Getting buy-in: financial stakeholders' commitment to strategic transformation

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Abstract:

Purpose: Strategic transformations are likely necessary for all organizations at some point in their existence, but the role of external stakeholders in committing resources to support transformations has been largely overlooked. This paper aims to begin to fill this gap by developing a theoretical model detailing which factors increase the likelihood that financial stakeholders will commit resources to strategic transformation. **Design/methodology/approach:** Neo-institutional and stakeholder theories are applied to the strategic transformation phenomenon to develop six propositions regarding financial stakeholders' resource commitment to strategic transformation. **Findings:** Moral legitimacy, pragmatic legitimacy and unfamiliarity with the firm directly affect the likelihood that financial stakeholders will commit resources to strategic transformation. Cognitive legitimacy or familiarity amplifies the positive effect of pragmatic legitimacy on resource commitment, and pragmatic legitimacy lessens the negative effect of unfamiliarity with the firm on resource commitment. **Originality value:** This paper lays out a clear conceptual model of the antecedents of financial stakeholders' resource commitment to strategic transformation, aiding practitioners in securing critical stakeholder support and filling an important gap in strategic transformation/stakeholder literature.

Keywords: strategic resources | stakeholder analysis | organizational change | strategic transformation

Article:

1. Introduction

Change is inevitable. Consequently, all organizations will likely face the need to transform at some point in their existence (Burgelman, 1996). The impetus of such large-scale transformations can have many sources, including external forces like new technologies and shifts in consumer demand (Helfat and Eisenhardt, 2004; Porter, 1980) or internal forces like the arrival of new organizational leaders (Rosenbloom, 2000). Regardless of its motivation, discontinuous strategic transformation – a process of strategic renewal whereby an organization fundamentally changes its strategy, structure, or both (Agarwal and Helfat, 2009) – creates problems for organizations because it increases the odds of organizational death (Amburgey *et al.*, 1993) and necessitates heightened levels of resource inputs for successful implementation (Jawahar and McLaughlin, 2001; Penrose, 1959).

Accordingly, scholars have demonstrated interest in how organizations cope with large changes and achieve successful strategic transformation, focusing especially on the internal organizational processes and mechanisms. Yet, the role of external stakeholders in achieving strategic transformation has not received much attention even though their commitment of critical financial resources is needed to implement large-scale change (Barker and Duhaime, 1997; Bourgeois, 1981).

The purpose of this paper, therefore, is to develop a theoretical framework for understanding why financial stakeholders in particular support discontinuous strategic transformations by committing resources. Financial stakeholders are the focus here because their monetary contributions and/or decision-making power can enable or block strategic actions (Freeman, 1984; Kuratko *et al.*, 2007; Porter, 1980). Although other stakeholders, such as customers, may change after transformation, key financial stakeholders are likely to remain critical partners, and securing additional resources from them is vital for implementing transformation (Barker and Duhaime, 1997; Bourgeois, 1981).

Understanding why financial stakeholders might support strategic transformations is important for strategic transformation research. First and foremost, firm- or leadership-level actions to implement a transformation may prove fruitless or impossible without the injection of critical financial resources. Second, as I discuss in more detail below, organizations are under increased scrutiny and pressure from financial stakeholders regarding the social benefits (or costs) of their activities, so financial stakeholders are increasingly interested in participating in firms' strategic planning (Atkinson *et al.*, 1997). Indeed, certain financial stakeholders, such as shareholders, can sometimes wield their power to block strategic initiatives (Anand and Singh, 1997; Porter, 1980), and their (at least tacit) approval is therefore needed to undergo transformation.

The framework presented herein supplements previous scholarly work on strategic transformation by adding knowledge about how firms acquire the resources necessary for transformation from financial stakeholders and why these steps are necessary for successful transformations. Practitioners contemplating transformation may benefit from suggested strategies for securing important resources to aid in the transformation process. In Section 2, I provide an overview of research relating to strategic transformation and the role of stakeholders in organizational change. Because radical organizational change is similar to beginning a new organization (Amburgey *et al.*, 1993), legitimacy is a key concern. I therefore apply neo-institutional theory to the entrepreneurial and stakeholder context of strategic transformation and propose that moral and pragmatic legitimacy are important precursors to financial stakeholders' commitment of resources to strategic transformation (Section 3). I further delineate how cognitive legitimacy or familiarity increases the value of pragmatic legitimacy and how pragmatic legitimacy lessens the reluctance to commit resources of financial stakeholders who may be unfamiliar with the focal firm. Finally, in Section 4, I conclude with a discussion of the implications of this framework for scholars and practitioners.

2. Strategic transformation and stakeholder support

Strategic transformations entail sweeping replacements or replenishments within organizations, resetting organizational goals, products, services, resources or capabilities with the objective of long-term growth (Agarwal and Helfat, 2009). Such changes often occur rapidly in short periods of "punctuated equilibrium" (Romanelli and Tushman, 1994), whereby old organizational processes or structures are quickly replaced with new ones. Because of this suddenness and speed of change, certain organizational structures are more readily amenable to transformation than others. Organizations with loosely coupled, modular divisions and the dynamic capabilities to adapt to rapidly changing environments can harness learning and knowledge across divisions, enabling them to undergo continuous transformation by shifting away from unprofitable industries and toward more profitable ones (Martin and Eisenhardt, 2004).

Leadership is another important factor in strategic transformation. Before undergoing large-scale changes, leaders must overcome the cognitive inertia associated with previous strategies (Audia *et al.*, 2000; Barr *et al.*, 1992). Once the need for change has been recognized and transformation begins to be implemented, it can create role conflicts for managers that must be carefully navigated such that control systems are changed at crucial junctures in the transformation process (Floyd and Lane, 2000). Additionally, the mode of implementation must be carefully weighed. Path-breaking strategic transformations can be facilitated via acquisition or internal development (Capron and Mitchell, 2009; Karim and Mitchell, 2000), but leaders must do so judiciously, as the choice of internal or external development of new capabilities can create social friction within the organization (Capron and Mitchell, 2009). In total, literature regarding transformation has told us much about managing change *within* the organization but little about how change should be managed *outside* the organization, such as generating support among important financial stakeholders.

Freeman (1984) posited that successful stakeholder management consists of identifying stakeholders and perceived stakes, understanding the organizational processes used to manage stakeholders, understanding the set of transactions or bargains among the organization and its stakeholders and ensuring these transactions fit with the organization's stakeholder map and stakeholder management processes. Stakeholders have certain powers (formal/voting or economic/political) and certain stakes (equity, economic and influence). Identifying relevant organizational stakeholders is the first step in effective stakeholder management. Next, organizations should proactively and voluntarily manage stakeholders, using clear language when communicating with them and overspending on their needs to serve them better. To accomplish these tasks, organizations must have a strong sense of identity and strategy and understand their place in society. This will help them achieve fit between their values, the expectations of stakeholders and the social issues that determine their ability to sell products or services. In turn, stakeholders may affect an organization's posture toward its environment: by proactively managing stakeholders, organizations may become more entrepreneurial, and stakeholders are therefore necessary partners when organizations seek change (Kuratko *et al.*, 2007) such as strategic transformation.

Despite the importance of stakeholders for facilitating transformation, there is precious little research in this area. Most scholarly focus has been on the communication between managers and stakeholders, especially regarding how strategic changes are framed. For example, the characteristics of firm ownership (e.g. government ownership, family ownership, etc.) shape how managers frame or condense meaning when communicating changes to shareholders, and strategic changes may be more successful when the framing fits with different shareholder preferences, when it is appropriate to the institutional environment and when managers decouple the announcement and implementation of strategic changes (Fiss and Zajac, 2006). Similarly, different rhetorical techniques, such as analogy and metaphor, may be more appropriate for increasing stakeholder understanding, depending on the type and scale of change being pursued (Cornelissen *et al.*, 2011). Finally, highly risky organizations, such as those operating in volatile environments, are more prone to alter their stakeholder management activities, probably because frequent strategic adjustments – and the corresponding stakeholder support – may be needed (Shropshire and Hillman, 2007).

Yet, what is lacking is a robust theoretical explanation for why the stakeholders *themselves* might support or oppose a given strategic transformation. By understanding stakeholder rationales for supporting strategic transformations, managers can tailor and deploy the abovementioned framing and rhetorical strategies in a way that maximizes the odds of stakeholder support. Additionally, stakeholders can be very diverse, ranging from primary stakeholders, who are directly impacted by the firm (such as shareholders and customers), to secondary stakeholders, who may not be directly impacted by the firm (Eesley and Lenox, 2006). To facilitate theoretical accuracy and meaningfulness, my focus here is on primary, financial stakeholders. Financial stakeholders are those with financial power, including investors, shareholders, lenders and creditors (Freeman, 1984).

A concentration on financial stakeholders is used because such stakeholders may be the most important group for achieving successful strategic transformation. First, transformations are very resource-intensive (Barker and Duhaime, 1997; Bourgeois, 1981; Penrose, 1959), requiring firms to look for external financial backing (Pfeffer and Salancik, 1978). Specifically, during periods of transformation, organizations often proactively focus their stakeholder management activities on financial stakeholders because of the need for additional resources beyond those currently under their control (Jawahar and McLaughlin, 2001). Second, if these stakeholders do not view transformation favorably, they can sometimes use their power to block it (Anand and Singh, 1997; Porter, 1980), making the support of this group of stakeholders critical for successful transformation. Put differently, primary financial stakeholders provide unique value to strategic transformations. Monetary resources above and beyond those currently committed to the firm are needed to implement transformation (Agarwal and Helfat, 2009; Jawahar and McLaughlin, 2001). Furthermore, other stakeholder groups may not provide this important resource. For example, sales from existing customers may help sustain current firm operations but are unlikely to be enough to implement transformation. Additionally, key customer groups may change as the firm transforms and offers new products/services. Indeed, a time of reduced profit can follow a transformation (Rosenbloom, 2000), making resources from financial stakeholders even more critical.

For these reasons, it is important for managers to actively shape the perceptions and opinions of financial stakeholders to garner their support for transformation (Arogyaswamy *et al.*, 1995). The following theoretical framework is a guide for doing just that, detailing the circumstances under which financial stakeholders are likely to commit resources to a proposed strategic transformation.

3. Development of financial stakeholder resource commitment framework

3.1 Theoretical lenses and assumptions

Because transformation represents a fundamental change in a firm's strategy and/or structure, it is somewhat similar to the launch of a new organization, in that the firm must learn new modes of operating. Indeed, any kind of strategic change – and especially a large one such as transformation – resets the liability-of-newness clock (Amburgey *et al.*, 1993), resulting in a very high risk of failure during the initial period following change (Freeman *et al.*, 1983; Stinchcombe, 1965). For example, as the typewriter industry declined, Smith Corona attempted to become an office supply company. However, the transformation was a failure and the organization died because it could not develop the competencies needed to compete in the new industry (Danneels, 2010). Organizations that transform will thus face some challenges similar to the ones new organizations must grapple with, as they must learn anew how to compete using a novel strategy and/or organizational structure.

As noted, another challenge associated with strategic transformation is the acquisition of resources, which is also a problem faced by new entrepreneurial organizations (Zimmerman and Zeitz, 2002). Numerous scholars have argued that strategic transformation is a type of *corporate* entrepreneurship (Guth and Ginsberg, 1990; Kuratko *et al.*, 2007; Sharma and Chrisman, 1999; Zahra, 1991). Because of the similarities between transformation and starting a new venture in terms of liabilities of newness and acquiring needed external resources, I draw on literature from entrepreneurship – in addition to strategic transformation and stakeholder theory – to explicate the antecedents of financial stakeholders' resource commitment to strategic transformation. A large part of this literature involves gaining legitimacy, as having high levels of legitimacy motivates stakeholders to support an organization rather than passively allowing it to exist or perhaps even working against it, according to neo-institutional theory (Suchman, 1995). Additionally, gaining legitimacy is one of the primary challenges of successful entrepreneurship (Williamson, 2000). I, therefore, apply neo-institutional theory to theorize how strategic transformation might meet legitimacy concerns of financial stakeholders.

To set the tone for my arguments and facilitate nuanced theoretical development, I assume that organization leaders can recognize the need for transformation and manage the process. I also assume some level of monitoring or involvement on the part of the focal firm's current financial stakeholders although the exact amount may vary among them (e.g. large shareholders may monitor more than creditors). Without at least a little monitoring, it is unlikely that stakeholders would commit anything to the organization (Suchman, 1995). However, I also assume that the level of monitoring can vary among stakeholders and may be low for those who have more of an arms-length relationship with the firm or those who have no pre-existing relationship with the firm. I deal with this issue explicitly below when I theorize about the level of familiarity between the firm and its financial stakeholders.

Within the bounds of these assumptions, I propose that moral legitimacy is the ultimate precursor of resource commitment, the establishment of which allows financial stakeholders to proceed to assessing the value-creating potential of the transformation or its pragmatic legitimacy. The greater the pragmatic legitimacy, the greater the odds of resource commitment. I further propose that cognitive legitimacy or familiarity with the firm can enhance this relationship. Finally, I theorize that unfamiliarity with the focal firm undergoing transformation may lessen the chances of resource commitment, but this negative relationship can be attenuated with greater pragmatic legitimacy. These relationships are depicted in Figure 1.

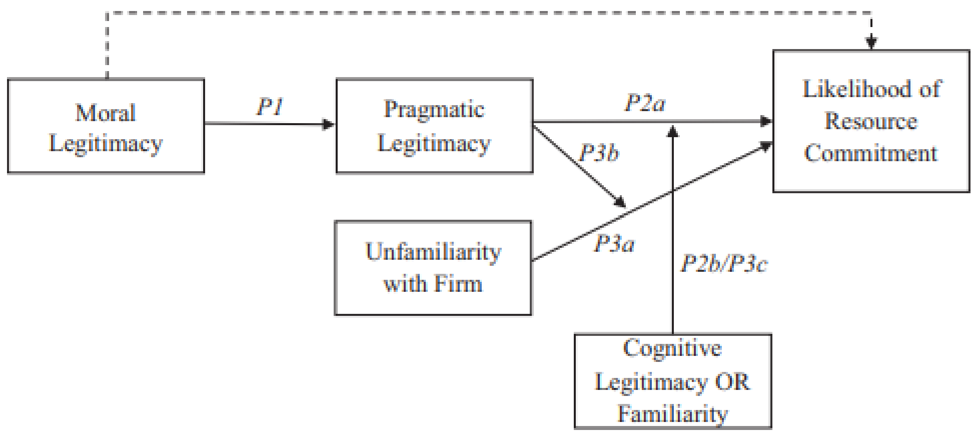

Figure 1. Framework of financial stakeholders' commitment to strategic transformation

3.2 Antecedents of financial stakeholder resource commitment

Neo-institutional scholars have investigated how sociological forces, such as norms, shape social actors, including organizations (Powell and Dimaggio, 1991). Organizational theorists have stressed the need for organizations to conform to these social norms to gain *legitimacy* (Pfeffer and Salancik, 1978) or "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" (Suchman, 1995, p. 574). Legitimacy enhances the stability and comprehensibility of organizational activities, and, if social actors (such as the government and customers) perceive these activities to add value to society, they may actively support and trust the organization rather than just passively acquiesce to its existence or seek its dissolution. Legitimacy is especially important for gaining financial resources that can then be used to acquire other resources needed for firm operations (Zimmerman and Zeitz, 2002). For example, a legitimate organization can more easily gain funds from investors and use these funds for operational or strategic purposes.

Suchman (1995) distinguished between three types of legitimacy: pragmatic, moral and cognitive. Pragmatic legitimacy is exchange-based, in that external actors will scrutinize how an organization's activities will affect their self-interests and lend their support if the organization's activities will benefit them. Moral legitimacy rests on the perception that the organization's activities are good for society as a whole. Finally, cognitive legitimacy is the comprehensibility of an organization's activities: if external actors cannot understand what an organization does and how its processes function, they may not actively support that organization. To achieve full cognitive legitimacy, however, the firm's actions must be understood to the point of being taken for granted. Put differently, complete cognitive legitimacy means that stakeholders would view alternative firm activities as unthinkable.

Each of these types of legitimacy is important for organizations to survive. Yet, because strategic transformation entails engaging in novel activities, organizations must establish the legitimacy of the transformation when they undergo these large-scale changes (Cornelissen *et al.*, 2011). Next, I discuss how legitimacy affects financial stakeholders' commitment of financial resources to strategic transformation.

3.2.1 Moral legitimacy.

Moral legitimacy connotes stakeholders' perception that an organization's activities benefit society. Although moral legitimacy may seem simple to attain, in that most stakeholders would not question the morality of profit-seeking activities (Choi and Shepherd, 2005), in the wake of a global financial crisis and various financial scandals, doing so may be more complicated. Thus, when organizational managers seek a strategic transformation, they must first convince financial stakeholders of the goodness of the new activities.

Because they contribute critical financial resources, financial stakeholders have significant power in affecting the course of the organization (Freeman, 1984; Porter, 1980) and often wield this power to ensure organizations conform to their sense of morality. For example, the California Public Employees' Retirement System (CalPERS) – the largest public pension fund in the USA – frequently intervenes in companies in which it invests to promote more transparent corporate governance practices (Smith, 1996). Similarly, some religious organizations will not invest in businesses that contradict their values – such as alcohol, gambling and weapons manufacturing – because in their estimation, these business practices lack moral legitimacy (Guay *et al.*, 2004).

Many financial stakeholder groups that are not inherently values-driven, organizations are also increasingly concerned about the ethics of the businesses in which they invest and are more likely than ever to divest from companies which they do not view as ethical. For example, institutional investors like large universities have divested trillions of dollars from the oil industry because of concerns about global warming (Carrington and Howard, 2015). Similarly, as a somewhat novel type of business, firms in the private security industry must take many extra steps to convince financial stakeholders of the ethics of their operations (Elms and Phillips, 2009). It stands to reason, then, that financial stakeholders would, at the very least, not commit resources to strategic transformations they view as immoral. At worst, they might seek to block such transformations. When undergoing transformation, managers must therefore ensure that the firm's new activities fit with the values of critical financial stakeholders and with society in general. Failing to do so may lead to an unsuccessful transformation or, at worst, organizational death. When an organization pursues activities that are perceived as immoral, it can lose the support of a wide range of stakeholders, resulting in an often sudden organizational death (Hamilton, 2006).

Just as new or novel businesses must establish that their practices are ethical, managers attempting a strategic transformation must convince financial stakeholders of the morality of the proposed new activities. Importantly, the establishment of moral legitimacy must take place *before* pragmatic or cognitive legitimacy, as an organization's activities must broadly be acceptable to the stakeholders before they can determine how they might benefit from a relationship with the organization or assess whether its activities are taken for granted (Suchman, 1995). Hence, moral legitimacy is a necessary first step in the process of legitimizing a strategic transformation to gain resources from financial stakeholders. Thus:

> *P1.* Moral legitimacy of a strategic transformation is a necessary condition for financial stakeholders' commitment of resources to that transformation.

3.2.2 Pragmatic legitimacy.

Though a necessary condition for financial stakeholders' commitment of resources to a strategic transformation, moral legitimacy is, by itself, likely insufficient. This is because, in the words of Suchman (1995, p. 575): "To avoid questioning, an organization need only 'make sense.' To mobilize affirmative commitments, however, it must also 'have value […] '". In other words, moral legitimacy may be enough for financial stakeholders to leave an organization alone. For example, if CalPERS already views an organization's corporate governance practices positively, it may be less likely to intervene to try to change those practices. However, to extract a financial commitment from financial stakeholders, managers of organizations undergoing strategic transformation must be able to demonstrate that the transformation will add value for these stakeholders. Hence, when an organization undergoes a strategic transformation, one of the first questions financial stakeholders might ask after establishing moral legitimacy, is: How will this benefit us?

Although pragmatic legitimacy may have already been established when the relationship between an organization and its current financial stakeholders began, because transformation entails a fundamental change in strategy and/or structure, managers must present a new value proposition to stakeholders to renew their support. Furthermore, transformation may mean a radical change in organizational posture, creating the potential for discrepancies between stakeholder values/goals and post-transformation organizational values/goals and, therefore, the potential loss of pragmatic legitimacy. For example, managers may seek a transformation to enhance their own job security, status or the organization's growth, which may not align with investors' preference for wealth maximization (Anand and Singh, 1997; Hill and Jones, 1992). This happened at Hewlett-Packard, where CalPERS forced the resignation of top officers after three ill-advised acquisitions (Smith, 2013). If financial stakeholders believe the transformation may not align with their goals, they may be hesitant to commit resources to support it. Therefore, after moral legitimacy has been established, attaining pragmatic legitimacy for transformation activities will increase the odds of financial stakeholders' commitment of resources.

As an illustration of this mechanism, consider the investment funds of nonprofit organizations. For example, Sierra Club and the Humane Society of the USA both have investment funds, and both funds invest in firms that share the respective values of these nonprofits (Guay *et al.*, 2004).

Clearly, the recipients of these investments have moral legitimacy in the eyes of their nonprofit investors. Yet, because they are financial stakeholders, the investment funds of Sierra Club and the Human Society also seek a return on their investments; that is, they would likely *not* invest in companies that share their *moral* values but have little potential to create *economic* value. Similarly, although a strategic transformation may not be at odds with their morals, financial stakeholders will want to know the potential for value creation before committing resources for its implementation. Therefore, moral legitimacy is necessary but not sufficient for the commitment of resources from financial stakeholders, as the strategic transformation must also create value for them.

One way pragmatic legitimacy can be established is by assessing the connection between the goals of an organization and the goals of its financial stakeholders, such as growth or greater stock value. A broad range of stakeholders have been found to support organizations if they perceive their goals as matching those of the organizations in question (Choi and Shepherd, 2005). If the goals of the strategic transformation and those of financial stakeholders are consistent, pragmatic legitimacy will likely be established, making financial stakeholders more likely to commit resources to the transformation effort, as supporting it will help them reach their own goals. For example, investors must anticipate higher returns on their investments following an acquisition before committing resources to leveraged buy-outs (Bull, 1989). In this case, the organization may seek an acquisition for strategic reasons, whereas financial stakeholders may seek greater returns. Yet, a sensible acquisition could fulfill both goals, creating an exchange whereby both the organization and financial stakeholders benefit and, hence, pragmatic legitimacy.

Unlike moral legitimacy, however, pragmatic legitimacy may not be *necessary* for financial stakeholders to commit resources. If financial stakeholders are unsure regarding how a transformation may benefit them, they may choose to make initial investments and see how it plays out, with the option of removing support later on (McGrath, 1999). Alternatively, simple inertia may lead certain stakeholders to continue their support of the organization during transformation, choosing not to object so long as the organization’s actions generally make sense to them and do not blatantly violate norms (Suchman, 1995). Finally, powerful leaders in the organization, such as board members or CEOs, may be able to convince stakeholders to support transformation, even if pragmatic legitimacy may be lacking (Haynes and Hillman, 2010). In sum, though not necessary, pragmatic legitimacy should increase financial stakeholders’ proclivity to commit resources to a transformation. These theoretical insights lead to the following:

> *P2a.* Pragmatic legitimacy of a strategic transformation is assessed after establishing moral legitimacy and increases the likelihood of financial stakeholders’ resource commitment to the strategic transformation.

3.2.3 Cognitive legitimacy.

Likely the most difficult form of legitimacy to achieve, cognitive legitimacy reflects a deep understanding of what an organization does to the point that firm activities are “taken for granted”, and social actors see almost no basis to question them because they cannot conceive that things might be otherwise (Suchman, 1995). As such, cognitive legitimacy is different from moral and pragmatic legitimacy because it does not involve an evaluation on the part of stakeholders but rather reflects how well they comprehend the activities for the firm.

Unsurprisingly, taken-for-granted status “generally lies beyond the reach of all but the most fortunate managers” because there are so many competitors and strategic options in free markets (Suchman, 1995, p. 583), and, hence, stakeholders could plausibly think of many different strategic transformations the focal firm could undertake or they could simply think the firm should not undertake a transformation at all. Taken together, these insights suggest that cognitive legitimacy – unlike moral and pragmatic legitimacy – is not a direct antecedent of resource commitment because it is so elusive and difficult to achieve. Practically speaking, it is difficult to imagine cognitive legitimacy always or almost always being present when strategic transformations take place. For example, when Intel morphed from manufacturing memory chips to microprocessors, the transition was very combative because many stakeholders could not comprehend Intel’s move away from an industry where it had been so successful; yet, Intel did eventually transform without high levels of cognitive legitimacy (Burgelman, 1996).

However, when cognitive legitimacy of a strategic transformation is achieved, it could amplify the positive effects of pragmatic legitimacy. First, if the transformation is cognitively legitimate, then financial stakeholders could, theoretically, not think of alternatives. Thus, the strategic transformation would be the only conceivable option, and it would benefit them if it is also pragmatically legitimate. Second, the in-depth comprehensibility conveyed by cognitive legitimacy would allow stakeholders to see more clearly how the transformation might create value for them. When cognitive legitimacy of transformations is absent, “stakeholders find it difficult to consistently weigh risk/reward trade-offs […] as they have no tangible evidence that such actions will pay off” (Aldrich and Fiol, 1994, p. 651). For example, in its failed attempt to become an office supply company, Smith Corona managers had a difficult time convincing board members (representing shareholders) to support the transition, largely because they were more familiar and comfortable with the typewriter industry in which the company had always competed (Danneels, 2010).

On the other hand, when cognitive legitimacy is achieved, financial stakeholders should be able to understand more precisely how the strategic transformation will benefit them because they understand the activities of the firm well, reducing the causal ambiguity of the mechanisms that create value for stakeholders. That is, they could realistically assess the benefits that may accrue to them because of the transformation. Indeed, cognitive legitimacy has been shown to increase the likelihood of stakeholder commitment to a long-term relationship with new ventures because it reduces the uncertainty involved in the relationship (Choi and Shepherd, 2005). Similarly, financial stakeholders of existing organizations will be more likely to lend support to a strategic transformation with pragmatic legitimacy when there is also cognitive legitimacy because there is less uncertainty regarding how the transformation will create value for them. Thus:

> *P2b.* Cognitive legitimacy of a strategic transformation increases the positive impact of pragmatic legitimacy on the likelihood of financial stakeholders’ resource commitment to that strategic transformation.

3.2.4 Unfamiliarity with the firm.

As mentioned previously, strategic transformation is akin to forming a new organization in that it requires the use of financial resources, which are often sourced from external stakeholders (Stevenson and Jarillo, 1990). Importantly, firms undergoing transformation may need to seek out resources from *new* financial stakeholders or they may need to seek out additional resources from financial stakeholders with whom they have more of an arm-length relationship, such as creditors. Thus, the level of *unfamiliarity* with the firm will likely play an important role in the decision to commit resources to the transformation, as this is an important aspect of the relationship between stakeholders and firms (Sen *et al.* 2006). Indeed, familiarity conveys a type of legitimacy distinct from the others discussed heretofore: whereas moral, pragmatic and cognitive legitimacy involve stakeholders' general acceptance of certain activities, familiarity is a form of legitimacy that connotes awareness of a specific organization (Williamson, 2000). Additionally, some familiarity with a given firm is likely needed for stakeholders to determine its moral, pragmatic and cognitive legitimacy.

Financial stakeholders who are less familiar with the focal firm should, in general, be less likely to commit resources to a strategic transformation. This is because unfamiliarity increases the risks for financial stakeholders: they do not know the firm well enough to be sure of its general legitimacy, and, hence, they cannot be assured that they will receive the desired return on their investment (Williamson, 1979). Conversely, financial stakeholders are more likely to support firms with whom they are familiar (Choi and Shepherd, 2005; Williamson, 2000). This is likely because stakeholders have a more generalized sense of confidence in the firm's ability to provide a return on their investment, perhaps based on previous performance. Even if the firm is transforming because of poor performance, investors often use their existing knowledge of the firm's capabilities to gauge its potential for future success (Adler and Chaston, 2002). This logic should also apply to strategic transformations, as financial stakeholders who are familiar with the firm can more accurately gauge the odds of a successful transformation than those who are unfamiliar. These insights suggest that financial stakeholders – be they new or existing – who are less familiar with the firm would be more cautious when committing financial resources to a strategic transformation:

> *P3a.* The more unfamiliar a firm is to financial stakeholders, the lower the likelihood of financial stakeholders' resource commitment to that firm's strategic transformation.

Although financial stakeholders who are less familiar with the focal firm should, in general, be less likely to commit resources to a strategic transformation, this negative effect could be mitigated if there is strong pragmatic legitimacy for the transformation. In these cases, the potential benefits of committing resources to the transformation could outweigh the uncertainty of forming a new/stronger relationship with a less familiar firm. Indeed, despite the hazards relating to liabilities of newness, financial stakeholders are more likely to form a long-term relationship with new ventures when they perceive that the relationship aligns with their goals and will benefit them (Choi and Shepherd, 2005). Similarly, the risks of committing resources to a less-familiar firm undergoing transformation could be outweighed by the potential rewards if there is a strong alignment between the goals of the firm and the financial stakeholder in question.

For example, Uber is undergoing a transformation as it morphs from a new venture to a global enterprise. Although it is a privately held company (that is, its practices are not transparent or familiar to outsiders) based in the USA that only recently began operations in Saudi Arabia, the country's Public Investment Fund committed \$3.5bn to help fuel Uber's international expansion (Isaac and de la Merced, 2016). Despite a somewhat high degree of unfamiliarity with Uber, the Saudi Public Investment Fund managers concluded that the investment was worth the risk because the country seeks income streams beyond its traditional reliance on oil revenues (Isaac and de la Merced, 2016), and they thought that Uber could help them reach this goal, even though the company is somewhat unfamiliar. These insights lead to the following:

> *P3b.* The negative effect of financial stakeholders' unfamiliarity on the likelihood of committing resources to a strategic transformation decreases as the pragmatic legitimacy of the transformation increases.

Finally, familiarity may be an effective substitute for cognitive legitimacy in terms of enhancing the effect of pragmatic legitimacy when financial stakeholders decide whether to commit resources to a strategic transformation. Previously, I have argued that cognitive legitimacy should amplify the impact of pragmatic legitimacy, as it will enable stakeholders to understand more thoroughly how the transformation could create value for them. Yet, I also pointed out that cognitive legitimacy is, practically speaking, very difficult to achieve. Only in rare circumstances do stakeholders have a full and complete sense of a firm's activities, such that a proposed strategic transformation would be the only conceivable option known to them.

In cases where cognitive legitimacy is not achieved, familiarity could be an effective substitute. Although financial stakeholders in such a scenario may not have a complete understanding of the transformation or may be able to conceive of other strategic options for the firm in question, their familiarity with the firm could be a source of confidence. Here, having a general (rather than extensive) knowledge of the firm and an established relationship with it enables stakeholders to be more comfortable taking a risk in supporting a strategic transformation that meets their goals (Das and Bing-Sheng, 1998), even though the transformation may entail activities that the stakeholders do not understand well. This is because familiarity – in a general sense – makes a firm appear more predictable and trustworthy, even when it undertakes entrepreneurial actions like transformation (Williamson, 2000).

When a strategic transformation meets the threshold for pragmatic legitimacy, financial stakeholders who are also familiar with the firm should be more likely to commit resources than those who are unfamiliar. Put another way, financial stakeholders could potentially invest in many firms. Yet, it is not sensible to commit resources to a firm undergoing transformation simply for the sake of investment; financial stakeholders must also have confidence that the investment will pay off (McGrath, 1999). A general familiarity with the firm helps provide that confidence, even if cognitive legitimacy ("taken for granted" status) is not achieved. In sum, although cognitive legitimacy may be difficult to achieve, familiarity could play the same role in amplifying the positive effect of pragmatic legitimacy on stakeholder commitment of resources because it provides a sense of confidence in the firm. Thus:

P3c. Familiarity with a firm can substitute for cognitive legitimacy when affecting the impact of pragmatic legitimacy on the likelihood of committing resources to a strategic transformation.

4. Discussion and implications

An understanding of stakeholder commitment of resources is an important, but under-explored, aspect of strategic transformation, which is a critical means of maintaining organizational vitality. Burgelman (1996, p. 210) noted that “ […] firms continue to exist, in part, because old product-market strategies get replaced by new ones, and old distinctive competencies give way to new ones”. By securing resources from critical financial stakeholders, managers can proceed with the process of strategic transformation and ensure the continued existence of the firm. I have theorized here that moral and pragmatic legitimacy are direct antecedents of the likelihood of financial stakeholders’ commitment of resources to strategic transformation. Additionally, cognitive legitimacy or familiarity can play a moderating role. Although unfamiliarity with the focal firm may reduce the likelihood of resource commitment, increasing levels of pragmatic legitimacy should dampen this effect. Next, I discuss the implications of this theory for scholars and practitioners.

4.1 Theoretical implications

The theoretical framework presented here has numerous implications for scholarship regarding strategic transformation. It complements a robust stream of research on managing transformation *within* the organization by showing why managing transformation *outside* the organization – in the form of gaining support from financial stakeholders – is a necessary step in transformation implementation and by showing how this external management of transformation can be accomplished with regards to financial stakeholders. This contribution is important and timely: stakeholder theory has been criticized for focusing too much on how stakeholders affect firms’ short-term financial performance, with few implications for organizations’ long-term strategy and viability (Laplume *et al.*, 2008). The framework presenter here is a step toward addressing this criticism because it details how and why stakeholders are needed during strategic transformations, which are themselves critical for long-term performance (Agarwal and Helfat, 2009; Burgelman, 1996).

Moreover, by theorizing the drivers of stakeholder resource commitment, I demonstrate how established prescriptions for communicating transformation to stakeholders can be harnessed to achieve a successful strategic transformation. The type of firm ownership influences how managers should frame or condense meaning when communicating changes to shareholders (Fiss and Zajac, 2006), suggesting that managers must frame their cases for legitimacy carefully to convince financial stakeholders to commit resources to a transformation. Similarly, because framing should match the institutional environment (Fiss and Zajac, 2006), managers must ensure that their framing of transformation communication to shareholders is consistent with the legitimacy demands of the institutional environment. Specifically, metaphors (rather than analogies) which are relational (that is, exhibit many deep counterparts rather than a few superficial ones) that fit within these constraints would maximize financial stakeholders’ positive perceptions and understanding of proposed transformations (Cornelissen *et al.*, 2011).

Additionally, framing the transformation as balanced in its goals may help financial stakeholders understand that the change will benefit diverse groups of stakeholders; conversely, an acquiescing framing can be used to communicate the singular benefits of the transformation to financial stakeholders (Fiss and Zajac, 2006). Table I summarizes some of the strategies that could be deployed to gain legitimacy for transformation.

Table I. Managerial strategies for developing legitimacy for strategic transformation

Type of legitimacy	Managerial strategies
Moral	Use of balancing framing (Fiss and Zajac, 2006)
	Isomorphism (Powell and Dimaggio, 1991; Zimmerman and Zeitz, 2002)
Pragmatic	Use of acquiescence framing (Fiss and Zajac, 2006)
	Use of past performance record (Zimmerman and Zeitz, 2002)
Cognitive	Use of relational metaphors (Cornelissen et al., 2011)
	Use of symbolic language and actions (Zott and Huy, 2007)

Future research could empirically investigate these prescriptions, examining which strategies on the parts of managers lead to greater resource commitment on the parts of financial stakeholders. Additionally, more work is needed to understand other specific strategies for garnering resources for strategic transformation. Although there have been scholarly prescriptions for framing change, how different types of legitimacy can best be demonstrated to outside groups is not known. There has been some related work that might be applicable. For example, Zott and Huy (2007) analyzed how entrepreneurs leveraged symbolic actions in order acquire resources from relevant stakeholders. They categorized four types of symbolic actions that can convey personal credibility, professional organizing, achievement or the quality of stakeholder relationships. Although these actions were performed by entrepreneurs, they could potentially be used by managers seeking resources for transformation to underscore the legitimacy of the firm and the proposed transformation. Narratives can also replace external validation as a means of attaining legitimacy (Aldrich and Fiol, 1994). If managers can lay out their vision for the transformation in an entertaining, engaging story, stakeholders may be more receptive and more willing to overlook the potential risks involved. Scholarly work is warranted to determine if these strategies could apply to the transformation process and how they fit with legitimacy.

Finally, given the importance of stakeholders to transformation, much more research is needed regarding how and why they support transformations. Although the focus here was on financial stakeholders, scholars could use the theoretical framework as a baseline to investigate why other stakeholders, such as employees, regulators, community members, etc., might support strategic transformations. Different stakeholders are affected by the firm in different ways and can have very different goals, so unique theories are likely needed for different kinds of stakeholders.

4.2 Managerial implications

To secure resources, first and foremost, managers should have well-established processes for dealing with stakeholders, as delineated above. By investing early in effective stakeholder management, managers can create productive relationships and increase the odds of stakeholder resource commitment for transformation before it is even considered. Additionally, managers should carefully consider the legitimacy of strategic transformations, and how this legitimacy might be perceived by financial stakeholders. The strategies displayed in Table I could be used to help communicate legitimacy to financial stakeholders.

5. Conclusion

Strategic transformation is an important part of an organization's life cycle (Burgelman, 1996) but is not well understood. I have explicated the antecedents of key financial stakeholders' resource commitment to transformation. Change may be inevitable, and it can create difficulties for organizations; however, organizations that embrace it as an opportunity for reinventing themselves will likely weather the storms of change better than those that succumb to inertia. The theory presented here offers a roadmap for how financial resources can be garnered to support such initiatives.

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