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The Good, the Bad, and the Unfamiliar: The Challenges of Reputation Formation Facing New Firms

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How do new firms first develop reputations among their stakeholders? Past studies offer insights on positive signals that a new firm can send, but say little about how stakeholder group members process such signals and come to share beliefs that a new firm possesses a desirable set of attributes. This process is particularly important to understand given that both negative and positive signals are often received about new firms. Our article draws on social cognition theories to develop insights regarding the process by which stakeholder groups develop reputational beliefs about new firms and to identify factors that facilitate or impede the development of reputations.

In 1998, a firm called PayPal was launched to provide online money transfers. By 2000, PayPal had 4.6 million customers, more than 50% of them using the service to make transactions on the eBay auction website. In 2000, eBay partnered with Wells Fargo to buy Billpoint, a direct competitor of PayPal, in a bid to win the business (Silverman, 2000). PayPal, meanwhile, was facing serious challenges to its reputation in some quarters. Its service was widely and publicly criticized and it struggled to overcome an unsatisfactory rating with the Better Business Bureau. Online swindlers were successfully targeting and defrauding numerous PayPal users; the company's antifraud detection software fueled more complaints because it froze customers' accounts; and in February 2002, disgruntled users filed a class action suit over the enforcement of contracts (Esch, 2001). Yet in that same month, PayPal made a very popular initial public offering, with shares leaping to $20 from an offering price of $13 on the first day (Overfelt, 2003). By mid-2002, eBay was persuaded that Billpoint could not overcome PayPal's lead. In June 2002, eBay announced it would buy PayPal and shut down Billpoint (Kane, 2002).

This case begs the central questions of this article. How can a new firm gain a promising initial reputation when its track record is short and signals about it have been mixed? How is information about the firm processed such that some information (in this

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case, negative) is seemingly discounted while other information has a disproportionate influence on its reputation?

A firm's reputation is widely considered to be a valuable resource associated with sustained competitive advantage (Amit & Schoemaker, 1993; Barney, 1991), if not *the* most valuable intangible resource a firm can possess (Hall, 1992). Research has shown that a good reputation provides significant benefits for a firm (Deephouse, 2000; Rao, 1994; Roberts & Dowling, 2002). Firms with favorable reputations benefit because they are more attractive to investors, customers, suppliers, and employees. This attractiveness can yield price, cost, and selection advantages. Further, these benefits can persist over time (Roberts & Dowling, 2002). Thus, forming and maintaining a good reputation is a key task in founding a firm.

Past research on young firms has identified the kinds of signals that enhance their reputations, including founders' track records, high-status partners, or wins in certification contests (Deutsch & Ross, 2003; Rao, 1994; Shane & Cable, 2002; Stuart, Hoang, & Hybels, 1999). However, limited attention has been paid to the process by which people form initial reputational beliefs about new firms. Furthermore, we know little about how emergent reputations are affected when stakeholders receive mixed positive and negative signals. These are significant gaps in our understanding. Without an understanding of how reputations are formed *initially*, our perspective on reputation is "left censored." That is, we lack insight into the emergence of those first impressions that are the basis for later updating as new signals are received. Furthermore, without a conceptual foundation that considers how both positive and negative signals are processed, we lack the tools needed to understand the processing of those mixed messages that are so common for struggling new firms (cf. Sorensen & Stuart, 2000; Stinchcombe, 1965).

To begin addressing these gaps, we conceptualize an organization's reputation within a stakeholder group as a function of the attitudes toward it held by individual members of that group. In order to understand how reputations are formed, we start at the individual level of analysis and examine how people form their first impressions of firms. We draw on social cognition theories to explain how reputational belief structures about new firms develop. We explore how beliefs about firm attributes can arise if signals link new firms to familiar categories, or if the stakeholders are highly motivated to process initial signals. We highlight how the valence of the categories with which new firms are associated combines with the valence of entity-specific information to create an overall positive or negative evaluation.

This research is valuable because it complements prior work on positive signals about new firms (e.g., Rao, 1994; Shane & Cable, 2002; Stuart et al., 1999), providing insights on how these may overshadow, or be overshadowed by, negative signals. It also complements research on the reputations of well-established firms (e.g., Fombrun & Shanley, 1990) by considering how the reputations of new firms come into existence.

While the article is rooted in theories of social cognition, our approach is consistent with work that views reputation as a firm resource (e.g., Barney, 1991; Hall, 1992). We address the challenge identified by Fombrun and Shanley (1990, p. 254) of developing insight into the cognitive structures underlying reputation. Our approach to the phenomenon complements sociological and economic approaches by deepening our understanding of the individual-level processes through which reputations develop. The article also contributes to entrepreneurial theories of venture creation. Aldrich (1999) has argued that the emergence of organizations has been undertheorized and underresearched, potentially leading to the neglect of early phases that are critical to subsequent outcomes. By examining how initial information influences the categorization and evaluation of new firms, we extend our current understanding of the start-up process.

The goal of this article is limited to addressing how new firms' reputations form within external stakeholder groups (Freeman, 1984), such as actual or potential customers, suppliers, or competitors. Stakeholders are identified by the common nature of their interests in the firm (Donaldson & Preston, 1995). Different stakeholder groups can be distinguished by the different potential risks or rewards they face as a result of the organization's activities. To maintain focus, we do not address differences between stakeholders in terms of their salience to the new firm (Mitchell, Agle, & Wood, 1997), but rather consider the general problem of reputation formation within stakeholder groups defined by their common interests. Likewise, we do not consider the differences across institutional contexts that may impact reputation formation, although differences in the use of customers as signaling mechanisms have recently been identified across distinct competitive contexts (Reuber & Fischer, 2005) and other such contextual differences may exist. A further limitation on the scope of this article is that we do not address processes that occur within stakeholder groups that lead to the sharing of opinions about new firms. While it would be of value, an examination of the factors, such as network features (e.g., Carter & Deephouse, 1999; Rowley, 1997), that facilitate the emergence of shared understandings among stakeholders, is beyond the scope of this article.

In the next section, we describe two dominant perspectives on organizational reputation that view reputational beliefs as a function of the attitudes held by stakeholders. We highlight the importance of considering both the content and the valence of reputations and then outline how they may be affected by signals about new firms. Finally, we consider the implications of the insights developed here for unanswered questions regarding reputation.

Organizational Reputation

In this article, our concern is to explain the formation of beliefs about and evaluations of new firms by external stakeholder group members. We consider the reputations that a firm has with its various audiences to be firm-level resources that are socially constructed but objectively held by those external audiences: Audience beliefs, however aligned with or decoupled from signals sent by firms, constitute the reality of reputations. Given the incomplete agreement in regard to the usage of the term "organizational reputation" (see discussion later), for purposes of this article, we will define it as the beliefs and evaluations held by external audience members, acknowledging that other usages also exist.

Our definition of reputation can be compared with those of at least four other socially constructed organizational resources: (1) organizational identity, (2) organizational image, (3) organizational legitimacy, and (4) organizational trust. In our view, firms' reputations are assessments made by outsiders. It is the *externality* of the assessment that differentiates reputation from organizational identity, which has been defined as what insiders think about their organization (Gioia & Thomas, 1996), and from organizational image, which has been defined as what insiders believe that outsiders think about it (Dutton, Dukerich, & Harquail, 1994). These terms, however, have been used in multiple and partly overlapping ways in previous research: Conceptualizations of both identity (e.g., Gioia, Schulz, & Corley, 2000) and image (e.g., Gatewood, Gowan, & Lautenschlager, 1993; Whetten, 1997) have included the mental models that outsiders have of organizations. To the extent that image and identity are beliefs held by outsiders about organizations, these constructs may overlap with the reputation construct as we have defined it.

Even more closely related is the construct of legitimacy (e.g., Deephouse & Carter, 2005; Lounsbury & Rao, 2004; Rindova, Pollock, & Hayward, 2006). Like organizational reputation, organizational legitimacy involves an external assessment. Moreover, both appear to require categorization by external audiences. In particular, cognitive legitimacy requires the "availability of cultural models that furnish plausible explanations for the organization and its endeavors" (Suchman, 1995, p. 582), while reputation requires that a firm be judged as of a certain type and compared to others of that type (e.g., Deutsch & Ross, 2003; Fombrun & Shanley, 1990). At the same time, neither reputation nor legitimacy can be reduced simply to a matter of categorization. Both reputation and legitimacy involve judgments by audience members that go beyond categorization. Rather than attempting to isolate the categorization of a new organization as a process uniquely associated with legitimacy or with reputation, we suggest that categorization is essential to the establishment of both, and that the ideas developed in this article that involve categorization have relevance to understanding the emergence of both reputation and legitimacy for new firms.

Another external assessment with which reputation can be compared is organizational trust. While some authors (e.g., Moorman, Zaltman, & Deshpande, 1992) have defined trust in behavioral terms, many consider trust—like reputation—to be an evaluation that *may* lead to behavior because it entails confidence in the trust object. For example, Morgan and Hunt (1994, p. 23) define trust "as existing when one party has confidence in the exchange partner's reliability and integrity." Multidimensionality constitutes another parallel between some conceptualizations of trust and of reputation. Increasingly, conceptualizations of trust emphasize that it is composed of a set of distinct but interrelated beliefs (e.g., Sirdeshmukh, Singh, & Sabol, 2002). Similarly, some conceptualizations of reputation highlight its multidimensionality and posit that a good reputation leads to trust as well as other outcomes (e.g., Roberts & Dowling, 2002).

A good reputation is beneficial because, in building trust, it reduces uncertainty about an organization (Weigelt & Camerer, 1988): As Shapiro (1983, p. 659) states, "the idea of reputation makes sense only in an imperfect world." This implies that a good reputation is particularly beneficial to new firms, which are associated with greater uncertainty than established firms because of the liabilities of newness (Stinchcombe, 1965). For example, a good reputation reduces uncertainty about the ability of a firm to perform as expected or desired (Weigelt & Camerer, 1988), addressing the liabilities associated with the need to develop effective routines and roles. A good reputation also motivates actors to enter or continue a relationship with an organization (e.g., Dollinger, Golden, & Saxton, 1997), addressing the liabilities associated with an absence of trusted and stable exchange partners. Two perspectives on organizational reputation can be identified from previous research. They are described later and are contrasted in Table 1.

Aggregate Perspective on Reputation

The first perspective on organizational reputation, labeled the *aggregate perspective*, is represented by the following definition: Reputation is "a perceptual representation of a company's past actions and future prospects that describe the firm's overall appeal to all its key constituents when compared to other leading rivals" (Fombrun, 1996, p. 72). Three dimensions of this definition are worth elaborating. First, an organization's reputation constitutes an overall, or aggregate, assessment by groups of stakeholders that builds on and transcends particular aspects of the organization's past or future. Although this perspective allows for reputations in particular arenas, such as being the "best place to work" (cf. Rindova & Fombrun, 1999), these arenas are themselves abstractions of multiple attributes. Second, building on the sociological concept of organizational status (e.g., Podolny, 1993), this view emphasizes that reputations are comparative. Based on

Table 1

Perspectives on Organizational Reputation

Dimension	Aggregate perspective	Componential perspective
Scope of assessment	Aggregated across organizational attributes	Specific to a particular attribute
Relevant assessors	Diverse audience groups, including the general public, aggregating across attributes	Specific audience groups focused on the specific attribute(s) being assessed
Basis of assessment	Emphasis on comparison with peer organizations	Emphasis on consistency of organization's past behavior
Role of signals	Signals are diverse and ambiguous	Signals are intentional and focused
	Signals can be accurate or inaccurate	Signals can be accurate or inaccurate
	Signals are generated internally and externally	Signals are generated internally
	Signal interpretation is a black box	Signal interpretation is tightly modeled

perceptions of past actions and future prospects, favorability assessments are made; these are compared with assessments of other similar organizations. Accordingly, this perspective has emphasized comparative rankings in empirical studies (e.g., Fombrun & Shanley, 1990).

Third, the definition is silent on how people learn about an organization's past actions and future prospects, reflecting Fombrun and Shanley's (1990, p. 234) argument that relevant reputational signals are inherently diffuse and ambiguous. Empirical research in this tradition has examined the impact on reputational assessments of diverse signals emanating from both inside and outside organizations, such as founders' track records (e.g., Shane & Cable, 2002); the prestige of partners and affiliates (e.g., Stuart et al., 1999), contest wins (Rao, 1994), direct experience with a firm's products or services (e.g., Ravasi, 2002); financial statements (e.g., Fombrun & Shanley, 1990); and media reports (e.g., Deephouse, 2000). However, work within this research tradition has not clarified how signals are interpreted.

Componential Perspective on Reputation

The second perspective on organizational reputation, labeled the *componential perspective*, is represented by the following definition: Reputation is "a probability that the firm is of a certain type or will act in a certain way" (Deutsch & Ross, 2003). As shown in Table 1, this perspective can be compared to the first perspective along the dimensions previously identified. First, rather than being an aggregate assessment, an organization's reputation constitutes an assessment of a particular attribute or characteristic: An organization has a reputation *for* something, such as having high quality products (e.g., Milgrom & Roberts, 1986) or being an aggressive price predator (Smith, Grimm, & Gannon, 1992). Second, rather than being assessed in comparison with peer organizations, organizational reputations are assessed on the basis of an organization's past behavior. For example, consistency of a behavior such as aggressive pricing over time leads to a lower variance estimate of the organization's future actions and strengthens its reputation for this behavior (e.g., Heil & Robertson, 1991).

Third, research in this tradition building on signaling theory has emphasized the role of signals both in forming and reflecting organizational reputations. For example, educational attainments can signal the quality of human capital (Spence, 1973), new product announcements can signal market aggressiveness (Heil & Robertson, 1991), while advertising expenditure, high pricing, and even the organization's name can signal product or service quality (e.g., Milgrom & Roberts, 1986). This line of research has pointed out the importance of interpreting signals in the formation of reputational beliefs about the sender organization (e.g., Heil & Walters, 1993). The centrality of signaling is reflected in statements such as "a sender's reputation depends on how the receiver interprets the sender's signals" (Prabhu & Stewart, 2001, p. 65). This statement also reflects this perspective's focus on intentional signals that are controlled and internally generated by the organization. In contrast to the aggregative perspective, the impact of externally generated unintentional signals on receiver beliefs is rarely explicitly considered and is sometimes precluded in the componential perspective (e.g., Heil & Robertson, 1991).

Reconciling the Perspectives: Reputations as Function of Attitudes

The foregoing discussion acknowledges differences in perspectives on reputation. However, one shared assumption is that an organization's reputation rests on individuals' categorizations and evaluations of the organization. While these categorizations and evaluations are likely to be influenced by the desired meanings of those who craft intended signals, factors beyond the signal itself can influence interpretations.

Thus, to understand how new firms' reputations form, we focus on the individual-level cognitive processes leading to attitudes that collectively constitute firm-level reputations. This approach is consistent with that used in marketing to understand consumers' beliefs about new brands and products (e.g., Keller, 1993), and is particularly appropriate given that it recognizes the possible disjuncture between intended signals and achieved interpretations (as reflected, for example, in the distinction drawn between intended brand concept and achieved brand image, cf. Park, Jaworski, and MacInnis ([1986]).

An attitude is a summary evaluation of an entity that "denotes an overall degree of favorability" (Ajzen, 2001, p. 29) toward the entity. Attitudes range from extremely positive to neutral to extremely negative. Attitudes also vary in terms of the certainty with which they are held (e.g., Pomerantz, Chaiken, & Tordesillas, 1995), ranging from high certainty or total conviction to low certainty or lack of conviction. Furthermore, attitudes are multiattribute belief structures (Fishbein & Ajzen, 1975.) Each attribute salient to an overall attitude is associated with a valence (Ajzen, 2001), ranging from positive to negative. Each attribute is also associated with a belief strength or perceived certainty that the attribute is a characteristic of the entity. The attribute "contributes to charities," for example, may have a lower valence for an investor than the attribute "is profitable," but may be believed with more certainty.

A crucial correspondence between the attitude literature and the reputation literature is the key role of uncertainty. Uncertainty is central to the relevance of reputations in general (Shapiro, 1983), and the reputations of new firms in particular (Stinchcombe, 1965). The attitude construct explicitly incorporates uncertainty about attribute-specific beliefs (Eagley & Chaiken, 1998), i.e., there are differences in how likely particular attributes are thought to be characteristic of a firm. Thus, attitudes toward a new firm will vary both in terms of the valence and strength of their beliefs that particular attributes characterize the firm.

From Individual Attitudes to Reputations within Groups

Attitudes are individual-level phenomena, while reputation is a group-level phenomenon. We regard the process of reputation formation as one of attitude formation by multiple individuals within a stakeholder category. To move from the individual level to the group level, we consider firms' reputations to be a function of the attitudes of multiple individuals within a stakeholder group. Clearly, individual stakeholders within a group will not have identical attitudes toward a new firm, despite the fact that they have the same kinds of interests in it. In fact, their attitudes are likely to vary, just as beliefs about organizational identity vary among organizational insiders (Scott & Lane, 2000, p. 43). Thus, to move from the individual level to the group level, it is necessary to consider the implications of differences between individuals.

The attitudinal perspective developed here suggests two dimensions along which reputations can be compared. First, reputations will vary in the level of consensus about the attributes that characterize the firm. When consensus is high, there is little variance across members of a stakeholder group in terms of which attributes they associate with the firm, or the likelihood that these attributes are characteristic of the firm. When consensus is low, members vary widely in the attributes they associate with the firm and/or the strength of their conviction that each is associated with it. Second, reputations will vary in valence (i.e., their degree of positivity or negativity) as a function of the positivity or negativity of individual stakeholders' attitudes. The overall valence of a reputation can be regarded as the average of the valence of the attitudes toward the firm held by individuals in a stakeholder group.

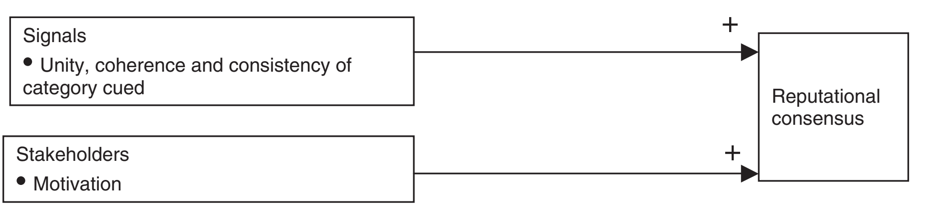
This attitudinal conceptualization of reputation is particularly useful for understanding how new firms' reputations form. It highlights two potential challenges in reputation building. One is to create a high overall valence of stakeholders' attitudes. The other is to create consensus regarding attributes associated with the firm. The following sections address both challenges.

Forming Impressions of Attributes

When potential buyers and sellers first encountered signals about PayPal, what attributes did they believe the new firm possessed? Their first exposure to the firm might have come from seeing the logo on the eBay website or reading about the firm in the popular press. Would such limited exposure lead stakeholders to form a relatively consistent set of beliefs about the attributes the firm possessed? The answer to this question depends on both signal and stakeholder characteristics: the nature of the category cued and the motivation level among stakeholders. Figure 1 summarizes the propositions developed in this section of the article.

Figure 1

Factors Contributing to Reputational Consensus Regarding Attributes



Categorical Cues

Entrepreneurship and marketing researchers alike acknowledge that one important way that people come to "know" new firms or new offerings is by associating them with preexisting known categories (e.g., Aldrich & Fiol, 1994; Gregan-Paxton & Roedder-John, 1997). This idea resonates with categorization research showing that people create mental representations for any new entity by using information in existing mental categories. Category-based processing is the most common way people process information about new entities (Fiske & Neuberg, 1990).

Which category or categories people will draw upon, however, is under-determined by real characteristics of a new firm. Categorization research suggests that there is a primacy effect, with a new entity more likely to be categorized by signals encountered earlier rather than later (Asch, 1946; Fiske & Neuberg, 1990). Research on products and people (e.g., Bargh, 1999; Gregan-Paxton & Roedder-John, 1997) suggest individuals form first impressions through stereotypes based on an early category cued, and typically do not defer making judgments until they have more complete information (e.g., Bargh, 1999). Categories are most easily cued when a category label is explicitly provided (for example, "eBay is an online auction site"), or when signals provide evidence of attributes that together suggest a particular category (Fiske & Neuberg, 1990). For example, "sells books," "firm's name ends with .com," and "has a shipping policy" are attributes that collectively suggest a firm is an online bookseller.

In order for multiple stakeholders to associate the same set of attributes with the new firm, however, it is not enough that each one simply categorizes the firm in their own manner. Rather, multiple stakeholders must associate the firm with a category bearing the same main attributes. Thus, for common perceptions of the attributes of a new firm to be shared by multiple stakeholders, it is necessary that a category that is familiar to, and similarly perceived by, a significant portion of those stakeholders be activated. Categories of this kind are referred to as having high perceived "entitativity." A category has high perceived entitativity when it is perceived as having a high degree of unity, coherence, and consistency (cf. Campbell, 1958; McConnell, Sherman, & Hamilton, 1997). People have a larger and more interconnected belief structure about categories that are more unified, coherent, and consistent: They associate more attributes, and associate them more automatically with members of such categories (e.g., Hamilton & Sherman, 1996). For example, the category "Silicon Valley start-up" will have a higher perceived unity, coherence, and consistency than the category "Chicago start-up" if new firms in Silicon Valley are perceived to share characteristics and a common fate to a greater extent than new firms in Chicago. In this case, a signal indicating that a firm is a Silicon Valley start-up would assign stereotyped attributes to the new firm to a greater extent than a signal indicating it is a Chicago start-up. This leads to the following proposition:

> **Proposition 1:** The more unified, coherent, and consistent the categories cued by initial signals, the greater the consensus among stakeholder group members regarding attributes that characterize a new firm.

How are the categories expected to be activated for new firms likely to vary in terms of perceived unity, coherence, and consistency? One major category into which new firms may be slotted is industry; another is geographical cluster. Research by Lickel et al. (2000) highlights factors that vary across categories and that affect perceived unity, coherence, and consistency: Three such factors relevant to both industries and clusters are (1) the extent of interaction among category members; (2) the perceived similarity of category members; and (3) the duration of the category's existence. This suggests that, in general, nascent industries will represent less unified, coherent, and consistent categories than established industries, to the extent that they rely on an unproven market and technology; they lack industry norms, governing bodies, associations, and favored forms; they have existed for a shorter period of time; and they have a membership still in flux (Aldrich, 1999; Aldrich & Fiol, 1994). It also suggests that geographical clusters of competing firms, such as those in Silicon Valley, will represent such categories more than do sets of nonclustered firm, due to their shared resources, capabilities, proximity, networks of interdependencies, and mimetic tendencies (Pouder & St. John, 1996).[1]

Individuated Information Processing

Although automatic categorical, processing is the default when an individual encounters signals about a new entity (e.g., Bargh, 1999), motivation can increase more effortful, individuated processing of signals (Fiske, Lin, & Neuberg, 1999). This does not mean that category-based inferences are overridden, but rather that categorical and individuated information are integrated. People can become motivated to learn more about a new entity when they perceive that its attributes are a poor fit with the current category, as happens when consumers try to understand brand extensions (Broniarczyk & Alba, 1994). Alternatively, they can be motivated to learn more about a new entity when they perceive that important outcomes depend on it (e.g., Fiske & Neuberg, 1990). For example, managers in existing firms may be motivated to learn about a start-up in the industry only if it is perceived as a threat.

Motivation leads people to strive for accuracy in processing signals (e.g., Chen, Schecter, & Chaiken, 1996). In striving for accuracy, people pay close attention to the details of signals and process them systematically (e.g., Chen et al., 1996). Even though initial signals cue a category and influence perceptions, however subconsciously (Bargh, 1999), motivated people integrate information in an individuated or "piecemeal" fashion to override expectations or to test initial hypotheses about the entity (Fiske & Neuberg, 1990). They supplement category information with attribute information specific to the signal and the entity, and integrate information in an attribute-by-attribute manner (Fiske et al., 1999). For example, in the context of new products, consumers who are highly motivated strive for greater accuracy in processing information about the brand (Campbell & Goodstein, 2001).

The average motivation among stakeholders in a group must be relatively high if many of them are to engage in this piecemeal processing that integrates entity-specific cues with categorical assumptions. High average motivation is likely when members of the group perceive that there are significant risks to and/or benefits of forming a relationship with a new firm. So, for example, potential investors are likely to have a high-average motivation to understand a firm like PayPal and to process signals carefully while potential consumers will have lower average motivation if the costs of a bad service encounter to them are relatively low. Higher motivation to process signals is associated with greater

1. These observations suggest that, in the domain of organizations, there is a correspondence between the unity, coherence, and consistency of a category and its degree of institutionalization (cf. DiMaggio & Powell, 1991). This is likely to be true in many cases, but the two concepts are not synonymous. For example, Internet-based commerce gained legitimacy and became institutionalized very quickly (Aldrich, 1999, pp. 329; Lounsbury & Glynn, 2001). At the same time, however, its turbulence and fluidity (cf. Rindova & Kotha, 2001) limits the extent to which the "industry" can be perceived as high in unity, coherence, and consistency.

accuracy of processing, and therefore with greater consensus in terms of the attributes associated with the firm. Thus we posit:

> **Proposition 2:** The greater their level of motivation to process signals, the greater the consensus among stakeholder group members regarding attributes that characterize a new firm.

The challenge of achieving a consensus regarding attributes is less for some new firms than others. "Reproducer" start-ups (Aldrich, 1999) in established industries such as banking or real estate are readily able to signal their membership in these well-known categories. If they attempt to differentiate themselves, however, start-ups in existing industries may face considerable variation in the perceptions held by stakeholders if motivation to process signals is, on average, low. Those who are less motivated will automatically pigeonhole the start-up regardless of entity-specific information conveyed in signals.

Firms such as PayPal—new entrants into new industries—face the challenge of getting stakeholders to connect them with a consistent set of attributes. Because the category "on line funds transfer companies" lacked unity, consistency, and coherence at the outset, stakeholders were unlikely to make consistent assumptions about the firm's attributes. Thus, expectations about the firm would vary. While firms can attempt to educate stakeholders about their attributes via signals, unmotivated stakeholders will pay little attention. Instead, they will make assumptions based on the few attributes they loosely associate with the category. Uneven processing of entity-specific signals across members of a category could help account, for example, for the fact that customers appeared to have quite diverse expectation of PayPal. Some complained and set up websites to undermine the firm (e.g., paypalsucks.com), while others remained loyal even when competition in the form of Billpoint became readily available.

Forming Impressions of Valence

In the previous section, the attributes associated with new firms, whether as a result of category membership or entity-specific information, were the focus of attention. Here, we examine how categorical processing and individuated information processing can influence the evaluations of new firms formed within stakeholder groups. Figure 2 summarizes our propositions.

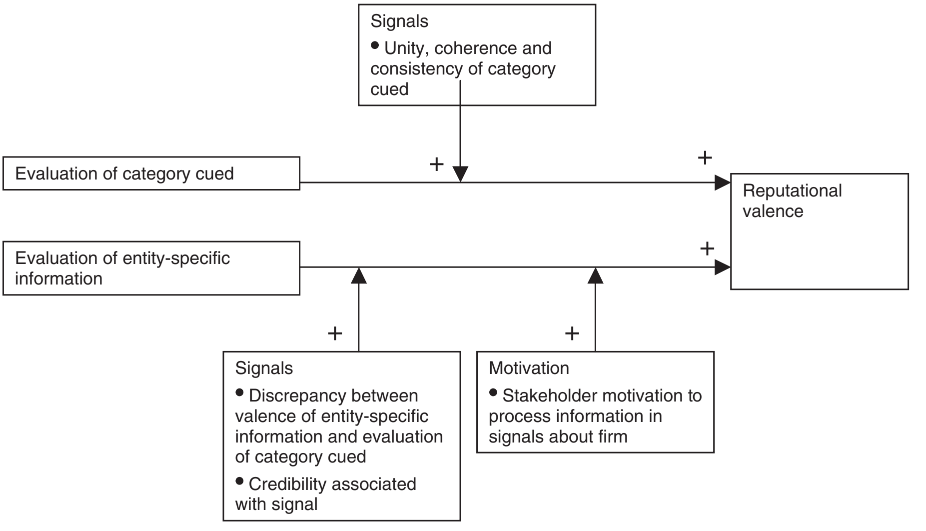
Categorical Processing

Automatic evaluation occurs spontaneously with automatic categorization: Initial signals trigger both categorization and evaluation (e.g., Bargh, 1994). In general, a category's valence becomes a member entity's valence: The entity is evaluated as a stereotypical (average) member of the category (Castelli, Zogmaister, Smith, & Arcuri, 2004), and no weighted assessment of its perceived attributes occurs. For example, upon learning that a new firm is an online bookseller, a consumer's evaluation of the firm is likely to be their stereotypical evaluation of the online bookseller category. A new firm would suffer or benefit depending on whether the valence associated with the bookseller category was positive or negative.

Category-based evaluation can occur despite the fact that evaluations of a firm's actual attributes would "add up" to a different overall attitude. Marketing studies suggest that category-based evaluations can prevent positive attributes of new products from impacting

Figure 2

Factors Contributing to Reputational Valence



evaluations (e.g., Moreau, Lehmann, & Markman, 2001). In general, specific attributes are not evaluated when an entity is encoded as a category member. Furthermore, since counterattitudinal information tends to be resisted in category-based processing (Eagley & Chaiken, 1998), any inconsistencies are unlikely to be evident and so aspects of a new firm that have a higher or lower valence than the category average are not likely to influence category-based first impressions.

This tendency to apply stereotypical category valences to new members of a category is heightened by a category's unity, coherence, and consistency. People associate more attributes, and associate them more automatically, with entities perceived as members of more unified, coherent, and consistent categories (e.g., Hamilton & Sherman, 1996). This results in faster judgments and more spontaneous stereotyping (e.g., Lickel et al., 2000). Conversely, there is a greater tendency to process information and learn about members of less unified, coherent, and consistent categories (Crawford, Sherman, & Hamilton, 2002), leading to more individualized evaluations. Thus, a stronger relationship between the evaluation of an activated category and the reputation of a new firm can be expected when the activated category is more unified, coherent, and consistent. This leads to two propositions.

Proposition 3: The valence of the category associated with a new firm by stakeholders is positively related to the valence of that new firm's reputation.

Proposition 4: The relationship between the valence of the category and the valence of a new firm's reputation is positively moderated by perceived category unity, coherence, and consistency.

Individuated Information Processing

With individuated processing, the evaluation of an entity is based on the evaluation of specific attributes, rather than being wholly anchored in an overall category valence, as is the case with categorical processing. Theoretically, a person's perceptions of the valence and the likelihood (belief strength) of *all* salient attributes associated with an entity should be relevant in determining the person's attitude toward an entity when individuated processing is used (Fishbein & Ajzen, 1975). This is an assumption made in reputational ratings, such as the *Fortune* ratings. The following reflects this basic tenet of attitude theory:

Proposition 5: The valence of the entity-specific information associated with a new firm by stakeholders is positively related to the valence of that new firm's reputation.

Beyond this basic tenet, studies of people and products have shown that unexpected entity-specific information has a greater impact on attitudes than does expected information (e.g., Ahluwalia, 2002). Entity-specific information is unexpected when it conflicts with category-based assumptions. For example, in the late 1990s, the category "pure Internet" firms had a positive valence in that firms were valued in multiples of revenues despite lack of profitability (Kotha, Rajgopal, & Rindova, 2001). An Internet firm that signaled profitably would have stood out and would have been likely to win an even more positive judgment from attentive stakeholders.

How will positive or negative firm-specific information be reconciled with a conflicting category valence? "Negativity effect" studies have highlighted that negative information is frequently weighted more heavily than positive information in forming overall evaluations (e.g., Baumeister, Bratslavsky, Finkenauer, & Vohs, 2001). One explanation for this tendency is that people weigh potential costs more heavily than potential gains in decision making (Kahneman & Tversky, 1979). Another explanation is that negative information is often more diagnostic than positive information: When "good" traits and behaviors are common and expected, "bad" traits and behaviors are more revealing (e.g., Skowronski & Carlston, 1987).

Despite frequent documentation of the negativity effect, recent studies of people and products have also identified conditions that lead to a "positivity effect" where positive information has a greater impact than negative information on overall evaluations (e.g., Ahluwalia, 2002; Skowronski, 2002). This occurs when only positive information allows people to discriminate one entity from other entities (e.g., Skowronski, 2002). For example, Folkes and Patrick (2003) found that positive signals about an insurance agent for a new company had more impact than negative signals. They reason that judgments in this context are more affected by positive than by negative information because of contrasts with category-based assumptions. Service lapses are common in the insurance industry, they argue, and hence positive information is likely to cause greater deviation from category-based judgments than negative information.

The unifying explanation for both positivity and negativity effects rests on the premise that valenced information must distinguish a specific object from others in the category to be impactful. Negative information will more likely influence a new firm's reputation adversely if its category is positively evaluated. Conversely, positive information will benefit the new firm's reputation more when such information is at odds with the stakeholders' average category valence. In effect, this means that valenced information will have its greatest effect if it contrasts with evaluations for the category. This leads to the following proposition:

Proposition 6: The relationship between stakeholders' evaluations of entity-specific information and the valence of a new firm's reputation will be positively moderated by the discrepancy between the valence associated with the specific information and the evaluations of the category: the greater the perceived discrepancy, the more the impact of entity-specific information.

This proposition helps explain why negative information about service quality had little apparent impact on PayPal's reputation. If the entire category of online funds transfer firms was evaluated somewhat negatively because all were assumed to provide similarly mixed service levels, PayPal's service would not have stood out. However, positive information that distinguished the firm from competitors, such as its lower cost and higher ease of use for eBay transactions, would have had more potential to impact its reputation in a positive manner.

Credibility. Credibility refers to the extent to which entity-specific information is believable. Unlike categorical inferences, which are relatively automatic, inferences based on entity-specific information are more effortful, making the credibility of information relevant.

Credibility can be established by either a credible source or a credible commitment. Source credibility has been widely studied in the market literature on new product evaluation (e.g., Herr, Kardes, & Kim, 1991). Perceived source credibility is higher when the source of a signal is regarded as more reliable, trustworthy, high-status, expert, and neutral (Fishbein & Ajzen, 1975). Source credibility is more relevant for externally generated signals than internally generated signals because internally generated signals are expected to be self-interested and therefore lacking in credibility. In the reputation literature, perceived source credibility has been found to stem from such factors as the industry prominence of affiliates (Stuart et al., 1999).

Perceived commitment credibility is a key concept in signaling theory (e.g., Schelling, 1960). Higher perceived commitment credibility indicates a stronger endorsement of the content of the signal on the part of the sender. Unlike source credibility, commitment credibility is relevant for internally generated signals. Perceived commitment credibility is greater when the information content of a signal is backed by more tangible evidence of commitment, such as a warranty in the case of a signal emphasizing product quality. For example, a new product announcement is characterized by a more credible commitment if the firm has made related investments in plant and equipment (e.g., Heil & Robertson, 1991; Heil & Walters, 1993).

By making signaled information more believable, source and commitment credibility increase the likelihood that valenced information will have an impact on new firms' reputations.

Proposition 7: The relationship between stakeholders' evaluations of entity-specific information and the valence of a new firm's reputation will be positively moderated by perceived signal credibility: the more the stakeholders perceive the signal as credible, the greater the impact of the valence of entity-specific information.

The moderating impact of source credibility is helpful in understanding why some signals failed to impact PayPal's reputation while others had considerable influence. Negative signals on the anti-PayPal website were generated by individual disgruntled users. Although potential users might tend to regard experienced users as credible, the inflamed tone of the criticisms may have undermined the credibility of the complaints. At the same time, the fact that eBay allowed PayPal to be featured on its website was a positive signal from a highly credible source, and thus is likely to have had relatively more impact.

This proposition can also help explain findings such as those reported by Kotha et al. (2001), who found that young Internet firms' reputations did not benefit from advertising but did benefit from media coverage. As our propositions suggest, the low source credibility of advertising placed by young firms should mitigate the impact of the advertising signal, while positive information in media coverage, which appears more impartial and therefore more credible, should have a greater impact.

Motivation. As previously indicated, motivation leads people to pay closer attention to entity-specific information provided in signals and to process them systematically (e.g., Chen et al., 1996; Maheswaran & Chaiken, 1991). In addition to diminishing the tendency to generalize attributes from a category to a particular new firm, the accuracy motivation is likely to diminish the extent to which evaluative stereotypes based on category associations dominate the evaluations of a new firm. When concern about accuracy is high, people will be more "data driven" and analytic, and will consider and evaluate any available information during the judgment process (Alba & Hutchinson, 1987; Hutchinson & Alba, 1991).

> **Proposition 8:** The relationship between stakeholders' evaluations of entity-specific information in signals and the valence of a new firm's reputation will be positively moderated by stakeholders' motivation: The greater the stakeholders' motivation to process signals, the more the impact of the valence of entity-specific information.

Discussion and Conclusions

The perspective developed in this article deepens our understanding of the belief formation process within stakeholder groups, and enables us to discuss three aspects of reputation development that have, to date, been minimally addressed. The first concerns whether new firms, in addition to suffering other liabilities of newness (Stinchcombe, 1965), also suffer from bad reputations at start up. The second concerns what factors facilitate or prevent the signals associated with new firms from creating reputations that are "sticky" over time. The third concerns how young companies develop different reputations in distinct stakeholder groups that receive the same signals. To help address these issues and to show how the propositions outlined here address them, we return to the example of the new firm PayPal.

Is Bad Reputation a Liability of Newness?

Stinchcombe (1965) has identified the lack of trust among potential exchange partners as a key liability of newness. If some stakeholder groups lack trust in new organizations, it is important to understand what this means for reputations. One possibility is that all new firms are considered untrustworthy and begin with a poor reputation; an alternate that is suggested by our propositions is that initial reputations vary according to categorization.

As Figure 1 indicates, when stakeholders first learn about a new firm, their knowledge is automatically stored in an associative network that categorizes the company with other firms. Stakeholders do not delay assigning a new firm to a category or associating it with attributes until they have more complete information about how it compares with others. Instead, mere exposure to information results in the initial stages of belief structure formation. In the case of PayPal, the initial signal potential users received (for example, seeing the PayPal logo on the eBay website along with other payment options), would have led stakeholders to classify the new firm as a funds-transfer organization. While knowledge of a new firm is updated over time, in the initial learning process, stakeholder group members associate attributes linked to comparable firms with the newcomer. If a new firm is categorized as belonging to a stigmatized type of operation, such as organized crime, this could lead to a bad reputation. In cases where the attributes associated with the classification are neutral or positive, however, the new firm is simply linked to the prototypical properties of the category. PayPal, then, would have been assigned whatever prototypical features vendors and purchasers saw in other funds-transfer organizations, and the valence of its reputation would have been that attached to the category as a whole.

In general, if stakeholder group members learning about a new firm assume that it has the basic properties of other firms in its category, it starts out with a reputation that is more aptly described as "average" for those in its category than as "bad." The mere fact that it is assumed to have the standard attributes of other firms of its type gives it a modest degree of credibility. Rather than having a reputational liability as start-ups, then, new firms may enjoy a slight benefit merely from being considered one of an existing set of organizations. This helps explain the "honeymoon" period in a firm's early stages (Bruderl & Schussler, 1990).

As stakeholders learn more entity-specific information about the firm and distinguish it from others, the attributes associated with it can deviate from category norms, along with the degree to which it is judged favorably or unfavorably. In the case of PayPal, its initially low user price (Esch, 2001) could have contributed favorably to its reputation within the user stakeholder category relative to other money transfer options, allowing the new competitor to be regarded not merely as average in valence relative to its category, but to be regarded more positively. At the same time, the mounting complaints about the firm's customer service and fraud protection practices could have undermined its reputation and led to an early demise—yet they did not. To understand this, we now consider what causes or what prevents reputational signals from "sticking" to organizations.

Reputational Stickiness

Reputational "stickiness" means that evaluations (positive or negative) become entrenched such that they have an ongoing impact on the firm's performance. Rao's (1994) discussion of certification contest wins by early automobile makers suggests that some signals achieved early in a firm's life have long-term consequences for reputations and performance. In general, however, we do not know what conditions must exist for such stickiness to occur.

Our article began by describing how PayPal flourished despite a host of distinctly negative reputational signals. What might have been happening—or not happening—in the minds of PayPal's stakeholder groups to prevent negative beliefs from becoming entrenched and consequential? One possibility highlighted by our work is that negative signals (for example, complaints to the Better Business Bureau, websites decrying PayPal's response to fraud attempts) may simply not have been processed systematically by many stakeholder group members. This explanation is simple but important. Studies of reputation typically assume that signals are processed thoroughly. Violations of this assumption will mean that the entity-specific information about the firm does not "stick" simply because it is not encoded by many people.

Even when signals are processed by a high proportion of stakeholders, our work suggests they will not always affect the valence of a young firm's reputation. If signals do not provide information that contrasts strongly with category-based evaluations, they will differentiate the valence of a particular firm's reputation minimally. For example, negative signals about PayPal's fraud-handling practices likely did not cause negative changes in knowledgeable stakeholders' reputational beliefs because, at the time, *all* online payment service firms were perceived as targets of fraud. Esch (2001) suggests, in fact, that analysts may have regarded PayPal as a pioneer in dealing with such challenges. Thus, these negative signals about PayPal could fail to stick to, and undermine, its reputation. Furthermore, if signals lack credibility, the valence of the entity-specific information is unlikely to stick to the firms' reputation. Even if negative signals do stick and lead to an unfavorable reputation with one stakeholder group, the outcome in other groups can differ. This raises the issue of differences between stakeholder groups.

Reputational Differences across Stakeholder Groups

For mature firms, reputations can vary considerably across stakeholder groups, such that the same firm that is well regarded by one external stakeholder group is reviled by another (e.g., Ravasi, 2002). The insights provided here clarify the origin of such differences even between groups of people exposed to the same signals from and about the same new firm.

First, the article highlights that differences in stakeholder groups' reputational beliefs could originate from different *a priori* assumptions about the category in which the new firm competes. Disparity in the classification of a given firm is possible even among top managers and organizational members who sometimes regard the same firm as having different strategic reference points (Feigenbaum, Hart, & Schendel, 1996). When members of different stakeholder groups assign the same new firm to different categories, differing assumptions will be made about its attributes and category-based evaluation. For example, PayPal would be associated with different attributes and categorical evaluations by a group that classified it as a "dot com" than by one that classified it as a funds-transfer firm.

Another possibility is that different stakeholder groups tend to classify the firm in the same way, but associate different salient attributes with the category. This is a cognitive explanation for past findings that different groups can have different interests with respect to a focal firm, which lead to different reputational assessments (cf. Carter & Deephouse, 1999). For example, both vendors and purchasers may have considered PayPal as part of the money-transfer industry, but see different attributes as salient. Whereas vendors care about transaction fees, purchasers are unlikely to. Indeed, the vendor complaints compared to purchaser complaints on websites such as paypalsucks.com illustrate this point. Differences in what attributes are salient could lead to variations in the set of attributes about which initial beliefs are formed and in overall evaluations. If a firm's reputation within a stakeholder group is path dependent, as studies of the reputations of mature firms suggest (e.g., Schultz, Mouritsen, & Gabrielsen, 2001), these differences will persist.

Differences in the favorability of a firm's reputation across stakeholder groups can also result from differences in how they process signals. Marketing research concerning the processing of information about new brands suggests that signals that marketers believe are unambiguous are open to different interpretations depending on the characteristics of signal recipients such as goal congruency (e.g., Martin & Stewart, 2001) or the tendency to self-monitor (e.g., Aaker, 1999). The propositions developed in this article highlight that groups that have greater average motivation to learn about firms in a category are more likely to process signals systematically and to update their beliefs about attributes and overall evaluations if warranted. Stakeholder groups with less motivation are more likely to process signals heuristically, and are more likely to change the favorability of their reputational beliefs based on the perceived credibility of the source (Maheswaran & Chaiken, 1991). In PayPal's case, high-volume sellers whose margins are affected by the pricing practices of money transfer organizations are more motivated to process signals about the firm systematically than are customers who occasionally buy goods through online auctions. As a result, such sellers are more likely than the buyers to examine carefully the information about such developments as lawsuits against PayPal (e.g., Wolverton, 2002). Sporadic purchasers, who lack motivation to process entity-specific information, are not likely to change their favorability judgments unless the credibility of signals conveying new information is extremely high. Thus, vendors and buyers exposed to the same signals might regard PayPal much differently.

Future Directions for Entrepreneurship Research

Overall, this article suggests several ways that different stakeholder groups can form different beliefs about new firms. It lays a foundation for future research examining the origins, extent, and implications of between-group differences in reputations. It also highlights the need for future research on attitude strength, or the confidence with which new firms' stakeholders hold their beliefs. A research program is required to identify those factors that increase the likelihood that intended signals from new firms are interpreted as intended, and that stakeholder groups hold these beliefs with confidence so that they are difficult to change. It is possible that certain signals, or clusters of signals, facilitate both attitude formation and attitude strength, and further investigation of this is warranted.

Methodologically, this article highlights the need for more experimental studies that allow for manipulation of signals and for direct measurement of attitudes and of cognitive processes that lead to their formation. Longitudinal research that examines factors that lead to between-period changes is also called for if we are to fully understand the emergence of organizational reputations.

Substantively, two general issues are highlighted by the perspective developed in this article. The first concerns the measurement of reputation. If audiences do not always form beliefs consistent with reputational signals, then studies of reputation building, particularly for new firms, need to distinguish measures of signals sent from measures of what audiences actually believe. For example, measures of such factors as founder's track record or performance in certification contests (cf. Rao, 1994; Shane & Cable, 2002) should be regarded as indicators of reputation-building signals, but not of reputation *per se*, since the signals may not have the anticipated effect on beliefs within or across audiences. The risk of mismeasurement due to the conflation of measures of signals with measures of reputation is particularly acute for newer firms if the between-audience differences in reputation belief structures are greater for new firms. Any given signal is less likely to be correlated with actual reputational beliefs across audiences if there is considerable between-audience heterogeneity. To measure reputations, as opposed to signals, then, requires taking assessments within audiences of the extent to which firms are regarded favorably or unfavorably.

Measures of reputation can and should be distinguished from ratings or rankings, such as annual evaluations of business schools in *The Economist* or *The Wall Street Journal*. The attributes assessed in such rankings cannot be assumed to be relevant to all audiences. In practice, the attributes measured are typically those that the publication decides are important and often are salient to one audience but not to others. For example, the *Fortune* corporate reputation index may reflect organizational reputations among investors, but is less likely to indicate the views of consumers, given the attributes it assesses (Fryxell & Wang, 1994). Scholars who wish to use multiattribute measures of reputational beliefs, therefore, should identify the qualities that are salient to each audience of interest, and use them to measure beliefs about the relative rating of firms.

The second issue regarding the assessment of reputation for new firms concerns the types of signals that should be investigated. Past research on new firms' reputations has commonly examined either the track records of founders (e.g., Shane & Cable, 2002) or the prestige of affiliates (e.g., Stuart et al., 1999) as signals that shape opinions. While these factors are likely important to investor audiences, they will be less so for others, such as customers. Researchers must be sensitive to the differences between audiences when considering which signals are likely to enhance reputation within particular audiences.

Summary

This article has examined how new firms' reputations are formed. It complements prior research on the consequences of reputation by focusing attention on the cognitive processes that lead to reputations, and extends research on reputational signals by outlining how information is integrated into beliefs within stakeholder groups. It highlights that reputation formation can and should be managed long before a firm establishes a track record.

This final point is of particular importance for managers who are building the reputations of new firms. Important stakeholders will not defer judgment until they see tangible evidence of performance. Mere exposure to signals about the firm will lead to categorization and initial evaluation. Accordingly, managers need to manage actively these first impressions.

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