while in an alliance may be challenging. Furthermore, legitimacy itself drives firms to replicate stable structures and processes, which may result in a firm being less able to change in response to environmental demands, thereby decreasing its future adaptability. A firm within a strategic alliance that fails to maintain its legitimacy will have to take a proactive response to its illegitimate status to regain or repair its lost legitimacy. Such responses might include the provision of some kind of normalizing account to separate the firm from the untoward action that led to the illegitimate status, or the development of additional alliances with partners who may be able to contribute needed legitimacy. Overall, these issues suggest the need for longitudinal research into changes in a firm's legitimacy status over time.

To conclude, there are four theoretical implications associated with the framework developed in this paper. First, given that all alliances are embedded in an economic and normative context that defines appropriate economic activity, most alliance activities will have an underlying legitimacy dimension that affects the success of the partnering firms and the alliance. Second, given the socially constructed nature of legitimacy issues surrounding alliances, the conditions for developing and maintaining a favorable alliance arrangement may be more malleable and more conducive to impression management than most strategic or economic perspectives tend to suggest. Issues of reputation, trust, and partner credibility are all partially socially constructed phenomena and yet have a potentially profound effect on the integrity and effectiveness of the alliance. Clearly, there is considerable managerial discretion for managing the less tangible and more socially defined elements of alliances to advantage. Third, the identification of five distinguishable types of legitimacy derived from participation in an alliance suggests the need for more theoretical and empirical attention to the internal and external stakeholders that alliances are intended to satisfy. One of the revealing aspects of an institutional perspective on alliances is the extent to which alliances function to address the demands of constituencies beyond the alliance partners. Finally, the role of legitimacy as a means to gain economic and competitive ends cannot be understated. Particularly under those conditions outlined in the first five propositions, firms would do well to consider how their legitimacy, and the legitimacy of their business activities and alliances, has a potentially profound impact on their ability to attract resources, potential partners, and opportunities for market growth and sustainable competitive advantage.

ACKNOWLEDGEMENTS

We would like to thank Michael Hitt, Richard Martinez, Keith Provan, and James Westphal for helpful comments on an earlier draft of this paper. We are also extremely grateful to the Associate

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Editor, Ed Zajac, and the anonymous reviewers for their insightful comments and suggestions.

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Fonte: Strategic Management Journal,v.28, n. 2, p. 169-187, Feb. 2007.