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INTER-FIRM CONTRACTS GOVERNING COOPERATIVE BUSINESS RELATIONSHIPS

A DISSERTATION APPROVED FOR THE
MICHAEL F. PRICE COLLEGE OF BUSINESS

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I. INTRODUCTION

A defining feature of modern economic behavior is that individual business organizations must increasingly rely upon associations with cooperative business partners. For example, in the computer technology industry alone, over 2,200 alliances were created between 2001 and 2005 (Barney & Hesterly, 2008). Furthermore, future expectations hold that these cooperative structures will be increasingly widespread. In spite of the recent economic downturn that has resulted in fewer capital investments and decreased merger and acquisition activity, almost one third of the consumer products companies plan to forge new strategic alliances in the next twelve months.[1] In addition, PricewaterhouseCoopers predicts that the entertainment and media industry alone will grow by $2.2 trillion by the year 2012 and that this growth would be largely structured through strategic alliances.[2]

These cooperative business associations can be structured as joint ventures, joint promotions, co-branding, alliances, associations, franchises, coalitions, and many other similar forms. These cooperative structures require business firms to learn how to manage their tangible and intangible assets in light of these arrangements. Managers, as they cope with an environment that often requires the implementation of the conflicting strategies of flexibility[3] and specialization[4], require tools to govern the exchanges involved in these important relationships. While many exchanges correspond to the spot transactions described by neoclassical economics[5], the marketplace often requires repeat transactions and even long-term relationships to develop. These long-term relationships are always guided and governed by the use of some form of contract and it is those contracts that are the focus of this study.

Interest in these contractual relationships is not limited to business practitioners attempting to develop beneficial, long-term relationships in the market place.

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[1] This information comes from a PriceWaterhouseCoopers LLP December 4, 2008 report concerning the consumer products industry. The information was retrieved from senior executives and their surveyed responses to questions regarding their expectations of the next twelve months.

[2] This information comes from a PriceWaterhouseCoopers LLP, June 24, 2008 report concerning the global entertainment and media industry. The report is a prediction by PriceWaterhouseCoopers LLP analysts. The growth is described as largely structured through strategic alliances stating the industry is faced with a "collaborative imperative".

[3] Strategic flexibility is a concept suggesting that managers are willing to override existing investment criteria and avoid capital investments in an effort to deal with market uncertainty and thus maintain a level of investment discretion for the future (Donaldson & Lorsch, 1983). This effort to maintain flexibility is the basis behind the real option models of strategic management.

[4] Specialization allows firms to focus their investments "deeper in their domain of core competence"(Tiwana & Keil, 2007). By limiting the scope of the investment choices, the firm has a higher probability of developing capabilities that become increasingly valuable. Such specialization, however, requires firms to rely on outside firms for complementary expertise and skills (Grant & Baden-Fuller, 2004). Where specialization encourages investment by reducing and focusing the investment choices, flexibility discourages new investments due to market uncertainty and the lack of information concerning investment opportunities.

[5] Neoclassical economics has defined the spot transaction between suppliers and buyers to exist in time at the point of the transaction. Abstracting from the realities of many market transactions, the transacting parties conduct their exchange with no emergence of a social relationship and no expectation of a future set of transactions that would require the development of any social relationship or social norms.

Academics have enormous interest to understand these cooperative efforts and the governance mechanisms they employ, such as formal contracts. Ronald Coase (1992) states that, "the main obstacle faced by researchers in industrial organization is the lack of available data on contracts and the activities of firms." Coase continues by urging that we "study the world of positive transaction costs", that while doing so, what "becomes immediately clear is the crucial importance of the legal system". The legal system's impact can rarely have a more important and practical influence on business practices than does the law of contracts and the legal guidelines developed to facilitate private agreements between business partners.

The term "contract" is specified as a device acting as a governing mechanism to guide and implement anticipated economic transactions.[6] Zhou et. al. (2003) explains that "without the *anticipated* economic exchanges, there is no need for contracts to establish and maintain such bilateral relationships between firms." In addition to describing the economic exchange, these mechanisms can also impose legal sanctions for parties not in compliance with the agreement. Macneil (1981) suggested that from a neoclassical economic perspective, a contract is "nothing more than a sale with a time lag". Karl Llewellyn took exception to this and described a contract as a relationship framework explaining the "major importance of legal contract is to provide… a framework which never accurately reflects real working relation, but provide a rough indication around which such relations vary… [7] Oliver Williamson (2005) further describes the simple purpose of a legal contract as "not to be legalistic, but to get the job done". However, Bagley (2008) recognizes that it is that "legalistic" nature of contracts, of which are enforced by courts, which allows market players to agree to their own private rules.

The art of contract; the ability to develop, commit and effectuate contracts is the foundation of building cooperative business relationships (Bagley, 2008). Increased specialization has amplified the need for firms to coordinate with other firms in order to achieve organizational goals. Recently, Poppo and Zenger (2002) made a unique call for research into the types of clauses that managers use in their contracts, specifically in the context of cooperative relationships. Typically, the management, economic and strategy literatures have implied contracts to be homogeneous, with little discussion concerning the vast differences that can exist between any particular set of contracts. Reuer and Arino (2007) made a unique contribution to this research by emphasizing contract complexity and the vast heterogeneity of contractual supports for inter-firm relationships. Both these studies imply that managers, making strategic decisions concerning cooperative relationships, have enormous discretion over the structure and design of inter-firm agreements (Reuer and Arino, 2007, James, 2000; Gulati 1995).

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[6] Macaulay (1963) describes contracts as "devices for conducting exchanges". Macaulay further describes contracts as having two distinct elements: "a) rational planning of the transaction with careful provision for as many future contingencies as can be foreseen, and (b) the existence or use of actual or potential legal sanction to induce performance of the exchange or to compensate for non-performance. Zhou et. al. (2003) defines contractual relationships as being all the formal and informal agreements between firms.

[7] Karl Llewellyn is distinguished as being a member of the first set of legal scholars to work and develop the Uniform Commercial Code, which was first presented to the States for adoption in 1952.

Based upon the limited research of such an important component of the cooperative relationship, this area poses an open field of research potential.

A. Statement of the Problem.

Currently, there exist deficiencies in our understanding of contracts within inter-organizational relationships. With so little research directly focused upon contracts, we know little about the development and maintenance of these formal agreements and the actions and motivations of those that develop these contractual relationships. Early research in this area may have developed assumptions about contracts that have later proven to be difficult when trying to reconcile academic theory with practical application. For example, several researchers have suggested that the use of contracts may create difficulties when attempting to develop successful, long-term relationships. Generally, practitioners would find this conclusion bizarre. However, with conclusions such as that previously mentioned, it is no wonder why so little research is being done to understand contractual components. Even if we were to recognize the importance of contracts, common misunderstandings of contract law do not allow us to consider some of the risks of implied obligations when the parties work together to create cooperative inter-organizational relationships. Each one of these problems will be reviewed briefly.

One of the most important studies conducted concerning inter-firm contracting practices was published by Stewart Macaulay in the American Sociological Review in 1963. This particular study, which will be described in greater detail later, offered the conclusion that inter-firm business transactions are often completed without the use of formal contracts. In fact, businessmen and engineers took affirmative steps to avoid having to develop formal contracts for transactions. In interviews, Macaulay recorded that one businessman said, "You can settle any dispute if keep the lawyers and accountants out of it. They just do not understand the give-and-take needed in business." Macaulay's study, and subsequent others, collectively developed a perspective that inter-firm relationships rely upon trust as opposed to contracts between trading partners. This trust between firms refers to the level of confidence one possesses that a partner will not attempt to exploit the vulnerabilities of the other (Barney & Hansen, 1994). Often citing the Macaulay study, much of the current literature argues that the development of trust reduces transactional costs and lessens the necessity to formally contract and develop formal safeguards.

Therefore, as a conceptual counterpart, trust is often characterized as the preferred alternative to the development of formal contracts. Ranjay Gulati (1995) states, in his important study of alliances and networks, that: "A detailed contract is one mechanism for making behavior predictable, and the other is trust… As a result, where there is trust appropriation concerns are likely to be mitigated, and organizations may *not* choose to rely on detailed contracts to ensure predictability"[8] Again, the conclusion

[8] Gulati (1995) creates this substitute argument between the use of contracts and trust as a relational governance mechanism. Gulati relates how he found that "firms select contractual forms for their alliances not only on the basis of their activities they include and the related appropriation concerns they anticipate at the outset"… but also base the nature of the contract on the "social network of alliances in which the partners

is that the existence of trust reduces the need to develop formal contracts (Dyer & Singh, 1998). In addition, research focusing upon cooperative business relationships has pushed another step further concerning the substitution effect of trust in the place of contracts. Malhotra and Murnighan (2002) experimented with an individual's sense of trust while changing the contract relationships. The study noted that increasingly binding contracts with stricter monitoring systems actually reduced trust. Ghoshal and Moran (1996) argued that the use of formal contracts in relationships requiring the existence of trust is counterproductive. This implies that the combined use of formal contracts and relationships built upon trust become problematic since they are conceptually, mutually exclusive. From this perspective, a successful cooperative relationship is based upon trust and since formal contracts are an indication of a lack of trust, the contracts themselves are counterproductive to the relationship.

It has also been acknowledged that there has been little study of how firms learn to manage their inter-firm cooperative relationships through the use of contracts (Mayer & Argyes, 2004). While transaction cost economics has generally been the theoretical foundation explaining why contracts are used as opposed to other governance structures[9], this theoretical approach does not involve itself in the nature of those contracts or how firms learn to utilize them. The management research that draws more upon sociology and follows the conclusions generated by Macaulay (1963) generally advocates the avoidance of formal contracts in favor of using trust as a basis for these relationships. Therefore from this perspective, the study of inter-firm relations receives little attention relative to the nature and use of contracts. So while the frequency of cooperative business relations is increasing, the focus on contracts as a governance mechanism has generally been neglected. This neglect is especially unfortunate in that cooperative inter-firm business relationships create a very productive context in which to study the development and maintenance of contractual governance structures between firms.

Another problem stems from a general misunderstanding of the law. Modern legal theory offers many instances in which legal obligations are imposed upon parties regardless of whether the parties themselves agreed to the specifics. If the parties act as if there is an agreement, they may incur legal obligations relative to their partners regardless of whether there exist a formalized agreement on the matter. Many of these obligations can be altered or clarified through formal contractual agreements, charters, etc. In other words, regardless of the commercial transaction, there is most likely a body of law affecting the governance mechanisms that will in turn impose implied terms and obligations to parties that fail to develop their own explicit contracts, charters, etc. This perspective calls into question the legal acumen of those parties that opt to rely upon "trust" alone to govern their relationships. While the cost of developing more complex contracts is high, the risks associated with allowing unmodified legal obligations to be

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may be embedded". This finding does suggest that trust modifies the formal contractual agreement, but it does not suggest a substitution effect between trust and contracts, as asserted by Gulati.

[9] Williamson (2005) states that "governance is predominantly concerned with ongoing contractual relations for which continuity of the relationship is a source of value… continuity can and will benefit from a spirit of cooperation…"

applied to the parties may often times be higher. Both the management and strategy research has generally avoided any recognition of the costs associated to implied legal obligations. The usually pragmatic approach of a legal perspective would include the costs/risk of implied obligations and argue for increased emphasis upon using formal contracts in cooperative, often times complex, business relationships in order to govern numerous transactions.

B. Purpose and Contribution.

The assertion in this study, contrary to Macaulay, is that firms consistently advocate and use formal contracts in their inter-firm cooperative relationships. Suggestions that firms use trust as a substitute for formal contracts are misleading with regard to current business practices and tend not to consider the risks and costs associated with implied obligations to the parties. All contracts are by practical definition "incomplete" and there will always be gaps in which there is need for interpretation of the parties' obligations.[10] As clauses are added to formal contracts, implied and formal obligations are modified as contingencies and contracting hazards are recognized. This implies that managing longer-term relationships requires frequent evaluation of existing contracts. These evaluations are designed to ensure adherence to existing agreements and to adjust existing contracts or new contracts with provisions that take into account new modifications for issues not previously addressed. The purpose of this study is to ask whether cooperative business relationships consistently use formal contracts in governing their inter-firm relationships; and assuming these contracts are utilized, how are these relationships modified through the use of contractual clauses as specific investments change or hazards are discovered.

The first phase of this study will be to evaluate firms that have had experience in developing and implementing cooperative business relationships. The primary question of this first analysis is whether the conclusions of the Macaulay (1963) analysis still hold. This phase will use a case study in order to assess the question of whether business professionals use formal contracts as a means to guide their repetitive business transactions with cooperative partners, or do business professionals seek to use alternative methods other than formal contracts to govern relationships as was concluded by Macaulay. Case studies offer researchers the opportunity to ask in-depth questions concerning complex relationships in various interconnected levels of analysis.[11] These studies can become the building blocks to formulate theory and up to now, have been the most prominent means to study these cooperative interfirm relationships. Similar to Macaulay (1963), the perspective of both lawyers and business professionals will be sought. This case study will provide the context in which to understand the interactions

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[10] Scott (2003) argues that "All contracts are incomplete. There are infinite states of the world and the capacities of contracting parties… are finite." Scott does, however, differentiate between those contracts that are incomplete because of the parties' lack of capacity to predict uncertain futures as opposed to those contracts that are deliberately incomplete by a party unwilling to specify future performance.

[11] Research making contributions to the management literature concerning the use of case studies within research include: Eisenhardt, K. M., Building theories from case study research, Academy of Management Review, 14: 532-550,(1989); Eisenhardt, K. M. and M. E. Graebner, Theory building from cases, Academy of Management Journal, 50: 25-32,(2007). Both of these studies provide information concerning the benefits of case studies to provide in-depth information necessary for the development of theory.

and complex relationships between lawyers and business professionals in the development and implementation of inter-firm transactions.

As previously discussed, Poppo and Zenger (2002) urged management researchers to investigate individual contract provisions. In response to this, the second phase of this study will attempt to develop and test constructs attempting to represent categories of contractual provisions. The first step will be to define these constructs. The second step will be to create external variables which will necessitate changes or enhancements to the contractual agreement. Often, newly discovered hazards and contingencies create disturbances in the otherwise programmed responses of the firm (Williamson, 1991). Transaction cost economics has identified several "disturbances" that require adjustment to any governance structure.[12] Executives, with the help of attorneys, are tasked with the responsibility to make modifications in existing formal contracts in order to address these undiscovered hazards or to make modifications to otherwise implied obligations. Referred to as the "engineers of transaction costs", lawyers will be used as primary informants on a survey that will attempt to assess their selection of contractual provisions in response to external conditions presented in the survey.[13] If contracts are assumed to be incomplete, increased information and external events will provide opportunities for modifications to existing contracts within long-term cooperative relationships. The last step will incorporate a statistical test that will help to make general observations regarding what types of contractual clauses are favored in given circumstances.

A primary argument presented in this study is that contracts, and the many components derived from classical contract theory, are still in place to organize the many business cooperative relationships. At best, socially complex interactions, which are conceptualized to develop trust, act as a modifier to these contractual relations, not as a substitute governance mechanism. As described by Williamson (1993), "trust… often requires added effort and is warranted only for very special personal relations…. Commercial relations do not qualify." Organizational effectiveness, relative to cooperative relations with other firms, is achieved when the proper contract clauses are emphasized relative to the circumstance and the potential hazards that exist (Williamson, 1991). The contribution of this study will be to increase our understanding of contracts used in cooperative business relationships and to make additions to an emerging research agenda that is attempting to investigate contractual components.

The contribution of this study will ultimately depend upon the results of the data. If the case study demonstrates that the Macaulay perspective does correctly describe cooperative business relationships, then more research should be developed to

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[12] "Disturbances", according to Williamson (2005, 1971), are those instances in which the firm is forced to make "un-programmed adaptations" in response to changes. Williamson also states that the main costs of governance are based on a mal-adaptation to these disturbances. The "hazards" referred to in transaction cost economics are the result of opportunism, uncertainties and performance measurement difficulties.

[13] Ronald Gilson (1984) original coined the phrase "transaction cost engineers" of which Williamson cites and appears to advocate the elevated status of those who design transactions. (Gilson, Ronald. 1984. "Value creation by business lawyers: Legal skills and asset pricing," Law and Economics Program Working Paper No. 18, Stanford University, Stanford, CA.)

understand the tools necessary to expand more effective "relational" contract agreements.[14] If this is the case, then the survey questions to attorneys should focus on the unique contribution of trust in the contracting experience, even though this is in opposition to the position taken by Williamson regarding trust. If the case study demonstrates that the Macaulay perspective does not correctly describe modern cooperative business relationships, then more research should focus on the contractual tools to develop more effective formal contracts taking into account implied obligation of the parties.

II. LITERATURE REVIEW

Cross-disciplinary studies have often been used to uncover new insights into distinct fields of study. Rarely have fields of study demonstrated so many important intersections and commonalities of interest than the study of business, economics and law. This is especially true relative to the study of contracts and as Macaulay (1963) would suggest, "each discipline has an incomplete view of this kind of conduct."[15] Cooperative inter-firm business relationships create a particularly dynamic context in which to study the development and maintenance of governance structures between firms. Economic and management research have greatly contributed to our understanding of these governance structures. As has been done in other areas of the law, this study will attempt to glean from a legal perspective concerning contracts in order to enhance our understanding of these cooperative business relationships.

The contributions of cross-disciplinary studies has been recognized from the likes of Justice Richard A. Posner, Judge of the United States Court of Appeals and Senior lecturer at the University of Chicago Law School who writes that "economics is a powerful tool for analyzing a vast range of legal questions" (Posner, 2007). After the 1960's, Posner describes that[16], "the application of economics to the legal system (is) across the board: to common fields such as torts, contracts, restitution and property; to statutory fields such as environmental regulation and intellectual property; to the theory and practice of punishment; to civil, criminal, and administrative procedure; to the theory of legislation and regulation; to law enforcement and judicial administration; and even to constitutional law, primitive law, admiralty law, family law, and jurisprudence." In fact, Justice Posner and the Chicago Law School are well recognized for their application of economics to deal with theoretical legal issues (Posner, 2007).

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[14] Macneil (1978) describes "relational contracting" agreements to mean contractual relationships in which there is a marked void in contract discreteness, creating the most flexibility and a "minisociety with a vast array of norms" to deal with and govern changes. This perspective discourages the use of formal contracts in favor of social norms and reputation as governance mechanisms.

[15] Macaulay (1963) published his study in a sociology journal, suggesting that he well understood the importance of trying to develop cross-disciplinary studies in this area. Evans (1963), commenting on the important of the Macaulay study, praised its contribution as a sociological study and suggested it would add to the "understanding of the relationship between legal and non-legal norms in society" as well as "the relationships among formal organizations".

[16] Posner (2007) writes that until the 1960's, the bulk of economic analysis used within the law came from anti-trust law.

In addition, the field of economics has recognized the importance of the legal perspective to understand economic systems. For example, John R. Commons urged the understanding of legal systems in order to enhance our understanding of the concepts and institutions underlying our economic system. Commons states that: "…transactions are the economic units and working rules are the principles on which the Supreme Court of the United States has been working over its theories of property, sovereignty and value, and … that court occupies the unique position of the first authoritative faculty of the political economy… begin(ning) with the court's theory of property, liberty and value." Along this same trend, Williamson (1985), before describing governance systems in business to business relationships, reviews contract law based upon classical, neoclassical, and what is later referred to as relational contracting regimes.[17] These cross-disciplinary studies have all recognized the contribution of research outside of their traditional, theoretical boundaries.

The understanding of contractual business relationships and the current need for a legal perspective requires a review of the contributing literatures. Many assumptions of the management and strategy literatures have their theoretical roots in economics and sociology. Therefore, a first review will describe the contributions from the economic literature as it applies to inter-firm contracting. Next, the pertinent contributions from sociology, which have also greatly affected the management and strategy literatures in this area, will be reviewed. Business management and business strategy literatures are often difficult to distinguish from one another, but will be reviewed consecutively. This review will then describe the legal perspective to contracts, as well as cover other areas of law that demonstrate a tendency to enforce implied obligations of parties. Finally, an attempt will be made to bring all these perspectives together and to justify the importance of this research.

A. Economics: Providing a Foundation.

Economists have recognized the need for societies to develop implicit and explicit agreements from which societal members take on obligations. While these agreements and obligations take on important meaning as individuals develop societal ties, these agreements become especially important to economic actors willing to cooperate and align their interests. Kenneth Arrow stated that "Societies in their evolution have developed implicit agreements to certain kinds of regard for others, agreements which are essential to the survival of the society or at least contribute to the efficiency of its working" (Arrow, 1974). John R. Commons (1924) describes reciprocal "promises and threats, express or implied, of man to man which determine the limits of human behavior in its social and economic transaction… their unit of observation

[17] Williamson (1985) attributes these categories to Macneil's (1978) distinctions between classical, neoclassical and relational legal regimes. Classical contract systems are characterized enhanced discreteness and presentiation, contracting parties irrelevant, formal aspects of contracts govern, third party adjudication discouraged…self liquidation. Neo classical contract systems are longer-term contracts characterized by "existence of gaps in their planning and the presence of a range of processes used to… create flexibility. Relational contracting is characterized with the full displacement of discreteness "as the relation takes on the properties of a mini-society with vast array of norms beyond those centered on the exchange".

becomes a transaction between two or more persons looking towards the future". In turn, economic systems also create governance systems from which to guide and direct the most important economic activity; the transaction.

The concept of governance emanated from John R. Commons as he argued the basic unit of analysis to be the "transaction".[18] In recognizing the importance of economic transactions, Commons described that this "ultimate unit… must contain in itself the three principles of conflict, mutuality, and order." This new approach diverted attention away from the traditional price mechanism of neoclassical economics. In 1937, Ronald Coase published his work on transaction costs. The most important contribution of Coase's work was the introduction of transactions costs[19] and an implied assumption that economic systems work to economize those costs (Coase, 1992). From there, Coase developed a dichotomy of economic transactions (Coase, 1937). He stated that, "Outside the firm, price movements direct production, which is co-ordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-co-ordinator, who directs production. It is clear that these are alternative methods of co-ordinating production." This dichotomy positioned all transactions being governed by either the structure of the firm, or placed in the market, designated as the alternative to the firm. While the market systems was surprising flexible to adapt to market information, the firm "consciously coordinated" their adaptations through the use of a management structure within the firm (Barnard, 1938). The comparative analysis between market transactions and these activities governed within the firm hierarchy is known as transaction cost economics.

1. Transaction Cost Economics.

Steven Chueng (1998) related that is was not until Ronald Coase published his work on social cost, of which both Chueng and Coase agreed should have been called 'economic cost', that the transaction cost perspective began to take hold. Coase (1960) writes that: "…it would hardly be surprising if the emergence of a firm or the extension of the activities of an existing firm was not the solution adopted on many occasions… This solution would be adopted whenever the administrative costs of the firm were less than the costs of the markets transactions that it supersedes and the gains which would result from the rearrangement of activities greater than the firm's costs of organizing them." While Ronald Coase first developed the transaction dichotomy describing the rational boundaries of the firm and the nature of economic transactions, Oliver Williamson's scholarship has been the most influential in bringing transaction cost economics to its current prominence as a theoretical foundation (Carroll & Teece, 1999).

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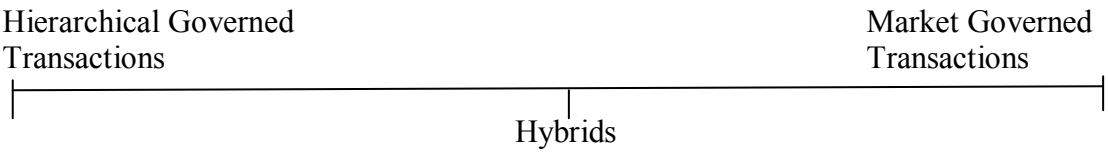
[18] Commons (1950) later urged that "theories of economics center on transactions and working rules, on problems of organization, and on… the organization of activity is… stabilized." Commons (1932) wrote that the "ultimate unit if activity… must contain in itself the three principles of conflict, mutuality, and order".

[19] The study of economics often develops models with the assumption of costless transactions. This is true today as it was when Coase first developed his theories.

As of the year 2000, it has been noted that there has been over 600 published articles using transaction cost economics as a theoretical foundation (Williamson, 2005).[20]

Transaction cost economics, as developed by Williamson, attempts to describe how trading partners to exchanges protect themselves from the hazards associated to transactions (Williamson, 1975, 1985, 1995). These transactions substantially differ in a variety of ways: the degree of idiosyncratic assets[21] that are involved, the uncertainty involved in both the economic future and intentions of transacting parties, the complexity involved in the trading arrangement, and the frequency of the transactions between the trading partners (Shelanski & Klien, 1999). The most important of these hazards is the real possibility of opportunistic behavior[22] after capital investments in specific investments are made (Williamson, 1975). The governance structures that are designed to respond to the variations in transaction characteristics can best be described along a spectrum. The cost effective choice of organizational form will vary "systematically with the attributes of the transaction" (Williamson, 1991)

At one end of the spectrum lies the pure, spot market of which occur simple market transactions (Shelanski & Klien, 1999). These market based transactions are characterized as discrete, short-term relationships between parties, in which the transacting parties maintain their autonomous conditions. These transactions are typically governed by contracts which, due to the short-term of the transaction, properly and easily define many if not all aspects of the transaction. Conflicts are enforced by the state through the explicit clauses found in the contract and implied obligations generated by the norms of the industry and application of the legal system. Market participants that use these structures have the ability to adapt quickly to changes in the marketplace.



In contrast, transactions within hierarchies are guided by organizational authority. Longer-term continual transactions, due to added uncertainties and potential hazards, may be guided more efficiently within an organizational structure (Williamson, 1975, 1985). Within the hierarchy, parties to the transaction are not autonomous, but conduct activities based upon the dictates of the firm's management as parties to the transactions are integrated under a unified ownership and control, called hierarchies.

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[20] In describing the number of studies done within the theoretical foundation of transaction cost economics, Williamson (2005) cites an unpublished study done by Boerner, C. & Macher, J. 2002. Transaction cost economics: An assessment of empirical research on the social sciences. Unpublished manuscript, University of California – Berkeley.

[21] Williamson (1985) attributes the concept of "idiosyncratic assets" to Alfred Marshall (1948) as Marshal describes trained employees "to be of no value save to the business in which he already is". Williamson describes these assets as "durable, transaction-specific assets" that in turn "experience lock-in effects" in that the value of the asset and the ability to extract rents is unique to its placement within the transaction.

[22] Williamson (1985) explains that "By opportunism I mean self-interest seeking with guile… More generally, opportunism refers to the incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, obfuscate, or otherwise confuse."

The costs associated to opportunism in the market force parties to consider more efficient relationships under a hierarchical structure. Hierarchies offer increased protection for idiosyncratic investments and provide a "relatively efficient mechanism for responding to change where coordinated adaptation is necessary" (Shelanski & Klien, 1999). Regardless of which governance mechanism is used, implied in transaction cost is the concept that efficiency will be sought out by the parties to the transactions in that governance structures will attempt to "economize transaction costs (Shelanski & Klien, 1999). Zaheer & Venkatraman (1995) pointed out that the endpoints are theoretical in nature and that "even the most fundamental model of discrete exchange includes some relational elements" enjoyed by the hierarchy. In addition, they argue that a transaction can neither be "completely hierarchical, as long as exit is an option".

However, between the endpoints of hierarchy and market governed transactions are cooperative structures described by Williamson (1985) as "hybrids". The importance of these hybrid arrangements to economics is voiced by Buchanan (2001) in that the "mutuality of advantage from voluntary exchange is, of course, the most fundamental of all understandings in economics". These cooperative structures describe all those transactions and arrangements not governed within a hierarchy and those not completely governed by the simple price mechanisms of the market. As mentioned previously, these arrangements include joint ventures, joint promotions, co-branding, alliances, associations, franchises, coalitions, equity linkages, and similar structures of which most all are typically governed by longer-term contracts or at least interactions with the expectation of developing longer-term contractual relationships. Williamson (1985) later admitted that these hybrids occur in business settings "more frequently than previously thought".

The primary behavioral assumptions with which transaction cost economics is based are "opportunism and bounded rationality" (Williamson, 1993). Williamson (1975) defines opportunism as "self-interest seeking with guile". This behavior is chiefly expected within transactions conducted through simple markets; however, opportunism becomes especially problematic within hybrid structures after transaction specific investments are made.[23] Contracts, as a governance mechanism, are formulated in an effort to reduce the threat of opportunistic behavior. The "completeness" of the contract is limited by the cognitive abilities of the parties. Bounded rationality is an assumption concerning the cognitive aptitudes of contracting partners in that each party is "intendedly rational, but only limitedly so" (Simon, 1957). Based upon the parties' cognitive limitations, contracts are limited in their ability to cover every detail or contingency. Therefore, as previously stated, all contracts are incomplete. The

[23] Transaction specific investments are those capital investments that are irreversible in that the only real value of the asset is contingent upon the continuation of the cooperative relationship. For example, a trucking depot that is especially designed for the transfer of product between two cooperating business firms will cease to maintain its value if the cooperative relationships ceased to exist. Williamson (1985) describes "specific investments" as "investments that are undertaken in support of particular transactions, the opportunity cost of which investments is much lower in best alternative uses or by alternative users should the original transaction be prematurely terminated, and… the specific identity of the parties to a transaction plainly matters… Transaction-specific assets experience lock-in effects".

development of incomplete contracts allows the potential for opportunism during economic transactions, especially within longer term relations.

2. Hybrid Structures.

Hybrids are distinguished from hierarchies in that the boundaries of the cooperating firms stay intact and each firm maintains its own identity. Hybrids are distinguished from market transactions because of the use of longer-term contracts. The value of the hybrid structure hinges upon the ability of the contracting parties to make transaction specific investments. Transaction specific investments increase the value of the business relationship relative to mere market transactions by increasing efficiency and reducing the threat of opportunistic behavior. Transaction specific investments made by all parties to the contract reduce the cost and risk to any one firm. These cost and risk reductions increase the value of the relationship relative to transaction conducted under hierarchical governance. Williamson (2005) states with regard to the hybrid form of governance, "The viability of the hybrid turns crucially on the efficacy of credible commitments..." Deficiencies in the completeness of the contract can undermine the effort to make credible commitments.

Primarily from a transaction cost approach, the study of economics has made extensive studies into many different topics relative to the study of contractual relationships between cooperative business firms. Studies have looked at the "completeness" of contracts and issues of renegotiation. Other studies have looked at the "hold-up" problem that exists when parties to the contract make suboptimal investments in transaction specific assets in an attempt to coerce favorable terms. Still other economic studies have looked at the contractual remedies provided for breach as a means to increase the motivation to adhere to formally agreed upon obligations. While most studies within economics have appeared to commit itself to the transaction cost economic model, some have attempted to understand more "relational" factors between the parties and how these affect the governance of inter-firm contractual relationship through self-enforcing contracts. Each of these contributions should be reviewed briefly.

Economic research into inter-firm contracts continues to cover topics related to the completeness of contracts. A contract would be considered "complete" if the design of the contract, as a governance mechanism, would be such as to perfectly accomplish two conflicting goals (Al-Najjar, 1995). First, a complete contract must eliminate the possibility that the parties to the contract behave opportunistically. Second, the complete contract must be able to be flexible enough to respond efficiently to contingencies that arise in the course of the relationship.[24] The concept of the "complete contract", due to the costs associated in creating such an agreement, makes its practical existence impossible (Scott, 2003). Parties using contracts must govern their

[24] Al-Najjar (1995) recognizes the impossibilities of "complete contracts" suggesting that "even small drafting costs can make this flexibility prohibitively costly, thus forcing the contract to be incomplete". Al-Najjar also recognizes that the efforts by parties to deal with incomplete contract are inconsistent and that contracts, used as governance mechanisms, will be largely heterogeneous.

relationships using incomplete contracts; less than optimal conditions, to discourage opportunism and reduced flexibility to deal with contingencies.

Since the value of the cooperative relation hinges upon the ability of the partnership to make specific investments, the largest problem recognized is that the use of incomplete contracts has the tendency to induce contract partners to "under-invest", or to make suboptimal investments, and therefore diminish the possibilities for optimal returns (Guriev & Kvasov, 2005). Specific investments are described as "sunk and irreversible" (Chung, 1995). It is the "specific" nature of these investments between cooperative partners that increases the investment risk to each of the investing parties. However, once specific investments are made, there develops a high propensity to want longer-term contracts in place to govern the relationship (Joskow, 1988).[25] The irony here is that specific investments increase the demand for long-term contracts. The long-term contract is incomplete, even more so relative to short-term contracts, which in turn reduces the incentive to make continued specific investments. Ultimately, the governance system that is successful and able to overcome the problem of incomplete contracts will approach increasingly optimal investments.

The reduction of incentives to invest, or under-invest, in the cooperative relationship is referred to as the "hold-up" problem (Guriev & Kvasov, 2005)[26]. The concept of the hold-up has received considerable attention in the research (Williamson, 1975, 1985). Literature concerning hold-ups suggests that, based upon the fact that contracting parties cannot develop "complete" contracts; specific investments must be made before an acceptable level of uncertainty is resolved. Therefore, based upon this investment requirement and in light of the limited protections of incomplete contracts, a party of the agreement will tend to under-invest in specific assets (Edlin & Reichelstein, 1996).

It has also been recognized that parties to contracts purposely use incomplete contracts, which do not have listed every potential contingency, which in turn, leaves the parties open to the possibility of hold-ups (Klien, Crawford & Alchian, 1978; Klien, 1996).[27] Crawford (1988) even proposed the use of sequential short-term contracts to govern longer term relationships.[28] These short-term contracts would be increasing able

[25] Masten & Crocker (1985), Goldberg & Erickson (1987), and Crocker and Masten (1988) also demonstrate that investment specificity is one of the determinants of the duration of the contract. Increased level of investment specificity is correlated to longer-term contracts being developed.

[26] Goldberg (1976) is attributed to have coined the phrase "hold-up" but applied its initial meaning to government contracts.

[27] Klien, Crawford and Alchian (1978) introduced one of the most famous cases of a "hold-up" that existed within the contractual relationship between Fisher Body and General Motors in 1919. These firms developed a contract that was incomplete, in that it did not prevent a hold-up situation for General Motors. General Motors threatened Fisher to reduce its demand unless Fisher reduced its prices. Fisher responded by pointing to a contractual clause that guaranteed Fisher of General Motors sustained demand of their product for ten years. The knowledge that General Motors was on the hook for ten years reduced the incentive for Fisher to make any new investments in capital expenditures relative to their economic relationship. This lack of incentive to invest by Fisher is the "hold-up", which substantially increased the cost of inputs to General Motors.

[28] Crawford (1988) initially suggested that most contractual relationships outlive the contracts used to govern them; therefore long-term relationships could effectively be governed by a sequence of short-term contracts.

to consider the details and contingencies of the longer-term relationship. Along this argument, other research suggests that the best solution to overcome the hold-up problem would be to "require perpetual renegotiation of the fixed-term contract allowing parties to re-establish the efficiency needed to induce the parties to make continued specific investments…"(Guriev & Kvasov, 2005). Ultimately Crawford concluded that "short-term contracting tends to yield too little sunk-cost investment". In other words, the success of the cooperative relationship is dependent upon long-term specific capital investments and short-term contracts, even if developed sequentially, will not induce the necessary investments.

Economic research has also investigated the use of contractual remedies designed to be carried out in the event of contractual breach by one or more of the parties. Schelling (1960) shows that a threat… can be made credible by entering into "advanced commitments" which by the nature of the commitment "make its fulfillment optimal or even necessary". Parties to a contract have an incentive to create high penalties placed against those who breach contractual commitments (Aghion & Bolton, 1987). The use of stipulated damages or other negative consequences outlined by contract are an effort to enforce inter-firm commitments designed in the original agreement. These legal remedies can counter the negative effects of the hold-up problem and attempt to compensate parties that are victims of breach (Edlin & Reichelstein, 1996).

However, the penalty of breach is only as effective as one's ability to carry through with the negative consequence. Often, courts are reluctance to carry out stipulated damages that are considered by the court to be too high (Chueng, 1995).[29] Therefore contractual threats often do not create the commitment necessary to carry out long-term relationships. This motivates parties to use other commitment devices that encourage compliance. Chueng (1995) advocated that firms use investment into specific assets, assets that are sunk costs and irreversible in that the value of the asset is only maintained when utilized within the partnership, as commitment devices to motivate parties to fulfill their agreements and remain within the cooperative relationship. This in turn reduces the ability of any of the parties to renegotiate the initial contract. The irony here, as Chueng demonstrated, the existence of contractual remedies for stipulated damages is not effective in securing the necessary commitment. Chueng demonstrated that specific investments are necessary to develop the necessary commitment. In turn, the necessary commitment is required to in order to induce contracting parties to make continued specific investments.

Crawford differentiates between two types of specific investments: reversible investments and sunk cost investments. Reversible investment, investments that could be reallocated if the inter-firm relationship terminated, were found to be efficiently governed through the use of short-term contracts. Sunk cost investments, which creates capital investments that could not be reallocated or withdrawn, were not found to be efficiently governed by short-term contract but necessitated the use of longer-term contracts.

[29] Masten & Snyder (1989) recognized the limits of the court to enforce "stipulated damages" of which they consider too excessive. They recognized this as the "penalty doctrine" and point out that this doctrine undermines the efforts of parties to make and enforce penalties through contractual clauses in an effort to make contractual compliance the optimal course of action by any one of the parties. This in turn requires the parties to renegotiate, reducing the commitment power of the original contract.

Economics has investigated other governance mechanisms to employ outside of the exclusive use of contracts; contracts which are known to be incomplete. However, the importance of these relational governance mechanisms is still debated. Some authors argue that "repeat transactions" which in turn reference an increased use of relational governance mechanisms[30] developed within the hybrid region, are substitutes to contracts (Corts & Singh, 2004). These repeated transactions encouraged firms within the off-shore drilling industry to reduce the number of formal, price fixing contracts. However, Kalnins & Mayer (2004) found that repeated transactions, developing relational mechanisms, were found to be compliments. Repeated transactions between U.S. information technology firms increased the usage of contractual agreements.

Economics has studied other strategies used by contracting parties to increase the flexibility of the contract to deal with problems associated to the bounded rationality of the parties. As stated previously, a complete contract must eliminate opportunism and increase flexibility enough to respond efficiently to contingencies that arise. For example, a strategy to increase flexibility is to supplement the incomplete contract with other governance instruments "such as reputation, conventions, property rights over physical assets, or the legal system" (Al-Najjar, 1995). Further strategies attempt to increase flexibility by introducing ambiguity in the terms of the contract (Al-Najjar, 1995). Bernheim & Whinston (1998) argued that parties often prefer to leave some aspects of the explicit contract ambiguous in order to allow discretion and flexibility in the relationship.[31] However, it is countered that the existence of more flexible alternative methods of governance will make "initially incomplete contracts even more incomplete" and therefore further complicate efforts to induce specific capital investment (Al-Najjar & Nabil, 1995).

B. Sociology and its Contribution.

Sociology has greatly contributed to our understanding of the inter-firm relationships and the sociological literature has published some of the most influential works in this area. Even Emile Durkheim, often considered the father of sociology, extensively wrote concerning the important impact that private contracts have on the social structure in that "men's wills can not agree to contract obligations if these obligations do not arise from a status in law already acquired, whether of things or of persons; it can only be a matter of modifying the status and of superimposing new relations on those already existing. The contract, then, is a source of variations which presupposes a primary basis in law, but one that has a different origin". (Durkheim, p.194)

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[30] Relational governance mechanisms and relational contracts are informal agreements and unwritten codes that affect the behavior of individuals. Baker et. al. (2002) describes these mechanisms as very flexible and based upon "detailed knowledge of their specific situation… For the same reasons, however, relational contracts cannot be enforced by third party and so must be self-enforcing".

[31] The effort to avoid writing specifics into the contracts appears to be desirable if "some aspects of performance are non-verifiable", thereby motivating parties to leave even verifiable performance ambiguous. This is referred to as "strategic ambiguity (Bernheim & Whinston, 1998).

From a sociological perspective, the significance of the inter-firm "contractual relationship" is that they are some of "the most crystallized economic relations common in the marketplace" (Zhou, 2003).[32] These influential works have recognized that longer term economic relationships are deeply embedded within social relations and social institutions. This particular approach develops explanations for organizational behavior beyond the traditional transaction cost economics. Zhou et. al. (2003) details three distinct "mechanisms" by which firms conduct their inter-firms relationships. The study lists the three mechanisms as: transaction costs, social networks and institutional links. The first mechanism is covered by traditional economics. The latter two, social networks and institutional links, represent the major contributions of sociology to these relationships. Social networks are represented by the very influential study published by Stewart Macaulay in 1963. Mark Granovetter's work covered the influence of both social networks and institutional links, published in 1985.

Zhou et. al. (2003) recognized Macaulay's contribution as the beginning of the "social-relation based" approach to inter-firm contracting. The article written by Stewart Macaulay, intended to be the first in a series of like studies, was one of the first attempts to study the use of contracts from a "behavioral approach" and points to the application of contract law as a "sociological significant area" important for continued study.[33] Macaulay's study suggested that business decision makers often rely upon other mechanisms than the use of contracts to guide inter-firm relationships. Macaulay notes that businessmen often times do "plan" their transactions in great detail, but mentions that "not all exchanges are neatly rationalized". While he does not explain the term "rationalized", he does mention "rational planning" to include a "provision for as many future contingencies as can be foreseen".

Macaulay describes that, "Businessmen often prefer to rely on a man's word in a brief letter, a handshake, or common honesty and decency – even when the transaction involves exposure to serious risk… (Lawyers) complained that businessmen desire to keep it simple and avoid red tape even where large amounts of money and significant risks are involved." A lawyer himself, Macaulay described situations in which the details of the contract were often left in a "vague state". One lawyer complained to him that "he was sick of being told, 'We can trust old Max', when the problem is not one of

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[32] Zhou et. al. (2003) defines contractual relationships as being all the formal and informal agreements between firms. In this study, three mechanisms of governing inter-firm relationships are compared when they considered the economic relationships between various firms in China. These three mechanisms were: social-relation based, institution-based and transaction cost-based. The study compares 877 contracts from 620 firms in 2 Chinese cities, Beijing and Guanzhou. The weak judicial structure, relative to contracts, would most likely demonstrate these firms having to rely upon more socially embedded mechanisms, a result that might be different if studied in the United States, having a relatively strong judicial structure. Granovetter (1985) predicts that these social "patterns may be more easily noted in other countries (than the United States) where they are supposedly explained by cultural peculiarities.

[33] Macaulay's study was conducted through interviews of "68 businessman and lawyers representing 43 companies and 6 law firms". All but two of the firms were located, or had locations, within the state of Wisconsin. 17 of the firms were machine manufacturers and he often uses these types of interactions to discuss very detailed work done between firms. Macaulay recognized the potential for bias in his sample and mentioned that the "existing knowledge has been inadequate to permit more rigorous procedures – as yet one cannot formulate many precise questions to be asked a systematically selected sample…"

honesty but one of reaching an agreement that both sides understand". The use of contracts, within Macaulay's study, demonstrated that the participants often relied upon "other" mechanisms to guide their transactions and that little practical use was made of formal contracts.

Macaulay asserted that in most of the transactions he observed, contracts were not needed and that there were efforts to rely upon the "customs of their industry…" He stated that "these customs can fill gaps in the express agreements of the parties". It is interesting to note that Macaulay often described businessmen engaging in transactions with "orders" which took no thought of any legal sanction for potential contingencies. These "orders" may, based upon a more modern legal approach, have been legally binding contracts. This may suggest that the application of the law has changed to a point in which what was not considered a contract in the early1960's, may be considered a valid contract today. Therefore, the reader of Macaulay's study must bear in mind that when he considered businessmen engaging in transactions without the use of contracts, those same transactions may be considered contractually sufficient within modern standards. Therefore, it might be supposed that fewer transactions were conducted without contracts than was suggested by Macaulay. Published comments by William M. Evans (1963) recognized the several deficiencies of the Macaulay paper, but in the end, recognized its contribution to the study of societal norms within inter-firm relationships.[34]

Zhao et. al. (2003) recognized Granovetter (1985) as the beginning of the "institutional links based" approach to inter-firm contracting. Mark Granovetter's contribution offers a critical assessment of the "undersocialized concepts of human action" as developed by traditional economic thought.[35] This position is similar to other studies focusing on individual ties and their effects on inter-organizational structural attachments (DiMaggio and Powell, 1983). Critical of the Williamson approach to governing mechanisms based upon transaction cost economics, Granovetter stated that: "social relationships between firms are more important, and authority within firms less so, in bringing order to economic life than is supposed in the markets and hierarchies line of thought. A balanced and symmetrical argument requires attention to power in 'market' relations and social connection within firms." Granovetter wrote concerning the relationships developed between firms as "so intimately bound up with networks of personal relations that any perspective that considers these relations peripheral will fail to see clearly what organizational form has been affected" (Granovetter, 1985). He

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[34] Evans (1963) characterized Macaulay's study as "preliminary findings". He recognized the need to further study the "relative bargaining power of the parties". His argument was that parties with relative "power" would have different incentives, relative to the use of contracts. This would suggest that the use or non-use of contracts was guided by the parties' ability to create sanctions against their non-compliant, transaction partners without the use of formal contracts. Any emphasis upon power structures by Macaulay would most likely make his work indistinguishable from that of Granovetter.

[35] Granovetter (1985) describes the economist's view of the social relations that may influence economic actors as "a frictional drag that impedes competitive markets". Quoting Adam Smith: "people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices". Quoting Williamson (1975): Economic man… is thus a more subtle and devious creature than the usual self-interest seeking assumption reveals.

urged that research "pay careful and systematic attention to the actual patterns of personal relations by which economic transactions are carried out".

Granovetter (1985), in great detail, makes extensive use of Macaulay's study to support his assertion that sociological forces have to be considered when attempting to understand the mechanisms by which firm organize their transactions. Most of Granovetter's assertions are made relative to the transaction cost approach to understanding the use of governance structures between hierarchies and markets. However, little distinction is made between the Granovetter study and that done by Macaulay, which might suggest that there is little difference between the social networks and institutional links presented by Zhou et. al. (2003). Granovetter does point to "concrete patterns of social relations" or "networks" which may distinguish its perspective from simple observations of social interactions. It appears as if Zhou et. al. distinguishes these two by relating social networks to simple social interactions while relating institutional links to include that relationship between the firm and government organizations having power over the firm.[36]

Studies within the sociological literature that have attempted to demonstrate the importance of social networks to predict inter-firm relationships have been extensive. For example, Uzzi (1996) argues that the importance of organizational networks improves economic performance until the network begins to "seal off" member firms from access to new information and opportunities outside of the network.[37] Baker et. al (1998) studied the effects of competition and institutional forces as stabilizing/destabilizing forces relative to inter-firm relationships. Lin (1999) studied the use of social business networks and the advantages associated with status. Later, Uzzi (1999) makes a similar argument relative to the networks of banks and their access to capital as well as its cost.[38] While many of these studies attempt to argue the importance of social relationships that develop between firms, they tend to avoid discussions of the use contracts between firms. While the contributions of sociology to understanding inter-firm business relationships started with an acute observation relative to the use of contracts, the study has later utilized the Granovetter approach and studied the use of networks as evidence of "embeddedness" as opposed to how they are organized and formally structured. Zhou et. al. (2003) is a noted exception. Only Macaulay seems to make particular note of the use of contracts within these relationships.

C. Strategy/Management Research.

[36] Zuken and DiMaggio (1990) classify embeddedness in four forms: 1) structural, 2) cognitive (mental processes), 3) cultural (shared beliefs and values), and, 4) political (institutional limits on economic power and incentives).

[37] Uzzi (1996) studies 23 apparel firms and argues that firms within social networks have a higher chance of survival as opposed to firms that conduct transactions within "arms-length market relationships". This pattern persists until at some point the network begins to have a negative effect on the firm's performance.

[38] Uzzi (1999) uses interviews to study how mid-sized banks work within social networks to receive affordable capital.

Research conclusions, from the management literature, have been mixed relative to its general assessment of governance structures for cooperative interactions.[39] Research that follows the transaction cost economic logic has concluded that appropriate structural decisions, made to successfully overcome opportunistic behavior, result in relationship success (Williamson, 2005, 1991; Hennart, 2006, 1988). Other research has concluded that trust is the alternative driving force used to avoid the costs associated to monitoring against opportunistic behavior thereby resulting in relationship success. In addition, many scholars, within the management literature, are often critical of the transaction cost approach (Colombo, 2003).[40] For example, possibly taking their hints from Granovetter (1985),[41] management researchers have argued that the basic assumption of "opportunism", in transaction cost economics, is exaggerated and a problematic assumption for practitioners (Ghoshal & Moran, 1996; Dyer and Singh, 1998; Hill, 1990).[42]

In an effort to differentiate the strategy perspective, Michael Porter (1991) stated that: "The reason why firms succeed or fail is perhaps the central question in strategy". The primary focus of strategic analysis is the business unit (Prahalad & Hamel, 1994). The distinction between the management literature and that of strategy is strategy's focus upon the development, maintenance and enhancement of the firm's competitive advantage. In order to achieve competitive advantages in the marketplace, firms must be able to organize assets and capabilities in such a way as to be able to extract economic rents from firm activities (Amit & Schoemaker, 1993; Barney 1991). Relational rents[43] are those economic rents generated from inter-firm activities that are beyond those rents create by the firms in isolation (Dyer & Singh, 1998). The governance of the hybrid relationship will play a vital role in the creation of relational rents. The governance mechanisms designed for the inter-firm relationship, in order to be effective in fostering economic rents, will need to reduce transaction costs as well as encourage the firms to

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[39] Realistically, the general management literature, including organizational theorists, has favored the relational governance mechanisms with emphasis upon building trust as opposed to the transaction cost economic approach. Some research has attempted to merge these approaches to intertwine trust within the transaction cost model (Zaheer & Venkatraman 1995; Doz, 1996; Poppo & Zenger). Most all of the research focused upon cooperative business relationships makes mention of both approaches suggesting trust and formal monitoring mechanisms are employed in these interactions although most research favors trust (Bagley, 2008; Luo, 2008).

[40] Colombo (2003) contends that the major weakness in the transaction cost approach is that it "overemphasizes individual parties' minimization of transaction costs, while holding other factors constant."

[41] Granovetter (1985) was specifically critical of the under-socialized approach of Williamson, even using the research conducted by Macaulay to enhance his argument.

[42] Hill (1990) argues that the market "weeds out habitual opportunism. In fact, the very threat of internal organization helps reduce opportunistic behavior in market transactions". On the other side of the TCE spectrum, Hill (1990) argues that the use of "hierarchy involves additional bureaucratic costs that do not have to be borne by actors who tacitly agree to cooperate and trust each other". Dyer and Singh (1998) offer a "relational view" of the firm, similar to the resource based view developed by Jay Barney; which focuses its efforts to explain the value of relationships outside the firm boundaries as firm assets and capabilities.

[43] The term "relational rents" should not be confused with the term "relational approach" discussed later. Relational rents are those economic profits achieved through inter-firm cooperative efforts, regardless of the governance mechanism in place. The relational approach describes a governance mechanism primarily implemented through the use of trust.

engage in value creating cooperative activities, both of which will develop, maintain and enhance competitive advantages.[44]

Much of the interest in the hybrid governance structure comes from the literature on joint ventures, strategic alliances and more recently, networks. Transactions between cooperating firms have traditionally been viewed within the transaction cost economic dichotomy (Ring and Van de Ven, 1992). While most of this research includes a description of the theoretical foundation of the transaction cost economic perspective, much of the research expands the topic to include trust as an important, if not the most important, component of the hybrid experience. Research regarding contracts and contract components has been a relatively recent interest of the management and strategy literatures. Contracts are considered the costly monitoring devices used to overcome the opportunistic behavior of the market, as argued by transaction cost economics (Williamson 1975, 1985, 2005). It is understandable that this interest in contracts is relatively recent due to researcher's otherwise focused attention on relational mechanisms such as trust.

An overview of this research must begin with a review of the importance of the cooperative business relationship. In addition, governance structures have been conveniently categorized into two perspectives: structural and relational (Faems et. al. 2008).[45] The structural perspective follows the theoretical foundations of transaction cost economics and relies upon the use of formal agreements such as contracts. The relational perspective relies heavily upon the use of trust as an alternative governance mechanism. Each will be reviewed consecutively. Management and strategy researchers have done extensive research in organizational learning. Learning will be reviewed as a potential alternative to the explanation of trust as an inter-firm governance mechanism. Finally, the recent literature on contracts will be reviewed in order to clarify the expected contribution of this study. The literatures from management and strategy are so intertwined so as to make it difficult, and in most cases, unnecessary to distinguish their differences unless a unique perspective emerges, of which will then be noted.

1. Value from the Hybrid.

Developing cooperative business relationships offer several advantages that have been noted in the management and strategy research literatures. Dyer and Singh (1998) stressed the importance of cooperative inter-firm relations for accessing resources and creating competitive advantages. Firms engaged in alliances can enjoy the potential effects of increased reputation and legitimacy (Fombrun & Shanley, 1990). Firms can also obtain important resources and social support through associations that provide

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[44] Colombo (2003) asserts that cooperative ventures are started, not only as an effort to reduce costs as is the case in transaction costs economics, but also an effort to "joint value maximize" return. Cooperative efforts are created when the "net present value of the payoff partners expect from the collaboration-that is, the difference between the revenues and the production and transaction costs of the collaboration-exceeds that of proceeding alone."

[45] Faems et. al. (2008) conducted their study relative to alliances. However, the arguments and application of theory appear to include most all of the structures between the hierarchies and market transactions. The portion covering contracts makes mention of marketing agreements and associations and even joint ventures.

institutional linkages Baum and Oliver, 1991). Relationships with higher status firms will generate increased visibility, helping the firm to distinguish it from competitors, and help signal the firm's increased stature to important stakeholders (Eisenhardt and Schoonhoven, 1996; Stuart, 2000). These signals can be an important means to acquire important resources such as needed capital[46] (Levitas & McFadyen, 2009; Uzzi, 1999).

While it can be argued that the success of the hybrid structure is determined by the ability of the cooperative firm to make transaction specific investments (Dyer, 1996), this is not the entire story. Controls must be introduced to insure that investments are equally shared, in order to avoid extremely asymmetrical levels of investment creating instability in the relationship (Hennart, 1988). Recent research by Luo (2008) suggests that the investment in specific assets is only part of the problem. Even if investments are made, cooperative firms must also involve themselves in a level of "economic integration".[47] Economic integration involves the level at which resources are "effectively combined in an alliance's value chain" and "operationally utilize and exploit integrated resources" (Luo, 2008). Therefore the successful governance structure must properly control, for the benefit and inducement of specific investments, and coordinate, for the benefit of proper integration to be able to exploit the combination of specific investments.[48]

2. Governance: Structural Perspective.

The structural perspective is based on transaction cost economics, discussed earlier, and contains the assumption that cooperative partners have the propensity to engage in "opportunistic behavior" (Williamson, 1985). Heavy emphasis is placed upon the initial structure, being one of the few aspects managers can truly have an effect upon (Hennart, 2006). The structural design is developed in an effort to reduce the probability that the cooperating partner will act opportunistically. However, attempts will be made to "economize" the framework offering the necessary protection at the lowest cost (Shelanski & Klien, 1999). The objective is to motivate specific investment of which will create its own safety mechanism. "Non-recoverable investments reduce a partners gains from cheating" and encourage more specific investments to be made (Schelling, 1960). The larger the potential loss from opportunistic behavior, the higher probability

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[46] Firm seeking external capital often have difficulties demonstrating the value of the management and organization ready to exploit the new opportunity, sometimes referred to as the "lemons problem" (Akerlof, 1970). Papaioannou et. al. (1992) recognized this problem and suggested that this difficulty is the reason small, high tech firms often hold relatively large amount of cash. Levitas & McFadyen (2009) reason that alliances can be used to increase opportunities to access external capital based upon the firm's association to firms with a higher public status.

[47] Luo (2008) defines economic integration as "interdependence between exchange members with respect to resources pooled by these members and the subsequent operations utilizing these resources. Interdependence refers to the degree to which alliance members interact to determine an outcome jointly". This research compares what the integration aspects of trust, governance and justice have on alliance stability and profitability. Luo concludes that integration has a positive effect on stability, but a diminished effect on profitability. The diminished profitability may be due to reduce levels of flexibility as the firms become more integrated.

[48] Control and coordination will be a consistent theme relative to proper governance structures. Control makes reference to the ability of the partnering firms to protect their investments in specific assets in light of an uncertain environment (Hennart, 1988). Coordination refers to the partner's ability to extract value from the integration of these specific assets (Luo, 2002).

an alliance partner will resort to creating "ex post remedies in the form of a tight legal document that incorporates strong safeguards" (Parke, 1993). Heide and John (1988) found that "financial performance was improved… provided specific investments were relatively high". Schelling (1960) made special note that "trust alone does not induce specific investment.

These contracts act as "safeguarding devices" which include clauses that are uniquely specified in detail so as to outline as many contingencies as economically possible (Faems et. al. 2005; Parke, 1993). Contracts are also recognized as "coordinating mechanisms" as they work to describe the "precise division of labor between partners and providing procedures for the integration of dispersed activities, simplify decision making and prevent disputes on how to achieve task" objectives (Faems et. al. 2005; Reuer & Arino, 2007). High commitment in non-recoverable investments induces parties to resolve problems and have a tendency to create "stable, high performers" (Parke, 1993). At the least, Larson (1992) suggested that formal contracts are necessary early in cooperative relationships in order to promote success in cooperative performance and to create the foundation for further contracts.

3. Governance: Relational Perspective.

The relational perspective attempts to stress the use of trust[49] as the primary means to govern and coordinate cooperative efforts. This perspective falls in line with the contribution of Granovetter and is sometimes described as "sociological" (Zaheer & Venkatraman, 1995). Macneil (1980) initially recognized the relational nature of contracting in that the "relational exchange is… largely represented by trust". The "modern relations… require solidarity and hence a degree of trust, or faith in others, to work successfully (Macneil, 1980). In addition, Hill (1990) determined that "the construction of a long-term relationship based around cooperation and trust is optimal" and then advocated for research to identify ways in which trust could be established. The relational perspective criticizes the traditional approach to cooperative relationship by insisting that the "empirical work informed by transaction cost economics precludes the possibility that an important economic and social context may alter the formal structure of those alliances and the transaction costs associated with them" (Gulati, 1995). It is argued that the undersocialized view of transaction cost economics tends to neglect the important social context found in cooperative interactions (Granovetter, 1985). Trust provides assurances that the assets and information provided by each partner will be used for the mutual benefit (Jones & George, 1998).

The relational perspective assumes partners tend to act in a trustworthy fashion (Faems et. al. 2008). The result of this is that the "perception of opportunistic behavior is likely to be limited, reducing the need for costly and inflexible formal safeguarding mechanisms such as complex contracts (Faems et. al., 2008; Dyer & Singh, 1998;

[49] Trust generally refers to "positive expectations regarding the other party in a risky situation" (Lewicki et. al., 2006). Zucker (1986), a sociologist, identified three forms of trust: "characteristic-based trust", trust formed from group identification; "process-based trust", trust resulting from past and future exchanges; and "institutional-based trust", trust derived from embedded social practices. Lewis & Weigert, (1985) argue that trust is a "leap" beyond the expectations that reason and experience would warrant.

Larson, 1992). Granovetter (1985) describes this as a "strong expectation of trust and abstention from opportunism". Because trust induces joint efforts, it thereby reduces the need for time-consuming and costly monitoring (Ring and Van de Ven, 1994). As a control mechanism, trust facilitates high quality information and tacit knowledge which are critical to innovation (Uzzi 1996). Trust is described as an "organizing principle" which "represents a way of solving the problem of interdependence and uncertainty"[50] (McEvily et. al., 2003) Coordination within the relational approach is achieved by mutual adjustment and not through contractual systems (Faems et. al. 2008). "Trust facilitates the exchange of resources that are difficult to put a price on, but that increase a firm's ability to solve problems…" (Molina-Morales & Martinez-Fernandez, 2009). These are often referred to as "self-enforcement" agreements[51] (Dyer and Singh, 1998; Telser, 1980).

However, the overwhelming enthusiasm over trust may have its limitations. Williamson (1993) stated that "trust should be concentrated on those personal relations in which it really matters… and is reserved for very special relations between family, friends and lovers… Commercial relations do not qualify". Recent research has demonstrated that there may be negative effects of trust in cooperative relationships. Molina-Morales & Martinez-Fernandez (2009) demonstrated that the value of trust can be described as an inverted U-shaped curve. Initial development of trust may be helpful, however, at some point, the cost of time and effort to maintain trusting relationships may have a negative effect on firm performance. The existence of a "trusting relationship" may induce partners to be more reluctant to monitor the relationship. Therefore, less monitoring may be a contributing factor decreasing firm performance (Langfred, 2004). This is in line with earlier research which argues that trust's "success can prove dysfunctional" (Adler, 2001). Contrary to advocates of the trust mechanism, achieving trust or "trust worthiness" is not costless (Parke, 1993). Not only does the reputation of being trust worthy require "deliberate strategies of forbearance", costs are also incurred when firms attempt to search for partners exhibiting trustworthy behavior. "It is costly to sort out those who are opportunistic from those who are not" (Williamson & Ouchi, 1981). These perspectives would suggest that trust is not costless and that there are important boundaries to the benefits of trust, assuming it even necessary.

4. Trust vs. Contracts.

Trust has often been portrayed as a substitute governance mechanism to take the place of complex contracts within the realm of the hybrid structure (Granovetter 1985; Gulati, 1995; Uzzi, 1997; Dyer & Singh, 1998; Adler, 2001[52]). Trust would operate as a self-enforcing mechanism to guide and direct interfirm activities. However, some researchers have even gone as far as to suggest that the existence of contracts is

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[50] McEvily et. al. (2003) describe trust as "a positive assumption about the motives ad intentions of another party, it allows people to economize on information processing and safeguarding behaviors. They go on to describe trust as an "expectation" or an "intention". Mayer, et. al. (1995) associated trust expectations with "notions of ability, benevolence and integrity".

[51] supra

[52] Adler (2001) does not specifically make the comparison between contracts and trust, but does refer to the trust mechanism as the primary governance mechanism to cover the theoretical region between hierarchies and spot market transactions.

detrimental to the interfirm relationship (Malhorta & Murnighan, 2002; Lyons & Mehta, 1997; Ghosal & Moran, 1996, Dyer and Singh, 1998, Macaulay, 1963). Formal contracts have been considered to undermine the effectiveness of trust and encourage opportunistic behavior (Ghoshal and Moran 1996; Macaulay, 1963). Malhorta & Murnigham (2002) argued that "Although contracts may be necessary as stakes increase, cooperation can be achieved without them… Trust increases cooperation in strategic interactions… Trust can also reduce uncertainty and lead to more efficient negotiated agreements". Dyer and Singh (1998) argue that "self-enforcement agreements" offer greater assurances that firms will be rewarded for their involvement in "value creation initiatives, such as sharing fine-grained tacit knowledge, exchanging resources that are difficult to price or offering innovations not explicitly called for in the contract.[53] "Self-enforcement agreements" provide greater value in that they are much more difficult to imitate by competitors, securing a more sustainable competitive advantage (Dyer & Singh, 1998).

Hoetker & Mellewigt (2009) provided an interesting insight into the use of alternative governance mechanisms (formal contract and relational) in the alliance environment. They conclude that formal contract and relational governance mechanisms are not interchangeable and that they are "highly dependent upon the alliance context". They first demonstrate that alliances with substantial investment in assets perform better due to the use of formal governance mechanisms. They argue that relational governance mechanisms perform better for knowledge-based assets, as opposed to formal contract governance procedures often due to the difficulty of measurement and enforcement (Oxley & Sampson, 2004; Kale et. al., 2000). This study contains two important observations that are informative. First, this study found that the costs of relational governance "may be higher than has previously been appreciated". Further, the study describes that "they may actually be counterproductive due to high costs and oversocialization". This may run contrary to the notion put forward by Dyer & Singh, 1998, that relational mechanisms have lower costs. Second, the study's conclusion suggests that "when possible, early activities in an alliance between two firms should primarily involve property-based assets, amenable to governance via formal mechanisms, rather than knowledge-based assets. As the firms develop trust and social identification over time, relational governance mechanisms become more feasible…"

Some sociologist have backed away from the notion of trust as an effective governance system citing the difficulties of creating trust, often taking long periods of time, and relative ease in terms of its destruction (Adler, 2001). Other research suggests that cooperative partners only "incrementally signal" their willingness to engage in further relationships (Larson, 1992). Partners are slow to commit because they understand that trust mechanisms alone can be problematic in that "it makes betrayal

[53] Dyer and Singh (1998) argue that self enforcing mechanisms are more efficient and lower transaction costs through: 1) contracting cost are avoided and replaced by relationships based upon trust, which is argued to be more effective against controlling opportunism; 2) lower monitoring costs because enforcement relies upon self-monitoring as opposed to external or third party monitoring; 3) lower costs of agreement adaptation and adjustments when parties are responding to unforeseen circumstances; 4) reduced cost in "reconstructing", based upon the fact that most contracts have a distinct duration after which the costs to renegotiate an updated contract increase.

more profitable" (Adler, 2001; Granovetter, 1985). More recently researchers have suggested that trust and formal contracts interact more like compliments; working together to create increasingly complex contractual arrangements. Poppo & Zenger (2002) found that increases in the level of relational governance were associated to increased contract complexity. In turn, increased contract complexities promoted more "cooperative, long-term, trusting exchange relationships".[54] They argued that "formal contracts promote relational governance in exchange settings and relational governance enables the refinement of contracts and promotes stability in the interorganizational exchanges". Zaheer & Venkartaman (1995) demonstrated that the manifestation of both, the economic perspective of contract and the sociological perspective of trust, were present as "complementary insights" into the governance of interfirm relations.

5. Dynamic Capabilities: A possible alternative explanation.

The argument, relative to contract vs. trust, is that trust is complimentary to contracts in that trust fills in the gaps of all contracts, based upon the fact that they are practical incomplete. Trust takes over when the contract does not address the issue. Assuming Williamson (1993) is correct and trust has no commercial application, learning and the development of dynamic capabilities could fill in the portions of the contract that are not economically feasible to have to cover in detail. For example, parties to a contract a contract may leave portions of the contract unaddressed and open to interpretation with the expectation that the parties will add more detail as they learn more and develop more interfirm capabilities relative to the partner. Parties to the contract, under the transaction cost economic logic, suffer from bounded rationality (Williamson, 1985). Understanding their limitations, contracting parties solve the contractual problems as they learn more about their distinct responsibilities in the relationship, the specific investments that will be required, and the ability they have to coordinate with their new partners. Dynamic capabilities develop relative to external relationship would have to be develop in order to build up "shared norms and familiarity", which have been identified as sources of trust (Adler, 2001). As a possible alternative explanation, it is the expected return and the expectation to learn and develop new capabilities that drive contracting partners to enter incomplete contractual relationships and make specific investments; not necessarily trust.

Capabilities are important to a firm as they are an effective means to achieve organizational success as well as competitive market success. The basis of that success is that these capabilities are unique or idiosyncratic and path dependant in their development therefore making these firm assets unique and non-imitable (Eisenhardt & Martin, 2000). These characteristics are those that contribute to the development of competitive advantages (Barney, 1991). Ianistik and Clark (1994) define capabilities as "dynamic" when the organization's general capabilities have the capacity for regeneration. Eisenhardt and Martin (2000) describe dynamic capabilities that manipulate resources to generate new competencies and renew existing capabilities.

[54] The results of this study demonstrated that "managers tend to employ greater levels of relational norms as their contracts become increasingly customized, and to employ greater contractual complexity as they develop greater levels of relational governance". (Poppo & Zenger, 2002)

The act of collaborating with other firms extends each firm's competencies (McEvily et. al., 2004)

While the dynamic capabilities approach has primarily focused upon internal resources, it has also extended to those capabilities to manage resources and relationships outside the firm (Eisenhardt & Martin, 2000). These abilities are "related to the development and exploitation of imitable collaborative interfirm relationships that confer access to resources and capabilities from differentially endowed firms (Doving & Gooderham, 2008). The essential dynamic capabilities of the cooperative partner include joint problem solving and service development with complementary business service providers (Jones, et. al. 1998; McEvily & Marcus, 2005).

One set of dynamic capabilities that has been identified is "legal astuteness" (Bagley, 2008). Bagley(2008) states that "legal astuteness" is imperative to management in that managers are better able to "exercise informed judgment". "We should find that legally astute management teams realize more value from their contractual relationships than teams" lacking such capabilities (Bagley, 2008). Mayer & Argyres (2004) suggest that managers, working within cooperative relationships, have the capacity to learn to craft better and more meaningful contracts. Zollo at al. (2002) suggests prior ties improve partner's interactions and help coordinate their alliance. Research has found that firms have often entered into alliances with partners from previous cooperative efforts (Dyer & Chu, 2003). "…relational governance alone is often insufficient to prevent reneging, making more expensive institutional arrangements necessary… A properly constructed long-term contract, for example, can reduce the instability that might result when dependent upon a single critical buyer or seller (Pfeffer & Salancik, 2003).

Research has suggested another set of dynamic capabilities relative to alliances which often lead to the development of inter-organizational routines, independent of trust (Zollo et. al. 2002). These routines can conduct "monitoring and coordination" procedures without enormous investments into contractual detail (Reuer and Arino, 2007). This repetitive momentum[55] would suggest that firms develop capabilities to work with other firms, which encourages the development of future cooperative arrangements (Goerzen, 2007).[56] Dyer and Singh (1998) described how "relation-specific" knowledge develops from "frequent and intense partner interactions" and serves to increase the efficiency of the alliance efforts. This increased mutual understanding and learning can "help firms mitigate ex post coordination, conflict resolution, or information-gathering problems that formal contractual provisions can

[55] "Repetitive momentum" makes reference to the notion that firms that have engaged in cooperative behaviors with other firms are more likely to repeat this effort in the future (Goerzen, 2007).

[56] Goerzen (2007) suggests that the justification for repeated cooperative efforts is due to increased trust and reduced cost associated to trust. However, the study admittedly does not rule out alternative explanations for repeat cooperative efforts. Goerzen (2007) points to "managerial efficiency" or managerial learning that results from repetitious activities. In fact this research notes that these repeat cooperative efforts "appear to derive diminishing economic benefits if their interorganizational network is more redundant…" suggesting the development of trust has its limits relative to increasing the performance of the alliance, if it truly has an effect at all.

otherwise attempt to address" (Reuer and Arino, 2007). Scott (2003) observed that "whether reciprocal fairness is a learned behavior that derives from the benefits of cooperation in repeated interactions or an intrinsic motivation remains an open question".

As previously discussed, research regarding governance mechanisms often place contracts and trust as substitutes. Where contracts are incomplete with regard to the relationship, trust provides a rich context from which to negotiate solutions between the partners. Faems et. al. (2008) provides an interesting case study regarding two consecutive contracts, both representing efforts to develop new technologies. The first contract contained various deficiencies with regard to the allocation of responsibilities. The contract soon failed to produce the desired result. A few years later, the two partners again contracted to develop a new technology. New personnel were involved in the second agreement suggesting trust was not a factor, since trust often takes time to develop. The later contract was noticed to have more detail regarding the allocation of work responsibilities. The second contracting experience was successful. Another explanation (trust excluded) for the success of this cooperative effort was the development of capabilities by each of the firms to successfully conduct contractual relationships. Additional research regarding capabilities within cooperative relationships needs to be employed to develop this notion further.

6. Formal Contracts.

Poppo & Zenger (2002) concluded their study by urging researchers to "develop more precise measures of contractual clauses". "Firms use formal contracts to protect against exchange hazards, such as opportunism and reneging, which is often associated with uncertainty, specialized asset investments, and difficult performance measurement (Williamson, 1985, 1996). The purpose of this admonition was to increase our understanding concerning the changes that occur within contracts as cooperative firms dealt with the unexpected "disturbances" of the market. These disturbances have a tendency to put considerable strain on the exchange relationship (Williamson, 1991). Typically, the management and strategy literatures have treated contract as generally homogeneous with little if any discussion relative to the vast differences in the clauses that makeup the contract. Reuer & Arino (2007) explained that in spite of the interest of Poppo & Zenger (2002) in contractual clauses for interfirm cooperative contract, the study of interfirm contracts has received little attention. This lack of academic interest has been persistent even though the "efficiency of individual alliances also hinges upon the particular contractual provisions that firms put into their collaborative agreements" (Reuer & Arino, 2007).

In an effort to introduce contract complexity[57] as a multidimensional construct, Reuer & Arino (2007) introduce two dimensions of contractual clauses. The first

[57] Contract complexity has been described as the partner's attempt to develop "complete" contracts. Contract complexity has been measured in very broad, global terms. Joskow (1988) measured contracts based upon their length. Macneil (1978) measured contracts based upon the degree to which the parties designed provisions that attempted to anticipate contingencies. Reuer & Arino (2007) also outline other more specific measures of contract provisions. Muellar & Geithman (1991) measured for provisions that dealt with

dimension described was the "enforcement provisions", of which captured contingencies within the contractual relationship which deal with issue such as property, breaches of contract and the agreed consequences and third-party adjudication. The second dimension was described as "coordination provisions", of which capture agreements upon the activities within the alliance. In other words, the coordinative provisions describe partner responsibilities and means to coordinate, in short, these provisions describe the activities that are the reason the alliance was created in the first place. Reuer & Arino (2007) stated that "coordination provisions are the weaker, informational provisions concerning the monitoring and adaptation of the alliance".[58] This research did note a strong positive correlation between the "complexity" of the contract and the investment in specific assets.

More recent studies have shown similar results. Hagedoorn & Hesen (2007) tested for the existence of several contractual provisions within cooperative business contracts. The study measured for the existence of provisions that covered revision, economic hardship and impossibility, damage measures, warranties, and dispute resolution mechanisms. While these provisions were all found to varying degrees, this particular research was "surprised" to see provisions regarding "project plans, explicit task and responsibility description, and association agreements" (Hagedoorn & Hesen, 2007).[59] This may be evidence that the Management and Strategy research often overlooks the "coordinative" benefits of contracts. Faems et. al. (2008) also identified two governance mechanisms: safeguarding devices and coordination mechanisms. Safeguarding devices with contracts mitigate the risk of opportunistic behavior and describe penalties for the commission of violating behaviors (Faems et. al., 2008). One interesting note concerning the Faems et. al. study is that it was recognized that the development of "trust" played no beneficial role to the successful conclusion of the second contract. The researcher noted that the increased level of detail regarding the coordinative activities played the most important role. Coordinative mechanisms within contracts specify "precise division of labor between partners" and provide "procedures for integration of dispersed activities" and attempt to provide guidance to simplify "decision making and prevent disputed on how to achieve task".

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territorial restraints in licensing agreements. Lafontaine (1992) dealt with up-front fees and royalty rates in franchise agreements. Joskow (1987) measured contract duration.

[58] The differences between the enforcement and coordinative appear very slight. In effect, it appears as if both categories of provisions deal exclusively with contractual contingencies. It may be necessary to take a more expansive view of coordinative clauses and better define the dimension. Contracts in this context have avoided certain aspects of contracts that describe the division of labor between partners and provide procedures for the integration of activities, simplify decision making, and prevent disputes on how to achieve tasks objectives (Faems et. al. 2005).

[59] Hagedorn & Hesen (2007) investigated the existence of five basic contract provisions: revision, economic hardship and impossibility, damage measures, warranties, and dispute resolution mechanisms. They were surprised to find the existence of provisions containing "elaborate appendices with project plans, explicit task and responsibility description, and association agreements". These provisions would fit under the category, presented by Rueur & Arino (2007), known as "coordinative clauses". In fact, these provisions described by Hagedorn & Hesen would provide a better fit under the description than clauses actually used in the model under Reuer & Arino. This may be evidence that management and strategy researchers typically regard contracts as monitoring and enforcement mechanisms and often fail to consider contractual clauses that provide "coordinative" guidance to partners.

D. A Legal Perspective in the Use of Contracts.

The research contribution of a legal perspective to the business community has been and will continue to be vast and insightful.[60] While extremely important, the study of contracts is only a part of the entire contribution. Two distinct assertions are made that should help to understand the use of contracts in interfirm relationships. First, the legal system of contracts has many examples of implied obligations of which can be altered and enforced through explicit agreement. These explicit agreements must meet general requirements of definiteness to be enforced.[61] Therefore, agreements to cooperate must be developed with a certain level of definiteness with an additional concern of the costs to the parties relative to the implied contractual obligations. The issues concerning implied obligations and requisite legal definiteness pose serious problems for those dedicated to the use of relational governance mechanisms. Second, the study of contracts has developed certain categories of clauses that when compared to those created in the management literature, may be helpful to understand contract development and contract change. Both of these issues will be addressed.

1. Contract Law.

From a legal research standpoint, the law of contracts has evolved into a very pragmatic approach to business application. Early in its development, the law had been able to assume the ability of parties to develop "complete" contracts. Every party would be responsible for the elements of the agreement as well as those elements left out of the formal agreement. The courts did little to fill in potential breaks in contract clarity and understanding. This approach is known as the "formalist" perspective (Atiyah & Summers, 1987). Formalists look to the validity of the agreement and then to the agreement itself to make judicial decisions. The concept of "definiteness" emerged from the formalist perspective as an important responsibility of the parties expecting their contracts to be enforced. Definiteness places the burden of responsibility on to the contracting parties to create provisions that are comprehensive and clear. For example, contracts that are left incomplete "will not be enforced as a contract if it is uncertain and indefinite in its material terms…" (Scott, 2003).

Contract law has moved away from these stricter notions in an effort to more effectively judge contracting relationships. This modern legal approach is known as the "realist" perspective (Schlegel, 1995). Realists place emphasis upon the outcome of the contractual relationship and attempt to adjudicate based upon the social interests served. Carl Lewellyn, principle drafter of the Uniform Commercial Code, was an advocate of this perspective, arguing for principles such as "good faith" and "unconsciounability". The contract legal regime has made definitive efforts to accommodate the fact that contracts will be incomplete, which in turn will necessitate a system flexible enough to

[60] In this study, the term "law" or any reference to a legal regime is strictly intended to refer to the laws of the United States and state constitutions, although many of the arguments are applicable to legal regimes outside the United States.

[61] The contractual requirement of "definiteness" insists that contracts must meet a reasonable standard of defining the terms of the agreement. An agreement will not be enforced as a contract if it is uncertain and indefinite in its material terms.

make interpretations and determinations of private agreements, using often crude expressions of the agreement.

Schwartz (1992) states that modern courts now have "three strategies when deciding contract cases: they protect the process values, interpret language, and supply terms when the parties' contract fails to provide for the dispute that divides them". This effort to "supply terms" is known as "gap filling". Schwartz continues by stating that "the court fills the gap with a rule specifying how to resolve the dispute at issue". However, Macneil (1980) extends these "gap filling" activities even further to include the use of contract principles that attempt to overtly "preserve" the cooperative relationship, in favor of "good faith and fair dealing" (Barnett, 1992). As a manifestation of this inclination, Hadfield (1990) examined franchise contractual disputes and interpreted that the prevailing tendency of the courts is to fill in the gaps of an incomplete contract in order to preserve the relationship. Scott (2003) noted that "conventional wisdom holds that courts should (and do) strive whenever possible to fill contractual gaps with general standards of reasonableness and good faith".

Courts are also known to apply extrinsic evidence to contracts in order to define the meaning of terms in addition to filling in the gaps of the contract. For example, in *Nanakuli Paving v. Shell Oil*, the court noted that under the Uniform Commercial Code, "an agreement goes beyond the written words on a piece of paper"[62]. The court goes on to state that in an effort to understand the agreement, courts must investigate, "other circumstances including course of dealing or usage of trade or course of performance…" Section 2-208 of the Uniform Commercial Code provides that while the explicit terms of the contract typically control, "course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable…" In addition to industry standards, the court in *Nanakuli* also issued an obligation of good faith, relative to business dealings and, more specific to this case, price. The court ruled that a "price to be fixed by the seller or by the buyer means a price for him to fix in good faith…" and that "good faith means the observance of reasonable commercial standards of fair dealing in the trade." Therefore, the courts have been willing to apply obligations to the contracting parties that go beyond the explicit agreement.

However, more recent research has concluded that the courts might be less willing to fill contractual gaps in favor of requiring more definitiveness in agreements. Scott (2003) notes in his research of court decisions concerning contractual obligations that "courts continue to adhere to the indefiniteness doctrine …" Courts are "declining to enforce contracts where the parties have intentionally declined to condition performance on verifiable measures that could have been specified in the agreement at relatively low cost"(Scott, 2003). Relational mechanisms profess to rely upon non-contractual means to govern inter-firm relationships. Under the Macneil perspective, the court would make efforts to preserve the cooperative relationship. The research completed by Scott (2003) would suggest courts are less willing to accommodate relational mechanisms. Failure to contemplate explicit contractual agreements would increase the risk that the parties would be subject to implied obligations perceived by a

[62] *Nanakuli Paving & Rock Company v. Shell Oil Company* 664 F.2d 772 (9th Cir. 1981).

third party or increase the likelihood that agreements would be dismissed by the court for incompleteness.

2. Implied Obligations.

All the governance structures that accommodate transactions along the hierarchy v. market dichotomy create implied obligations for the parties involved. These implied obligations can be altered by explicit contractual agreements or changes in the corporate agreement, called the corporate charter. Williamson (1991), while describing the three generic types of governing mechanism (market, hybrid, hierarchy), argued that "each generic form is supported and defined by a distinctive type of contract law".[63] This contract law defines obligation though explicit and implicit mechanisms. Williamson (2005) stated that: "The contract law of simple market exchange is that of legal rules… courts award money damages in the event of a dispute, there being no interest in continuity for such transactions. The hybrid mode is supported by contract as framework, which is a more elastic concept of contract and (within limits) promotes cooperative adaptation… the implicit contract law of internal organization is that of forebearance…"

Contract law as it applies to the internal workings of the firm is especially appealing if one accepts the description of the firm as a "nexus of contracts" (Alchian & Demetz, 1972; Jensen & Meckling, 1976; Fama, 1980). When describing the notion of the law of forebearence, Williamson described this situation when, "…access to the courts is denied, the parties must resolve their differences internally. Accordingly, hierarchy is its own court of ultimate appeal."[64] The hierarchy method of governance reduces the risk of implied obligations by reducing the ability of third parties to make binding decisions upon the firm.

While contract law may not allow third party adjudication within the hierarchy, Williamson's analysis may have been incomplete. Other bodies of law do exist that create implied, almost contractual obligations for decision makers within the hierarchy as well as allow third party adjudication for conflicts. Most all commercial relationships create implied obligations of the parties of which can be altered by the introduction of explicit contracts, charter, etc. Both the law of corporations and employment law provide examples in which implied obligations are created and, if unaltered by explicit agreement, offer the opportunity for third-parties to adjudicate disputes within a hierarchical governance structure.

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[63]Williamson (1991) goes even further and suggests that not only to alternative forms of governance enact differing forms of contract law, but that "… alternative modes of governance are realized, in part, with the support of complementary contract regimes."

[64] Williamson (1991, 2005) argues that the traditional notions of contract law apply to hierarchies, especially in terms of viewing the firm as a "nexus of contracts". However, the disruptions that occur within these contracts as the firm attempts to adapt to changes are decided by internal decision makers, avoiding the risk of third-party adjudication. "Bilateral adaptation effected through fiat is the distinguishing feature of internal organization."(Williamson, 1991) "Fiat has its origins in the employment contract"

The corporation can be viewed as a complex set of explicit and implicit contracts and "enabling the participants to select the optimal arrangement for the many different set of risks and opportunities" (Macey, 2004). Corporate directors and officers are under three generally implied legal duties: the duty to act carefully, the duty to act loyalty, and the duty to act lawfully (Eisenberg, 1990).[65] These act as implied obligations and do not necessitate a formal statement to be enforceable. For example, in *Meinhard v. Salmon*[66], it was determined that even though the two parties had ended their joint venture, their relationship was such to create an implied obligation of loyalty on the part of Salmon to at least inform his prior partner, Meinhard, of other opportunities he had been working on. The court ruled that the partnership created an obligation to at least inform Meinhard of other opportunities to invest. An explicit agreement between Salmon and Meinhard could easily have severed any obligations of Salmon toward Meinhard outside of their partnership.

Although the "duty of care" and the "duty of loyalty" have long been described as non-waivable, explicit agreements can be made to alter the extent of these obligations (Macey, 2004). Macey (2004) states that these "fiduciary duties only operate in the shadow of the expressed contractual arrangements". Eisenberg (1989) made the observation that virtually all state statutes, which permit corporations to limit or eliminate personal liability of directors for simple duty of care violations, can allow provisions that explicitly exclude duty of loyalty violations by either directors or officers. For example, *Union Trust v. Carter*[67] is a famous case in which the court approved a charter that deprived shareholder voting rights for the first six years of the corporation's life. This denial of one of the most basic shareholder rights can be altered by explicit agreement, in this case, the corporate charter.

Employment law also creates implied obligations that can be altered by explicit contract. Employment at will has often been referred to as the default rule.[68] Employment at will means that employer and employees are free to terminate the employment relationship for any reason, or no reason.[69] Employers and employees are able to alter this relationship through contract, whether they be expressed or implied. Implied contract modifications can be the result employer communication, oral statements and even the party's behavior.[70] For example, *Pugh v. See's Candies* is a seminal case creating just-cause employment contract[71], merely based upon the continued actions of the parties. This decision suggested that employers could create implied obligations to their employees based upon their "continued actions".

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[65] *Unocal Corp v. Mesa Petroleum* 493 A.2d 946 (Del. 1985), which provided two general standards of review of management conduct: business judgment rule, applicable to claims that management violated its duty of care; and the intrinsic fairness test, applicable to claims that management violated it duty of loyalty.

[66] *Meinhard v. Salmon* 164N.E. 545 (N.Y. 1928).

[67] *Union Trust Co. of Maryland v. Carter* 139F. 717 (W. Va. 1905).

[68] *Mers v. Dispatch Printing Co.*, 483 N.E.2d 150, 153 (1985).

[69] *Greene v. Oliver Realty, Inc.* 526 A.2d 1192, 1196 (1987).

[70] *Pugh v. See's Candies* 171 Cal. Rptr. 917 (1981).

[71] A just-cause employment contract limits the employer's ability to severe the employment relationship for no reason. Often these contracts require the use of explicit reasons to severe the relationship.

While the courts have since backed away from this very expansive view of implied employment contracts, many of its influences are still intact. For example, *Kestenbaum v. Pennzoil* decided that a just-cause contract was created on the basis of oral statements made by the employer when the employee was hired.[72] While the employer has limited implied obligations to employees, the employee does retain the implied duty of loyalty by the employee. For example, *Jet Courier v. Mulei* determined that an employee could not solicit the employer's customers for purposes other than the benefit of the employer.[73] In *Platinum Mgmt. v. Dahms*, it was determined that an employee, deliberately delayed making appointments with various clients until he started new job, had violated his duty of loyalty to the employer.[74] Again, most all commercial relationships create implied obligations of the parties, of which can be altered by the introduction of explicit contracts, charter, etc.

3. Explicit Contractual Clauses.

Legal research regarding contracts has also identified categories of contractual provisions. Working from a lawyer's perspective, Macaulay (1963) distinguished two contractual "elements". The first element facilitates "rational planning for as many future contingencies as can be foreseen". The second element provides "actual or potential legal sanctions to induce performance of the exchange or to compensate for non-performance". Macaulay suggests that these two elements are present to varying degrees in all types of cooperative relations, which in turn promises to provide insights into how those relationships are chosen and structured.

Also from a lawyer's perspective, Fox (2002) divides contract provisions into two categories: "operative provisions" and "risk allocation". The former largely conforms to the rational planning element identified by Macaulay. Operative provisions include "the description of assets or actions, calculations of value and payment methods and mechanism to transfer assets, if necessary". Fox's risk allocation category corresponds with Macaulay's second element emphasizing legal sanctions. Examples of these clauses include representations and warranties, covenants, conditions precedent, remedial provisions and explicit definitions.

E. Summary – Putting it All Together.

Once economists shifted their focus from exclusive price mechanisms to transactions, the importance of contracts became apparent. Contracts allow for the time lag that inevitably occurs with large transactions. Contracts guide the parties as to their responsibilities and obligations. Most relative to this study, contracts allow business organizations to specialize their skills with the expectation of coordinating with partnering firms to create economic value. While a diverse approach to the study of contracts creates higher levels of understanding through the influence of multiple perspectives, it also has the potential to create misunderstandings and problematic definitions. There has been a recent movement within the strategy literature to revive

[72] *Kestenbaum v. Pennzoil Co.* 766 P2d at 286.
[73] *Jet Courier Service, Inc v.Mulei* 771 P.2d 486 (Colo. 1989).
[74] *Platinum Mgmt, Inc. v. Dahms* 666 A.2d 1028 (1995).

the study of contracts and develop insights as to the elements that make up these agreements. This interest has created a need to investigate the various contributing literatures in order to keep this investigation into contracts tractable.

A legal perspective would suggest that regardless of the nature of the commercial transaction, contractual obligations are always present. In other words, contracts are omnipresent in every hybrid transaction. The party's obligations to these arrangements are defined by the expressed and implied terms of the agreement. The implied terms of agreement can be ascertained by evidence of past dealings, industry standards or general customs, such as good faith[75]. The expressed terms of agreement are found within the explicit contract and any explicit additions subsequently made to modify the agreement. Typically, the explicit clauses of the contract control the agreement between the parties and reliance upon implied terms is deemed necessary only when there are gaps in the explicit contract. In only very specific instances do the implied terms control over explicit terms.

As economists have demonstrated, all contracts are by their very nature incomplete. Therefore, all parties to contracts will be affected by implied obligations. The extent of this influence will depend upon the parties' ability to articulate, as much as possible, the important elements of the agreement. Reliance upon detailed explicit contracts to govern transactions will reduce the influence of implied obligations. Reliance upon trust, that serves to replace explicit contracts as a governance mechanism, expands the influence of implied obligations. In addition, this exposes the parties to risks and obligations possibly not considered when deciding to structure an agreement based upon trust. It is expected that parties, attempting to encourage specific investment into the cooperative relationship, will try to avoid risks associated to implied obligations and are forced to make detailed, explicit agreements. Therefore, trust should typically have little direct role within the agreement or governance of the transactions.

Various researchers have concluded that cooperative business relationships are heavily motivated to encourage transaction specific investments in order to secure economic benefits from the relationship. Parties will govern those relationships through explicit contracts and attempt to reduce the risk associated with implied obligations. In order to understand the nature of these explicit contracts, the transaction cost and strategy literatures have traditionally relied very heavily on the concept of contractual complexity[76]. The concept serves as a proxy in the few empirical studies completed in the research of contracts; but the notion of complexity offers little or no insights into the content of individual contracts. An important contribution of this study is the effort to operationalize categories of expressed contractual terms in an effort to distinguish important differences in contracts and observe unique modifications. These categories become operational as long as we can observe consistent contractual reactions to environmental conditions. This information becomes important to researchers and practitioners, who attempt to alter contracts in response to environmental changes.

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[75] See supra, on page 29 in the text in which the implied obligations of industry standards and general customs are discussed.

[76] See supra, page 27 concerning formal contracts including the footnotes regarding contract complexity.

III. METHODS

The purpose of this study is to build a better understanding of the contracts that act as governance mechanisms for cooperative business relationships. In addition, an attempt will be made to define and operationalize types of contract provisions in an effort to investigate how contracts change under different conditions. Researchers have consistently described a distinction between contractual provisions[77], but no research has attempted to operationalize these provision categories in an effort to see whether these distinctions resonate with the attorneys that facilitate the creation and modification of formal agreements.

Cooperative business agreements offer an important opportunity to see contracts evolve as the circumstances between the partners change. This transaction environment is distinguished from discrete transactions,[78] where contract provisions typically do not vary. Discrete transactions fixate upon performance, which is typically well defined due to the proximity of time between the agreement and the completion of the transaction. Contracts for cooperative agreements offer unique challenges in that there is often a great length of time between the initial agreement and actual performance by the parties[79]. The governance of this extended time period becomes critical when the "continuity of the relationship is a source of value" (Williamson, 2005). This often extended time lag offers the opportunity for the parties to make adjustments in formal contractual agreements. These changes are often a direct result of conditions external to the agreement. Assessing these external considerations and the resulting alterations within formal agreements, this study offers the prospect of increased understanding of contracts in the business environment.

The methods portion of this study is divided into two general techniques. The first technique is designed to use inductive reasoning in order to build a clearer understanding of alliance governance mechanisms and contracts. Inductive reasoning attempts to use specific instances and observations in an effort to create generalizations.[80] This method is especially useful in instance where little theory exists. Currently, there is no specific theoretical understanding of contractual governance structures thereby necessitating the continued use of inductive assessments. This section employs a case study to gather information regarding contracts and cooperative agreements.

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[77] Supra… section on contract provisions in the literature review, page #.

[78] Based upon Economics research, the discrete transaction is characterized by a one-time intersection between the parties that seek to conduct a single transaction. The parties do not develop any type of relationship to exist outside of the single transaction.

[79] It appears as if the greater time distance creates fundamental problems when attempting to align the early contract objectives with the actual performance. Contracting parties often refocus their attention away from performance toward problems related to breach or default.

[80] Inductive reasoning attempts to use specific observations, analyze and classify those observations, and infer generalizations from those limited observations.

The case study is a form of inductive evaluation. It is a research strategy that is designed to develop theory through an assessment of unique dynamics present in a single situation that can potentially lead to wide spread generalizations (Eisenhardt, 1989). Case studies have regularly been used in the business environment, although relatively few have been developed pertaining to the governance mechanisms of cooperative business relationships (Faems et. al., 2008). The particular case presented in this study offers insights into the negotiations, development of contracts, development of initial governance structures, and the expansion of several other contracts. This particular case study is especially helpful in understanding contractual arrangements because of the two-pronged approach of the master agreement and the sub-agreements, which will be explained later.

The second technique is designed to use deductive reasoning with regards to contracts.[81] If we can create generalizations through case studies, then these generalizations can be tested. The preliminary interviews required for the case study were designed to provide the necessary tools to later build a survey to be administered to attorneys, having a certain expertise in contracts. A survey is created that is intended to test attorneys' tendencies to consistently favor certain contract provisions, given specific conditions known to exist at some stage in cooperative business arrangements. The survey has two important steps. First, certain categories of contract provisions are developed and defined. These provisions are reviewed by a panel of experts, attorneys who have extensive experience with contracts. Once a set of contract clauses have been reliably identified under specific categories, the survey can be created and administered to attorneys having some level of experience with contracts. The results are expected to demonstrate that contractual provisions are selected in response to certain conditions.

A. Case Study.

Four sets of interviews were organized in order to gather and verify data for the case study. Initial research questions included: 1) How are cooperative contracts negotiated and designed? 2) Do the conclusions from the Macaulay (1963) study still hold and how does trust play a role? 3) Are there distinct differences in contract provisions and are there general characteristics which would allow us to distinguish between them? While these research questions were by no means a comprehensive list, they did guide the discussions and scripted questions used in the interviews (Eisenhardt, 1989)[82].

At the initial meetings, two attempts were made to record the discussions. It appeared as if those conversations were much more reserved. The second participant eventually asked to have the recorder turned off. Non-recorded discussions seemed more enthusiastic in terms of providing further anecdotal information. The method to record conversations was reduced to note taking. Specific notes were taken during the

[81] Deductive reasoning takes generalizations and tests those assertions using identified members of a class.
[82] Eisenhardt (1989) argued for an initial set of "tentatively" defined research questions "making a priori specification of the contracts" with a "clean theoretical slate". The research questions are used to develop structure regarding the data received and to identify important topics to investigate.

conversations. I took special interest in insightful quotes. I re-wrote the notes and added impressions of my own within an hour of leaving the meeting. Each interview provided on average four pages of notes, which included quotes and my own impressions of the information.[83]

Table #1			
Preliminary Interviews	Structured Interviews	Clarification Interviews	Closing Interviews
7 Attorneys	2 Attorneys	1 Attorney	
3 Executives	2 Executives	1 Executive	1 Executive
Open-ended Discussions	Focused Discussions	Follow-up Discussions	Feedback Interview
Introductions and informal conversations	Scripted questions	Scripted questions of specific events	Case study results

Next, a second set of increasingly structured interviews was conducted. The primary informants, expected to be the most helpful, were identified in the initial meetings. This led to the selection of a smaller group from which more structured interviews were scheduled. The questions presented were scripted and attempted to focus the attention on specific events. Meetings with the attorneys involved became impossible and the interviews were reduced to phone conversations.

The last set of interviews was designed to answer specific questions regarding the case. Both of these interviews were phone conversations limited to twenty minutes each. These conversations were designed merely to clarify a set of questions I had while beginning to write the case study. A final feedback interview was conducted to help correct any misconstrued information. It also served to allow the participant to see the final write-up and some of the theoretical conclusions derived from the events. This last interview was an effort to test the internal validity of the case findings and ensure the conclusions were not too distant from the facts (Eisenhardt, 1989).

Like most case studies, certain efforts should be made to increase the validity of retrospective data derived from respondents. First, I made an effort to triangulate the data[84] (Eisenhardt, 1989). In this case, two separate sources were used to verify the data; interviews, as previously discussed, and internal documents. I was able to obtain copies of 49 pages of contracts and internal documents. These documents were compared to the interview notes in order to verify the findings. Second, multiple informants were used and the data was verified between informants (Miller, et. al. 1997). By the third round of interviews, the data had been checked through multiple informants, sometimes multiple times. Third, Miller et. al. (1997) also suggested to have informants

[83] Eisenhardt (1989) writes concerning the importance of taking not only notes of discussion questions, but also to "write down whatever impressions occur". Listing impressions not only "gives the researcher a head start in analysis", but it also allows a level of "flexibility" important in these studies.

[84] Triangulation of the data requires that the researcher look to distinctly separate sources of information that independently verify the same event or facts (Eisenhardt, 1989).

focus on "facts and concrete events" in order to reduce "cognitive bias and impression management". All informants were responding with regards to a specific contractual arrangement. The specificity of the event and the fact that most of these events occurred within the last year would have lessened the effect of any cognitive bias.

Two helpful tools were derived from the case analysis. First, I was able to obtain and review the contracts that were put into place between the two parties. These contracts provided a set of clauses that would later be used to develop the survey. Two, through the interview process, I was able to informally assess attorney opinions regarding the theoretical categories for contract provisions that had been presented in the past literature. The overall opinion fell in favor of Vlaar's (2008) categories of "outcome" and "process" provisions.

Table #2

Contract Provision Structures:		Research Authors:
Rational Planning	Legal Sanctions	Macaulay (1963)
Operative Provisions	Risk Allocation Provisions	Fox (2002)
Coordinative Provisions	Enforcement Provisions	Reuer & Arino (2007)
Performance Provisions	Juridical Provisions	Faems, Janssens, Madhok & Looy (2008)
Processes/Behavioral Provisions	Inputs/Outcome Provisions	Vlaar, (2008)

It was suggested that that the categories present by Vlaar (2008) were the most helpful and intuitive. This level of "intuitiveness" became especially important when these categories were presented to a panel of attorneys who became essential in the process of developing the survey instrument.

B. Survey Panel.

As previous demonstrated, researchers are consistently beginning to recognize distinct differences between contract provisions. However, these distinctions have not had the benefit of clear and consistent definitions in order to develop testable constructs. The issue of construct validity begins early in the testing process. Proper "fitting to the constructs of interest is best achieved (1) by the careful pre-experimental explication of constructs so that definitions are clear… and (2) by data analysis" (Cook & Campbell, 1979). In order for these constructs to be developed properly for later testing, they must be well defined and tested for construct validity.

In spite of the fact that prior researchers have developed several terms to describe contract provision classes, this study will propose two categories of contract provisions known as "outcome provisions" and "process provisions". Efforts have been made to explicate these constructs "so that definitions are clear and in conformity with public

understanding of the words used" (Cook & Campbell, 1979). These constructs are defined as follows.

1. Outcome Determinant Provisions.

Outcome provisions are those formalized clauses that describe "conditions" existing as a direct result of the contractual agreement or those wished to be represented in the contract. These conditions can be characterized as those expected under current assumptions about the cooperative relationship or those expected under certain contingency assumptions (in response to what-if scenarios). These conditions act as standards, concerning agreed upon events and circumstances. They represent an accord regarding the expected state of affairs and objectives. To give a few examples, outcome provisions within a contract detail the particular: legal standards, product or service standards, confidentiality standards, representation and warranty standards, and property standards. Developing a list of the characteristics of expected conditions answers the simple question of "what we want" as a result of the agreement (Stevenson, 1998). Specific examples are as follows:

Contracts do have the capacity to outline the legal system or applicable law under which the contract will be evaluated. Within the United States alone, certain states have differences regarding how specific provisions are applied. For example, the concept of what constitutes effective "notice" may have a particular set of requirements in one state and a more liberal definition in another. States may also have differences regarding their statute of limitations, being the time period within which a party must file suit. An example of this clause can read: "The terms and elements of this contract will be guided and directed under the state laws of ___." These differences become even more apparent when comparing the legal systems of different countries. In addition to the applicable law, contracts can also have the capacity to choose a specific venue, or location, in which the case would be heard and decided.

Most business cooperative agreements are designed to organize the development of a product or service. Agreed upon standards are set to facilitate coordinated understandings of what is expected regarding the relative "output" of the arrangement. Performance is often difficult to gauge in long-term contracts and typically references are made to a set of pre-existing standards or expectations. These standards often result in a number of reports geared towards giving parties important information regarding performance. An example of a provision regarding output can read: "The equipment and software installation will conform to published requirements throughout the term of an order."

Controlling industry secrets and information concerning unique firm capabilities is almost always an issue within cooperative agreements. Measures are taken to protect information from third parties in an effort to secure property and market advantages currently existing within individual parties as well as to protect property and advantages created as a result of the cooperative arrangement. Provisions regarding confidentiality create a legal liability or responsibility to maintain control over acquired information regarding a partner's secrets. An example of this can read: "Each party will make

reasonable efforts not to disclose the other party's confidential information to any third party."

Most cooperative agreements make an effort to outline specific material representations put forth by each of the parties. Stated representations provide a general understanding of a partner's assets and capabilities they are willing to contribute to the cooperative effort as well as provide conditions for breach.[85] If cooperative parties do not possess the requisite or stated assets and capabilities understood to exist during contract negotiations, the formalized representation provides a condition of breach in that the "non-breaching party" would then have the unilateral right to terminate the agreement. A representation is generally a statement of conditions prior to the agreement. An example of a contractual representation could read: "Each party asserts that all current financial information is true and accurate and provides a good representation of their financial position."

Most contractual agreements also make efforts to include warranties put forth by each of the parties. Warranties represent obligated responses by each of the parties to stated contingencies. Contracts often carefully describe the conditions or contingencies which obligate any of the parties to contractually respond. The lack of response by any of the contracting parties set up conditions of breach and the potential for more substantial liabilities. An example of a contractual warranty could read: "If a contracting party is not satisfied with any delivered equipment, party A will provide a replacement, with the identical equipment, at no additional charge."

Contractual agreements typically make assertions concerning the ownership of tangible and intangible assets contributed and created within the cooperative arrangement. Coordinated activities often pull in assets which, over time, are difficult to separate and define, in terms of title and ownership. Similar to representations, declarations of ownership state conditions at any point during the contractual agreement. Outcome provisions can clarify conditions by identifying the asset and the party who maintains title. Outcome provisions can also clarify agreements, between partnering firms, regarding the title of assets created as a direct result of the contractual arrangement. An example of this can read: "Party A assigns, grants, conveys and transfers all rights to any output of services, as a result of this agreement, for any applicable order."

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[85] This form of breach is often referred to as "adverse selection". Adverse selection occurs when a contracting partner makes a representation relative to the assets they intend to bring to the cooperative effort, but in reality, they do not current possess or control said assets (Barney & Hesterly, 2008). Due process activities, typically done by attorneys and accountants, are efforts to minimize the possibility of adverse selection by verifying the existence of certain assets. The due process procedures become increasingly complicated when attempting to verify the existence of certain capabilities, as opposed to tangible assets, possessed by the firm. Representations may also describe promises to allocate resources to the partnership that the firm does in fact possess. A breach occurs when the partner, although possessing the resource, chooses not to allocate the resource for the benefit of the cooperative relationship, or chooses to allocate a resource of lesser value than was promised. This type of breach is referred to as "moral hazard" (Barney & Hesterly, 2008). Further definition of these terms can be found in Barney, J. B. & Ouchi, W. G. 1986. *Organizational economics*. San Francisco: Josey-Bass.

2. Process Determinant Provisions.

Process provisions are those formalized clauses that describe joint or complimentary "operational activities" existing as a direct result of the contractual agreement. These provisions include those expected under current assumptions and those expected under contingency assumptions (in response to "what if" scenarios). Process provisions codify activities and behaviors through which parties achieve contract objectives. Basically, these provisions outline "how" outcome conditions are realized. To give a few examples, process provisions within a contractual agreement detail: resource accessibility, work schedules, transaction orders, pricing mechanisms, payment, and necessary confidentiality disclosures.

Process clauses are mostly overlooked by researchers attempting to understand the characteristics and components of contracts. These clauses are unique to the circumstances in which they are written. In other words, because these provisions are so specific to the business activities they are designed to describe, it becomes difficult to create categories to generally portray them. In other words, making generalities concerning the collaborative activities of one contract are difficult to use when attempting to assess the collaborative activities of another contract.

Complementary activities between cooperative business partners often require accessibility to assets owned by the other partner. This is not an issue of title and therefore not an outcome provision. If possible, contracts often specifically designate the asset(s) requiring accessibility. An example of this type of provision may read: "Parties will permit each other and their agents to use or access, all hardware, software and workspace."

Process provisions can also articulate the designated work schedules or work parameters. Often, this provision is an attempt to coordinate complementary activities throughout the partnership. This can also work to specify precise divisions of labor, responsibilities and information flows, especially when considering larger projects. An example of this type of provision can read: "Maintenance services will be provided during standard working hours."

Transaction orders are specific descriptions of identified transactions. While cooperative agreements can cover large periods of time, orders discuss individual transactions at any point in time. The individual order is distinguished from the collaborative agreement in that performance of the order may discharge any liability created by the order, this same performance does not however discharge the responsibilities each party has to the contractual agreement. Process provisions may discuss details related to the activities surrounding orders, such as: time limits, notice, receipt and formalities (such as required signatories). A process provision that describe transaction orders could read: "Orders may be submitted via hard copy or electronic means."

Pricing information can often be described as a predetermined process. Pricing and the ascertainment of pricing can be described in great detail. Typically for inter-

firm transactions, pricing is determined through some form of agreed upon calculation. A process provision involving pricing may read as: "Pricing will be set forth in each order".

Often complementing price information is a detailed understanding of payment schedules. Payment schedules dictate the rules of payment, the time between delivery and final payment, and the terms for late payment. Late payment schedule are considered process provisions up to the point of default. After default or breach of contract, the agreed remedies are no longer considered process. An example of this type of provision can read: "For any payment not received within 30 days of the due date, the parties agree to pay a late charge of 5% of the amount due."

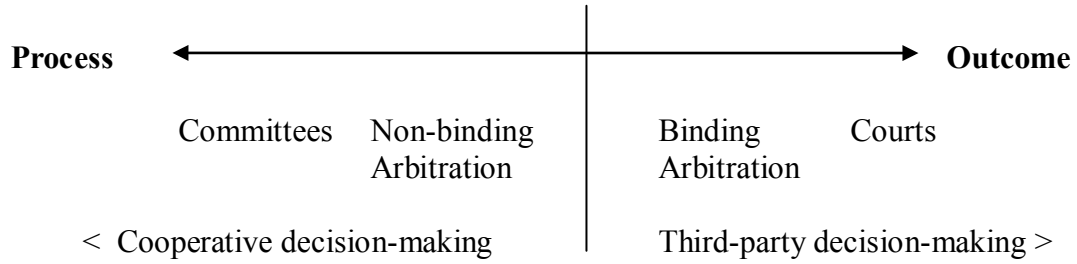
While the provisions that protect confidential information are similar to asset title issues, a provision concerning the receipt of confidential information is similar to acquiring access of assets. Provisions are often placed into contracts to insure that the parties will have access to confidential information possessed by their partners. Outcome provisions are also used to insure that the parties protect confidential information from third parties. A process provision regarding access to confidential information may read as: "Each party will disclose to the other certain business information identified as confidential".

3. Provision Clarifications

A few sets of provisions have need for further clarification to determine whether the clause is an outcome provision or a process provision. These clarifications are the result of a pre-test completed with the help of two attorneys, before the panel was selected. A pattern begins to emerge with each explanation. If a general sense of control (of the processes, decisions or property) remains within the partnership, the provision is most likely a process provision. If control is relinquished to a third party (competitors, mediators or courts), the provision is most likely an outcome provision. This distinction is similar to the "juridical clause", discussed by Faems et. al. (2008), in which these provisions attempt to define conditions with respect to third-parties. The following explanations attempted to clarify those subtle distinctions between provisions that were more difficult to classify:

Dispute provisions.

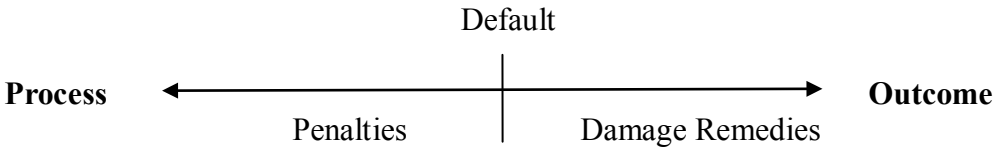
Dispute provisions are not intended to produce an entirely new set or category of contract clauses. These provisions provide a prescribed description of intended responses to contingencies; contingencies which occur as a direct result of disputes regarding the contractual agreement. The division between those dispute provisions considered "process" and those provisions considered "outcome" depends upon the level of control over the final decision. If the parties abdicate control of the dispute outcome to a third party as, for example, parties do in the courts and within binding arbitration, the provision is considered "outcome". If the parties do not abdicate control of the dispute outcome to a third party, as for example, non-binding arbitration or committees, the provision is considered "process".



Penalties and Remedies.

Performance of the contract is the primary method in which the parties fulfill their obligations and terminate their liabilities to a contractual agreement. Longer-term contracts are unique in that performance is often difficult to define, making fulfillment of contractual obligations difficult to judge. Therefore, parties to longer-term contracts often turn their attention from performance and instead emphasize contractual default. Contractual penalties incentivize parties to make payment, but keep the parties from contractual default and are consider "process" provisions. Contractual penalties allow the offending party the opportunity to avoid contractual default and provide the "means" to come back into full compliance. Based upon this reasoning, agreed upon penalties are "process" provisions as long as they are not a direct result of contractual default.

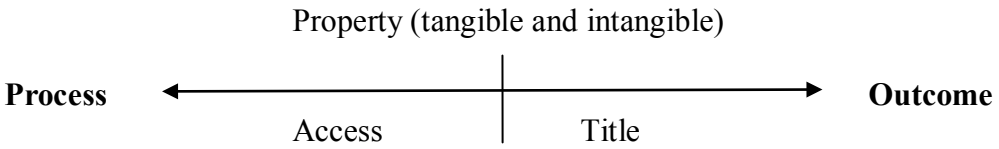
Contractual default occurs when one or more of the contracting parties are unable or/and unwilling to perform. For example, liquidated damages are sometimes calculated in order to define the penalty obligation as a direct result of contractual default. These damages are expected to compensate the non-defaulting party for any negative consequences of the contract default. These damages are also theorized to coerce parties to comply with their agreements and encourage performance. However, once default occurs, the pre-determined damages are assess and a direct outcome of the default. Based upon this, damages assessed as a result of contractual default are considered outcome provisions. Remedies are often assessed after the parties experience contractual default and therefore are labeled "outcome" provisions.



Access and Title.

As previous discussed, firms often have to add provisions that protect firm property rights and provisions that allow access to property within the cooperative effort. Property includes those assets both tangible and intangible. The protection of property rights include provisions that appear to fall under three categories: those provisions that

define existing property rights, provisions that define property right of assets created as a direct result of the partnership and those provisions that create protections for intangible property such as goodwill and trade secrets. Other provisions are designed merely to allow access by the partnering firms. Access may be granted to tangible assets such as equipment or records, or intangible assets such as internal capabilities and trade secrets.



4. Construct Validity.

A panel of experts was designed to test the convergent and discriminate validity of the constructs. Once clear definitions of the constructs have been completed, the construct should be tested. "…assessing construct validity depends on two processes: first, testing for convergence across different measures or manipulations of the same thing and, second, testing for a divergence between measures and manipulations of related but conceptually distinct things" (Cook & Campbell, 1979). Convergent validity assesses "the tendency for different measurement operations to converge on the same underlying trait" (Loehlin, 1998). Divergent validity assesses "the ability to discriminate among different traits (Loehlin, 1998).

With definitions of the two contract provision constructs formulated in the previous section, a panel of experts was organized to designate example contract clauses as either outcome provisions or process provisions. The case study provided several contracts from which to extract contract provisions. An attempt was made to find provisions that covered as many topics as possible. When completed, the list of provisions included fifty contract clauses that seemed to represent almost all aspects of the contractual agreement. Admittedly, I attempted to provide as many contract clauses representing each category although no attempt was made to divide the list in half between what I perceived to be outcome provisions and process provisions. Each clause is described in a single sentence even though the contract provisions, from which they came, were often described in paragraph. The purpose of this was to reduce the complexity of each provision in order to allow the panel experts to cover more ground and increase the number of decisions they made concerning the classification of each provision. A one-page explanation of the definitions was given to the panel participants. Each participant was asked to classify all fifty contract clauses as: outcome (O), process (P), or left blank in that they did not fit into either category. (See Appendix #1)

The expert panel was selected based upon their experience with contracts. The entire panel consisted of eight attorneys. This group make-up consisted of three attorneys acting as corporate general counsels, three attorneys specializing in property and energy contracts, and two attorneys working as independent counsels in commercial

and property law, both having served in political office. The assessments of the clauses were done independently, eliminating any conversations that would alter the attorney's first impressions. The feedback was collected and organized relative to the grouping, whether outcome or process, and assessed regarding the strength of the classification. Many of the provisions received unanimous votes regarding their classification. This process served to test both convergent validity (fifty items were categorized) and discriminate validity (most of the items consistently fell within one of the two categories). The contract provisions that were "most consistently" classified under one of the two definitions were selected to represent the constructs in the survey instrument.

C. Survey Instrument.

The survey instrument seeks to extract information regarding an attorney's tendency regarding the selection of contract provisions within a governance structure. The targeted participants for the survey are attorneys. The logic of the survey is that environmental conditions (independent variables) should have a direct effect on the selection of contract provisions (dependent variables). The results of this survey should further validate the constructs representing the contract provisions. The dependent variables are the previously discussed constructs: outcome provisions and process provisions. The environmental conditions that should effect the selection of the contract provisions are taken from the analysis of transaction cost economics, as describe by Williamson and other researchers. First, the independent variables portraying the environmental conditions should be discussed. Second, the organization of the survey instrument is specified.

Williamson (1991) expressed that transaction cost economics is really an effort to "align transactions, which differ in their attributes, with governance structures, which differ in their costs and competencies, in a discriminating way". Differences that exist in contracts, acting as governance structures, are merely reflections of the unique circumstances in which the parties find themselves. Taking cues from the Shelanski & Klien (1999) discussion of transaction cost economics, necessary changes in the governance of transactions depends upon: 1) the "frequency" with which the transactions occur with a particular trading partner, 2) the degree of "relationship specific assets", 2) the "amount of uncertainty about the future", 3) the "complexity of the trading arrangement", and 4). Accepting this logic, I have attempted to use these differing environmental circumstances as independent variables and test whether their existence will created differences relative to the types of contract provisions that attorneys have a tendency to select.

Past experience with trading partners has been shown to have an effect on the party's willingness and ability to develop contractual relationships (Dyer and Singh, 1998; Bagley, 2008). Experience is determined by the "frequency" of the transactions, which has been shown to have an effect on the governance structures employed (Dyer & Singh, 1998). Prior experience increases the possibility that the partnering firms have developed important routines and expectations of each other. More specifically, the

level of experience the partners have in conducting transactions should alter the selection of contract provisions governing the relationship.

The investment in asset specific investments has been the most studied factor when considering the nature of the governance structure within the transaction cost arguments (Chiles & McMackin, 1996). Asset specificity refers to the extent in which that value of the asset is dependent upon the existence of the transaction relationship (Williamson, 1985). These assets are specialized to such an extent that they can only be used at a much lower value in alternative applications. The degree to which the partnership must invest in such assets should have an effect on the selection of contract provisions governing the relationship.

Performance measures are often difficult to understand, even within a partnership. This misunderstanding is not only created by a limited perspective, as described through bounded rationality, but also compounded by the asymmetric conditions of information. Williamson (1985) describes performance measures as "the ways by which better to assure a closer correspondence between deeds and awards". The degree to which the individual parties of a partnership can understand performance as it is measured and reported should have an effect on the selection of contract provisions.

Williamson (1985) describes uncertainty as a condition in the market place "associated with unique events". "The occasion to make successive adaptations arises because of the impossibility (or costliness) of enumerating all possible contingencies and/or stipulating appropriate adaptations to them in advance." (Williamson, 1985)[86] Williamson describes uncertainty as an "exogenous disturbance", which is affected by both behavioral and environmental conditions. The effects of bounded rationality limit the party's ability to predict future conditions. The ability or inability to predict general market conditions should have an effect on the selection of contract provisions that govern the cooperative relationship.

The organization of the survey instrument attempts to capture each of the independent variables in contrasting conditions. (table #3) For example, the independent variable that describes the "past experience with contracting partner" is presented twice; once indicating extensive past experience and a second time indicating no past experience. The expectation is that the contract provision decisions will change when faced with contrasting conditions. Attorneys may have tendency to select an outcome provision or process provision when faced with "extensive past experience" and select the opposing provision when faced with "no past experience". To the degree that respondents do differentiate between the contrasting contract provisions when faced with contrasting conditions, the survey will increase the validity of the construct and the

[86] Williamson (1985) also included the nature of "behavioral uncertainty" which would include the intentions of any partners to behave opportunistically, similar to what is assumed within open marketplace conditions. Williamson states that, "Uncertainty of a strategic kind is attributable to opportunism and will be referred to as behavioral uncertainty." However, the behavioral attributes of uncertainty are not specifically included in this model in favor of considering the general market conditions only.

internal validity of the survey model. More importantly, the success of the survey will make a contribution to our understanding of contracts and operationalize constructs for further study.

Table #3		
Independent Variable		**Circumstance Descriptions**
Past Experience with Contracting Partner	+	Extensive past experience with partnering firm.
	-	No past experience contracting with this firm.
Specific Capital Investments	+	Extensive investments in equipment.
	-	Not require new investments of capital or time.
Performance Measures	+	Readily transparent and progress easy to assess.
	-	Difficult to measure performance of partner.
Market Conditions	+	Stable conditions, easy to predict.
	-	Unstable market conditions, difficult to predict.

IV. CASE STUDY

The case study I have selected for observation concerns a strategic alliance between two large firms, both incorporated and conducting business primarily in the United States, but both having extensive activities abroad. This particular alliance is between a large North American based Retailer (RETAILER) and a large technology firm (ITSUPPLIER), which supplies advanced equipment and software, especially designed for business application. The selection of this answered specific calls to research case studies regarding different sorts of alliances. The current need is "to study other forms of contracting, in particular inter-firm partnerships where technology is not of primary importance (eg. marketing partnerships, customer-supplier relationships, outsourcing, co-production contracts)"[87] (Hagedorn & Hesen, 2007). This particular partnership, while starting out resembling a customer-supplier relationship, edged closer to a marketing partnership as time went on.

I selected this alliance intended for this study for practical as well as academic reasons. First, and the most practical of all reasons, I was offered access to both the contracts and the personnel involved with initiating the relationship, developing the contracts, modifying the relationship with further contracts and implementing the business activities. Second, the contractual arrangement is relatively new suggesting the alliance relationship has evolved relatively quickly since the beginning negotiations. Participants have been able to witness relationships build quickly, sometimes out of pure

[87] A few examples of the resent research: The primary source of data regarding inter-firm contractual relationships has been the case study. Hagedoorn & Hesen (2007) reviewed four technology based case studies. Faems et. al. (2008) used two case studies, both with the same two alliance partners, under two sets of contracts regarding the development of a new technology.

necessity. Recollection of events would be relatively "fresh". Third, this particular alliance has been structured and formalized through a series of contracts which tie and make reference to one another. Larger organizations, such as these, have been linked to higher levels of formalization (Zeffane, 1989). Fourth, unlike other studies, with the possible exception being Macaulay (1963), both executives and attorneys from both companies are involved in the interviews. This gives a unique perspective on the interactions between executives and attorneys within the context of developing and executing contracts in an alliance.

The purpose of this case study is to inductively develop a more in-depth understanding of alliance governance. Seventeen interviews were conducted of varying length of time. Interviews began as relatively unstructured conversations concerning the alliance relationship. Attempts were made to record conversations, however, the informants communicated their dislike of being recorded and the practice was abandoned. Written notes were taken and transcribed into progressively more organized facts. Both face-to-face and phone interviews were conducted. Subsequent interviews were held to clarify facts and further make clear some of the quotes. A final interview was conducted with an executive to go over the case as written to make sure the injections of theoretical reasoning did not alter the facts relative to the case study. All information concerning the events, people and documents was expected to be maintained confidential. As promised, the case study was sent to all the participants.

A. Case Study.

This particular alliance emerged out of necessity. RETAILER made a strategic choice to offer a specialized mix of business services. RETAILER committed to create "business centers" as a new retail outlet. These business centers would be specifically designed to cater to small business needs regarding storage, copying, printing and technology interfaces. RETAILER made several inquiries concerning the expected level of competition within this specialized market. Relative to the needed equipment and the service skills, RETAILER realized they had little to no expertise in this area and opted to search for a partner to provide the capabilities to develop these business centers.

In the analysis conducted by RETAILER, ITSUPPLIER emerged as one of the few firms that could offer the level of expertise, hardware and software, and service necessary to implement this new service to business customers.

> "We have some of the best equipment in the marketplace today. Some of the equipment is so sophisticated that it requires specialized service. Since we consider ourselves to be a service firm that offers equipment and not an equipment firm that offers some service, we were especially suited for the project." (ITSUPPLIER Executive)

ITSUPPLIER possessed a unique combination of qualified personnel and high tech equipment. In addition to the capability requirements, RETAILER was also constrained by a self-imposed time constraint. ITSUPPLIER was further distinguished in that it was one of the few firms with the capabilities to perform within the accepted time frame.

"We had set our completion dates relative to a new store that was opening. We did not want our new store to open without the business center completed. The completion date was extremely important to us." (RETAILER Executive)

ITSUPPLIER, on the other hand, had made previous attempts to develop a business relationship with RETAILER. RETAILER's enormous size and organizational complexity made it a prime candidate for ITSUPPLIER's equipment and services.

"We had up to this point little to no significant working relationship with RETAILER. We had tried for years to find way to get their business, but they had had a relationship with an IT equipment provider for several years and it did not look as if that was going to change soon." (ITSUPPLIER Executive)

RETAILER had historically maintained strong, long-term, supplier-customer relationships with other technology firms making ITSUPPLIER's chances of engaging in a business relationship to this point minimal. The "business centers" were recognized as a prime opportunity for ITSUPPLIER to develop an initial working relationship with the hope of a longer-term cooperative business relationship. What ITSUPPLIER had originally perceived as a relatively simple supplier-customer, almost discrete transaction, relationship turned into a longer-term contractual alliance resulting in several contracts and operational opportunities.

Within the initial negotiations, RETAILER and ITSUPPLIER conducted what was referred to as a "knowledge exchange workshop" (KEW).[88] This particular workshop was an initial attempt to make agreements as to the final make-up of the business centers. For the most part, these workshops were opportunities for RETAILER to define "exactly what they wanted to have happen". RETAILER was particularly concerned with the dates of completion and wanted to make sure that, although they were interested in providing the best service for their customers, the dates designated for completion were met. ITSUPPLIER quickly provided the specifications for the necessary equipment and the project was able to begin, even without a completed final contract.

RETAILER was so focused on completing the business center on time that a lot of time in the KEW was spent giving them the specs on the equipment… so that they would have the information to build." (ITSUPPLIER Executive)

[88] The "Knowledge Exchange Workshop" is a systematic approach, developed by IT SUPPLIER, to develop a detailed understanding of customers, as well as, business partners. It is portrayed as representing the DEFINE stage of the Six Sigma Methodology. This approach helps to breakdown and analyzes business issues and concerns deemed important by either of the partners. It also attempts to include in the analysis any "compelling events" and their expected effects. Ultimately, this approach is expected to develop a set of "initial solutions" that are acceptable to all parties involved. ITSUPPLIER considered this approach to be an industry standard and both parties appeared to be acquainted with the terminologies. This stage of the process develops a detailed report of the initial objectives with a list of details necessary to implement the process. (ITSUPPLIER Internal documentation)

The initial attempt to formalize an agreement was focused on creating a "master agreement"[89]. This master agreement would detail all representations and warranties of both parties. Early in the process, it was expected that after the master agreement was completed, all other agreements would be effectively attached to the master agreement through reference. In other words, any other transactions conducted between ITSUPPLIER and RETAILER would be guided by the terms and conditions of the master agreement. The details of the transaction would be considered addendums to the master agreement. This bifurcation of the contracts is an effort to reduce the cost of contracting for each individual transaction. Once the master was completed, ITSUPPLIER would then have the "inside track" to not only this particular project, but to any others that might be organized.

> "The real costs of contracting are in making this initial agreement. If we can complete this, all other agreements just reference the master agreement and it cuts down on the time and money of further agreements" (ITSUPPLIER Attorney)

The master agreement contained provisions that dealt with various issues related to representations, jurisdiction, warranties, indemnifications, assignment to third parties, remedies, payment, and a few provisions relating to equipment capacity and title. There were no references to the business centers or any other specific transaction. A majority of these provisions dealt with conditions based upon a specified set of contingencies raised by both parties.

> "The work of the attorney, and the sign of a good attorney, is the ability to include as many contingencies as necessary. If there is some possible outcome, you want to have a response…" (ITSUPPLIER Attorney)

> Another attorney observed that "when it comes to contract negotiations, the attorneys negotiate primarily over contingencies, and try to affect the consequences of any of these possibilities. That's where the real battle is…" (ITSUPPLIER Attorney)

Attempts to complete the master agreement within the time constraint failed. The delays in the contract negotiations were centered around three issues. The first issue of concern was the jurisdiction of the agreement. The corporate offices of the parties

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[89] The master agreement is also referred to as a "master service agreement". This agreement is especially designed for business relationships expected to be maintained over longer periods of time. This contracting approach bifurcates the formal contractual agreement. The master contract is designed to govern general terms and conditions between the parties. The subsequent agreements, or sub-agreements, representing the actual transactions between the parties are referred to as "orders". Orders describe transactions and make reference to the master agreement as a controlling document. The parties also have "addendums" which are designed to make changes to the master agreement or make additions or exceptions only for the individual orders. The system is designed to reduce the time it takes for a firm's legal experts to negotiate transactions between business partners. Attorneys have only to review the order and compare it to the master agreement in order to give approval. It is generally expected that the master agreements come under review to update every two to four years. Attorneys often mention that master agreements, often lying in the background, go unnoticed for long periods of time by the business executives. Updating these master agreements appeared to be a point of conflict between lawyers, trying to keep these agreements current, and executives who rarely review these larger, more detailed agreements.

were in separate states. Corporate attorneys typically have their expertise in the laws of specific states. If the jurisdiction was decided to exist outside of the state, the foreign corporation may incur the costs of hiring attorneys outside of their state. Typically, the laws between the states are relatively standard, with few exceptions. Had the contract just centered on relatively discrete transactions of goods, the Uniform Commercial Code, which has been ratified at least in part by every state within the United States, would have prevailed and the rules would have been relatively standard across the states. If the contracts deal with transactions that occur within relationships such as alliances, many UCC established standards may not directly apply and the state differences may have been more profound.

The last two concerns dealt with contingencies regarding property. ITSUPPLIER wanted RETAILER to indemnify them of any liability relative to the equipment. RETAILER wanted to increase the specified liabilities to their building, also related to the equipment. In addition, RETAILER wanted to increase the indemnity amounts for any liability created by an injury to a customer. While these issues were not insurmountable, they did place delays on the completion of the master agreement. Another solution for this first project had to found.

The two parties quickly overcame this failure[90], or at least delay, by developing a short-term agreement that solved the immediate concerns of the parties and allowed more time for the master agreement to be completed. Attorneys for both parties developed what was later referred to as the "trial agreement". First, the parties agreed that the agreement would be subject to the law of New York, which solved the question of jurisdiction. The question of liability was also address in the trial agreement. The trial contract stated that even though the equipment was installed and placed into operation, the:

> "Equipment shall remain personal property, and you will not attach any of it as a fixture to any real estate or make any permanent alterations to any of it". (Trial Agreement)

The effect of this provision was to maintain the parties' liabilities to the extent of their investments into the project. ITSUPPLIER would be assured the equipment would not be altered and, since title would not pass upon installation, they held all liabilities for their own equipment. RETAILER would not take actual title of the equipment which limited their own liability for its usage. In effect, the equipment would be installed and maintained on a limited "trial bases". No payment would be required until the master agreement was completed.

These solutions seemed to overcome both parties' initial objections and allowed the project to continue on time. The trial agreement was designed to cover "60 days", which allowed for the master agreement to be completed. Once completed, the trial agreement was augmented with two addendums which effectively transferred the title of the equipment to RETAILER, increased indemnification limits for ITSUPPLIER on

[90] When I started to gather information regarding this initial project, the inability to timely develop a master agreement placed the entire project in jeopardy. To the executives related to the project, this constituted a failure at the time. The attorneys involved developed a short-term solution that overcame these problems.

RETAILER's behalf, and made the entire agreement for this specific transaction subject to the master agreement.

The effects of this master agreement were almost immediate. By the time the master agreement was completed, ITSUPPLIER had three other smaller projects with RETAILER, not related to this initial venture. The first set of addendums was designed to attach all the existing contracts to the master agreement.

> "The intent of the master agreement was to make an investment in our future relationship. Once the master agreement was completed, all other "sub-contracts" would make reference to the master making it easier for legal to review the new projects." (ITSUPPLIER Executive)

The master agreement appears to have been important to the development and implementation of several other contracts, often referred to as "sub-agreements" or "addendums"[91]. By the end of the interview process pertaining to this study, seven other contracts had been developed applying the recently developed master agreement as a controlling document (ITSUPPLIER Contract Chart).

B. Case Study Observations.

While the business aspect of this particular cooperative agreement was still being played out by the end of the interview process, it appeared as if the contractual format had been successfully established. A few general observations should be covered concerning the case study data. First, the academic literature within economics has extensively studied the rational for long-term and/or short-term contracts. Existing research has compared the rigid application of a single contract as opposed to the application of multiple, smaller contracts. It appeared as if the arrangement between RETAILER and ITSUPPLIER was attempting to reap the benefits of both, long and short-term contract practices. Second, the case provided an opportunity to reflect on whether the same conditions between business managers and the use of contracts, as was observed by Macaulay (1963), were still applicable. Third, a simple observation of the contractual agreements demonstrated that each contract, master and sub-agreement, tended to emphasize a distinct set of provisions. This distinction may reinforce the proposed constructs of outcome provisions and process provisions.

The contracting practice of using a series of short-term contracts has been studied for some time (Crawford, 1988). The argument was that contractual relationships typically exist longer than the contracts they use to govern their relationships. Longer-term contracts are inflexible and notoriously incomplete. Short-term contracts are typically based upon more accessible information making them more complete and efficient. However, Crawford (1988) points out that short-term contract may not be the supportive mechanisms to encourage further investment in "relationship specific investments". Therefore, it has been theorized that while the short-term contract

[91] While addendums have a specific legal meaning, the business executives interviewed often referred to the sub-contracts (orders referencing and applying the provisions of the master agreement) as addendums. From the attorney's perspective, addendums are used to either change the master agreement or used in an order to create exceptions or additions to that specific transaction.

does encourage rational planning because of the added information of relevant events, it tends not to promote incentives for long-term investment. Short-term contracts have also been associated to inefficiencies due to opportunistic market behavior such as price gouging (Farrell & Shapiro, 1989).

It would appear that the bifurcated agreements attempt to provide the benefits of both long-term and short-term contractual agreements. The master agreement tends to design governance mechanisms for the long-term business relationship. It attempts to provide predetermine outcomes or conditions for a multitude of contingencies and makes representations that are the result of significant due diligence efforts. These contracts are expensive to develop and, in turn, increase the switching cost to the parties involved.[92] These high switching costs motivate parties to maintain their existing contractual relationships, possibly to the point where other relationship-specific investments can be justified by the parties. Therefore, it appears as if the master agreement is "long-term oriented" enough to encourage long-term, specific investments and discourages the opportunistic behavior concerns of the market place.

The sub-agreements, or orders, tend to increase the specifics of the individual transactions. The time horizon tends to be shorter and easier to predict. The set of contingencies that need consideration are minimal. The sub-agreement "attaches" itself to the master agreement by merely constructing a clause that states that "all the provisions of the master agreement apply". The sub-agreement has the protection of the master agreement and all the flexibility to make relevant contractual agreements at a fraction of the cost. An attorney mentioned that parties who use this system:

> "Tend to reduce the cost of contracting. I receive an order that gives me enough information to understand the transaction. I only have to compare the order to the master agreement to insure no material conflicts. This saves money and time". (RETAILER Attorney)[93]

As discussed previously, the study conducted by Macaulay in 1963 asserted that transactions conducted by collaborating business partners were governed by other mechanisms than the exclusive use of contracts. Macaulay pointed to various instances in which contractual agreements where avoided in an effort to evade the cost of formal agreements. The present case study offered an opportunity to explore whether the Macaulay conclusions still hold or should we view the Macaulay conclusion as merely an artifact of practices that have long changed.

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[92] Much of the economic analysis of contracts tends to analyze short-term and long-term contracts under the assumption of zero costs for contract design and formation. Management literatures have taken note of the cost of contract formation and argued the benefits of non-contractual governance mechanisms. Business attorneys and executives seem to be very sensitive to the costs associated to the formation of contracts. Depending upon the detail, contracts can be very expensive to create. The high costs of these contracts appear to have created a significant justification to maintain existing relationships.

[93] This particular attorney mentioned this practice as an industry standard. Even older contracts were being reviewed to see if they could be converted to this bifurcated system. Instances where a completely new, complex contract had to be developed for every transaction were considered extremely rare.

The dealings between ITSUPPLIER and RETAILER suggest that opinions relative to contracts have changed to some extent. When asked whether the project could have gone forward without contracts, the reply from executives from both companies was "absolutely not!" Their primary concern revolved around the "risk of being sued". They were, however, willing to work together with the understanding that a contract was eminent. ITSUPPLIER was also highly motivated to create a working relationship with RETAILER and would have exercised enormous patience regarding the completion of a contract. This is in line with research that asserts that it would not be uncommon for a less powerful party to engage and commit to a relationship with a more powerful party as long as the long as the potential pay-off is higher than the potential costs associated with any opportunistic behavior (Zajac & Olsen, 1993). Based upon the brief discussions within this case study, the current state of business practices may suggest changes are needed regarding our understanding of contracts.

However, four important issues may serve to explain the differences between the Macaulay conclusions and the current case study. First, when questioned whether larger firms require more formalization with regard to contracts, the response by executives was "Yes, without question!" (ITSUPPLIER Executives). The practice observed by Macaulay may have been by smaller firms requiring less formality in their transactions. This would be consistent with research regarding the formality requirements of larger organizations (Zeffane, 1989).

Second, the use of modern information systems and different contracting practices may have combined to increased efficiencies with regard to contract reviews. It is likely that the "red tape" experienced by business people observed by Macaulay does not exist to the same extent. The reduced cost of contract reviews may be more acceptable given the modern risk of lawsuits. In addition, the Macaulay description of the lawyers and businessmen typically finds them in conflict regarding the business transaction. Businessmen are frustrated by the "red tape" created by attorneys. Lawyers become frustrated over risky, unstructured business practices. The attorneys and executive in this case were typically perceived as "professional and helpful" on both sides. To a large degree, the attorneys saved the deal regarding the first business center by quickly developing the trial agreement, while the master agreement was still being negotiated. This is in stark contrast to the Macaulay observations.

Third, lawyers for both ITSUPPLIER and RETAILER had great concerns over implied obligations relative to their firm activities and industry practices. One attorney observed that:

> "We have spent a lot of time planning and talking to one another (making reference to the KEW experience) and we do not need unintended liabilities, just because we neglect to complete a formal agreement". (RETAILER Attorney)

The cost of these liabilities, given over forty five years of legal experience since Macaulay, may have motivated parties to formalize their agreements to avoid unintended consequences.

Lastly, a final element may also distinguish modern contract practices portrayed in this case from the conclusions of Macaulay and more recent management literature. This regards the use of trust as a governance mechanism for cooperative business relationships. RETAILER and ITSUPPLIER did in fact display an element of trust with regards to the initial negotiations. One attorney observed that:

> "Trust is great, especially when the parties start to negotiate their deal. For example, the due diligence process absolutely relies upon trust between the parties. You have to trust that the other firm is giving you the right information". (ITSUPPLIER Attorney)

When encouraged to talk further about trust within a collaborative relationship, this same attorney also observed that:

> "But trust has a problem… It has no successor of interest"

This viewpoint is in line with past research that has suggested that moving key personnel, involved in collaborative projects, is detrimental to the project (de Rond & Bouchikhi, 2004; Ring & Van de Ven, 1994; Doz 1988)[94]. Current research has ignored recognizing this serious deficiency of trust relationships, when emphasizing relational governance structures.

Based upon this limitation and others, most attorneys recognized that trust has limited benefits for long-term business relationships. But this is a conclusion that would be expected coming from attorneys that typically favor contracts. However, the executives involved in this case were also asked about "trust" and their response very similar if not more forceful. An executive stated:

> "I do not trust anyone… I do learn about people and how their businesses work, but I don't trust them and I expect that they don't trust me… that's why we have contracts". (ITSUPPLIER Executive)

This response may be a product of working for a larger firm whose personnel have been conditioned to expect more formalized structures. It may be difficult to generalize these statements to smaller firms which may not require this level of formalization. However, this finding is in line with a recent research case study by Faem et. al. (2008), in which the study did not find that the emergence of "trust dynamics reduced the importance of contracts as governance mechanisms". This study went on to state that "Although previous studies have suggested that, as positive trust dynamics emerge in alliances, formal contracts are pushed to the background and norms of fairness, honesty, and

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[94] Faems et. al. (2008) suggested that changing personal "hugely contributed to the positive trust dynamics". However, this particular study focused on two consecutive contractual interactions between the same partners from which the first interaction failed and the second succeeded. It was observed that a change in the personnel changed the contract, which changed the relational interactions, which changed the outcome from negative to positive. Taking a failed interaction between the contracting parties and changing the personnel resulting in a positive outcome is at best weak evidence that mobility of key persons during collaborative projects contributes to positive trust dynamics. It is possible that the skills sets of the new personnel involved were merely more compatible to the increased relational interactions that were later apparent and which added to the success of the second contract. This also potentially undermines the researcher's argument that a change in the contracting practices changed the outcome of the interaction. However, an argument regarding the benefits of changing personnel in a collaborative project is going to have to be made in order to justify relational structures governing long-term relationships. Nothing less than this will overcome the simple observation that, "trust… has no successor of interest". It is a simple fact that long-term contractual relationships typically outlast the people initially involved.

reciprocity take on a powerful role in governing the alliances, our data showed that the contract remained an important safeguarding and coordinating device, even after positive trust dynamics emerged in the … alliance." (Faems et. al., 2008)

Based upon observations of the contracts, distinctions between the provisions in the master agreement and those contained in the sub-agreements, or orders, are apparent. This bifurcated system of contracts creates documents that have a tendency to emphasize certain provisions over others. The master agreement contains provisions that cover topics such as representations, general warranties, title of property, notices, payment, arbitration, indemnification, access to property and confidentiality. The master agreement covers issues especially related to contingencies. Based upon the definitions presented in this study, it can easily be argued that the master agreement contained a majority of "outcome" provisions, for both expected and contingent conditions.

One the other hand, the sub-agreements are based upon shorter time horizons. Very few contingencies are written into the agreement. Provisions are included into the agreement that make reference to the master agreement as a controlling agreement. The sub-agreements agree to all the provisions put forth in the master agreement, unless there is added an addendum to the order. A few of the sub-agreements contained provisions that exempted certain provisions found in the master agreement relative to the transaction they covered. The sub-agreements contains provisions that generally cover topics such as reports, timetables, resource accessibility, payment schedules and penalties for non-payment and a detailed description of the object or service covered in the transaction. Based upon the definitions presented in this study, it can also be easily argued that sub-agreements, or orders, contain a majority of "process" provisions, primarily for expected conditions with little coverage of contingencies.

The case study regarding the alliance activities of RETAILER and ITSUPPLIER provided insights into a cooperative business relationship that was created to exploit a specific market opportunity. The manner in which the contracts were set up appeared to give the partnership the benefits of both long-term and short-term contracts. Efficiencies in contracting might suggest the argument between contracts of different time horizons to be mute. These findings may also suggest that the observations described by Macaulay (1963) do not appear to apply. This case study, in addition to another recent research study, appears to agree that the existence of trust does not come forward to replace the use of contracts within alliance activities, as is suggested by other research in management. The observations of the contracts within this study also demonstrate that there exist distinctions between contract provisions, depending upon what is the intended purpose of the contractual agreement. This is in line with several research studies that have observed similar distinctions among contract provisions.

V. SURVEY

The purpose of this survey is to introduce deductive reasoning to the study of contracts and their design. Much of the research regarding inter-firm contracts has focused on distinctions between relational (trust) and structural (contracts) mechanisms. However, researchers have made several attempts to design and define categories for contract provisions. Their attempts have been helpful, but not definitive enough to develop "provision constructs" from which to study contracts and their specific clauses. The purpose of the survey instrument is to develop and test the validity of provision constructs with regard to independent variables.

This particular survey was developed through three primary stages. First, a case study was conducted which contributed the actual contracts (and contract provisions) and an understanding of how these contracts were used. Second, actual contracts were dissected and divided into distinct provisions. Assisted by existing research, specific definitions regarding provision types were constructed. These definitions allowed a panel to classify each provision. Third, the selected provisions were used as contractual responses to described circumstances. The "circumstances" or scenarios described attempted to portray conditions developed under that transaction cost analysis.

A. Building the Survey.

As previously explained, the case study provided the contracts and additional information concerning how these contracts are used. Unlike most prior research regarding contractual business relationships, a case study involving the development of new technologies was not used. Instead, this case study focused on a partnership that is better described as a customer-supplier relationship, if not a marketing partnership. The most probable difference between these contracts and the contracts guiding technology development is the increased definiteness with regard to the contract detail. The partnership was developed for a well specified purpose which in turn allowed those developing the contracts to have more details to include in the agreement. But this effort did not dissuade attorneys from including provisions that would protect rights regarding the development of new technologies. For example, in an effort to protect each partner, the contract had a provision that allowed each partner to retain a "50% ownership interest in the development of software resulting as a direct result of this agreement".

Another distinction presented by this case study was the contractual bifurcation or the manner in which these contracts were organized. Upon inspection of the master contract and the sub-agreements, I observed differences in the focus of each contract. The parties, within the case study, generally regarded the sub-agreements as extensions of the master agreement and considered the two documents as "one" contract. However, distinct purpose of each of these agreements amplified the differences between the documents. For example, the master agreement was designed to put forth a general understanding of the two parties' relationship. Given the definitions put forth in this paper, I could see that the master agreement generally consisted of outcome provisions,

provision that attempted to describe conditions, whether expected or those agreed upon in direct response to contingencies.

I used the master agreement and one of the sub-agreements from which to extract contract provisions. I sought to include as many topics as possible into the selection of contract provisions. One of the concerns was that most contractual provisions do not fit the entire intent of the provision in a single contractual clause. In fact, most provisions include several clauses incorporating increased detail into the agreement. However, shortening the length of each provision in order that I could increase the frequency that attorneys made observation relative to the provisions became the top priority. Therefore, each provision presented to the panel was reduced to one sentence. This effort was to allow the panel member to make more decisions regarding the provisions. The selection of the provision topics are as follows:

Table #4

Transaction Orders	2	Indemnification	3	Performance	1
Representations	3	Dispute Committee	1	Force Majeure	1
Warranties	6	Arbitration	2	Prohibition to Hire	1
Confidentiality	2	Reports & Notices	2	Definitions	3
Property Access	2	Default	2	Payment & Pricing	5
Property Ownership	5	Jurisdiction	1	Assignment	2
Service & Maintenance	3	Contract Term & Termination	3	**TOTAL**	**50**

Each member of the panel was given a one-page definition of outcome and process provisions. As previously discussed, each member of the panel was asked to categorize each provision as "outcome", "process" or neither. (See Appendix #1) Each member of the panel categorized the provisions individually, without consultation of other panel members. Ideally, the provisions accepted to be included in the survey were those most consistently selected to represent either a process provision or an outcome provision. The results of the panel were as follows:

Table #5

8 – 0 Response	14
7 – 1 Response	19
6 – 2 Response	3
5 – 3 Response	6
4 – 4 Response	8
TOTAL	**50**

The results of the panel demonstrated that 36 out of the initial 50 provisions were in the same way classified by 75% or more of the panel members. This would indicate that the panel was able to determine and agree on a large majority of the provisions

independently presented. This demonstrates both convergent and divergent validity of the newly defined constructs. I decided to discard all those provisions that received less than a "7-1 response" from the survey. (See Appendix #2) A pool of 33 provisions made up the list of potential contractual clauses intended to be included in the survey.

The next step was to create pairs of provisions to represent the choices between the outcome provision and the process provision. The final survey design was intended to present a specific circumstance and ask the participant to choose between one of two contract provisions, one representing process and the other outcome. I attempted to locate those pairs that did not bias any one clause over the other. In other words, certain clauses may be deemed too important to any contract regardless of the provision with which they are compared, thereby biasing the attorney's preference regardless of whether it represented the appropriate response based upon the circumstances. For example, a "prohibition to hire" provision was included to discourage the practice of offering positions to personnel of the other firm within the partnership. Firms often come into contact with multiple personnel, with valuable skills, working for the other firm in a partnership requiring the need for this type of contractual limitation. The panel overwhelmingly selected this clause as an outcome provision. It was not selected to be presented in the final survey based upon the reasoning that attorneys might select this provision regardless of the environmental conditions that might exist for the firms. I also attempted to create pairs where the relative importance of a clause did not overly outweigh the other, again attempting to avoid a certain bias. In the end, 10 provisions were selected to represent process provisions and 13 provisions were selected to represent outcome provisions.[95] The selection of provision topics was reduced to the following:

Table #6

Transaction Orders	2	Property Ownership	3	Reports & Notices	2
Representations	1	Service & Maintenance	2	Default	1
Warranties	1	Indemnification	1	Jurisdiction	1
Confidentiality	2	Dispute Committee	1	Performance	1
Property Access	2	Arbitration	1	Payment & Pricing	2
				TOTAL	**23**

After developing the pairs of contractual provisions to represent the dependant variables in the survey, the portrayal of the circumstances intended to represent the independent variables became necessary. As previously discussed, the independent variables will subscribe to the arguments developed by Shelanski & Klien (1999). Changes in the governance system between cooperating partners depend upon: 1) frequency of transactions[96], 2) relationship-specific investments[97], 3) market

[95] Each contrasting scenario was assigned the same pairs of contract provisions. Most of the provisions selected for the survey were used at least twice in the survey. The same pairs were used for contrasting scenarios in order to reduce any variance explained by the differing clauses.

[96] Shelanski & Klien (1999) describes the frequency of the relationship transactions to have an impact on the governance structure of the partnership. I have decided to capture this variable by describing a set of

uncertainty[98], and 4) the complexity of arrangements[99]. These independent variables will be presented in contrasting conditions. For example, the independent variable representing specific investment will be presented as both "extensive specific investments" and "minimal specific investments".

Each condition will be presented in a brief scenario followed by opportunities for the respondent to select outcome provisions or process provisions as the appropriate overtly contractual response. No definitions will be given to the respondents; therefore the selection will be solely based upon their impression of the provision. Eight brief scenarios will be presented to the respondent. Each scenario will have a contrast. Five pairs of contract provisions will follow each scenario which attempts to assess the respondent's preference towards process provisions or outcome provisions given the scenario circumstances. Each set of scenarios depicting the independent variables and the expected responses with regard to the dependent variables will now be described briefly.

1. Propositions.

Transaction cost economics has heavily contributed to the study of governance mechanism between collaborating business partners. Several independent variables have been applied in order to observe the resulting changes in the governance system between partnering firms. For example, studies within transaction cost economics has often focused upon the level of transaction specific investments made between partnering firms and then observed how this has affected changes in the governance system. Each of the independent variables utilized in this study will be briefly described with a brief explanation of the expected result of the survey completed by attorneys. Propositions will be given for each independent variable presented.

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contrasting circumstances. For example, the participant is asked to consider changes in the contract when dealing with a partner in which, 1) no prior transaction have been conducted representing a "zero-frequency", and 2) many transactions have been conducted, representing "high frequency".

[97] Williamson (1985) describes these "specific investments" as the most important component of the collaborative experience. Shelanski & Klien (1999) recognizes these investments as the most studied topic under the transaction cost analysis. I decided to capture this variable by describing contrasting circumstances. The participant is asked to consider changes in the contract when 1) extensive investments are made in relationship specific equipment, and 2) minimal investments are made in time and non-specific assets, which can be reallocated easily.

[98] Shelanski & Klien (1999) defines the level of uncertainty as the "uncertainty about the future and about other parties' actions". I decided to focus my definition of uncertainty to include market conditions only and to explicitly avoid including the opportunistic behavior described under "under parties' actions". Again, in contrasting circumstances, the participant is asked to consider changes in the contract when facing 1) an unstable general economic environment which are difficult to predict, and 2) a generally stable market condition with extensive barriers to new competition.

[99] Shelanski & Klien (1999) suggests the "complexity of the arrangement" will have an impact on the governance structure. The increased complexity involved in the transactions between the partners results in difficulties assessing performance. This complexity loosens the connection between "deeds and awards" (Williamson, 1985). Attempting to represent this complexity, the participant is asked to consider changes when the 1) activities of the partner are readily transparent, and 2) the performance measures are difficult to assess.

Past experience between partners has been shown to have an effect on the governance of the partnership (Dyer & Singh, 1998). It is expected that these distinctions in the governance system will manifest themselves in the provisions emphasized in the contracts. More experienced partners, having conducted numerous transactions, would imply that the parties have agreed upon the "conditions" of their relationship as being sufficient to protect each party's interest. With these safeguards in place, emphasis would then focus toward developing information regarding the details of the next set of collaborative "activities" or transactions. Therefore, those that have had numerous transactions in the past should attempt to emphasize process provisions.

Partners that have had little to no experience regarding transaction with a specific partner have little to no agreement relative to those conditions being sufficient to protect each party's interest. Therefore, it is expected that those partnerships having no past experiences would tend to emphasize outcome provisions, or those provisions that clarify desired conditions between the parties. Partnerships with experience are looking for increased information regarding the details of their collaboration. The expectations of the survey results are as follows:

Independent Variable:			Process Provision	Outcome Provision
Past Experience with Partner	+	Extensive past experience	P-1	
	-	No past experience		P-2

Proposition #1
Collaborative business partnerships between partners having extensive prior experience organizing transactions will tend to emphasize the addition of process provisions to the contract.

Proposition #2
Collaborative business partners between partners having no prior experience organizing transactions will tend to emphasize the addition of outcome provisions to the contract.

Within the transactional cost analysis, the factor that has been the center of a majority of the research regarding governance mechanisms has been relationship-specific investments (Shelanski & Klien, 1999; Williamson, 1991). These investments are unique in that the positive value of the asset(s) is dependent upon the continued existence of the partnership. These particular assets are difficult to redeploy to other activities and partnerships. Therefore, the parties possessing such assets are exposed to the possibilities of opportunistic behavior by partners. The opportunistic behavior that attempts to alter contractual conditions after investments have been made is referred to as "hold-up"[100]

[100] Supra, page on hold-up and any important references, economics.

Partners that have extensive investment in specific assets will structure their agreements to protect their investments and create resistance to any attempt to engage in hold-up activities. The formal contractual agreement would most likely contain numerous provisions establishing agreement concerning acceptable "conditions". Therefore, partnerships that require extensive investment in specific assets will emphasize the use of outcome provisions.

Partners that do not have extensive investment in specific assets will attempt to create value through collaborating activities. Based on this, partners would emphasize increased detail relative to collaborative, value creating activities. This effort will tend to emphasize interest in developing formal contract with a focus on process provisions. The expectations of the survey results are as follows:

Independent Variable:			Process Provision	Outcome Provision
Specific Capital Investments	+	Extensive specific investments		P-3
	-	Minimal investments	P-4	

Proposition #3
Collaborative business partners having extensive investments in transaction specific assets will tend to emphasize the addition of outcome provisions to the contract.

Proposition #4
Collaborative business partners having minimal investment in transaction specific assets will tend to emphasize the addition of outcome provisions to the contract.

Performance measures are an important component of the overall governance effort of the collaborative relationship. While the main concerns of the governance structure under transaction cost economics is to "facilitate efficient adaptations" to the transactions, the development of performance measures are "the ways by which better to assure a closer correspondence between deeds and awards" (Williamson, 1985). Collaborative activities between firms often create information asymmetries that would not necessarily exist if all activities were to be conducted within a single firm. Often because of the joint interlocking efforts of the partnering firms, the contributions of each partner are difficult if not impossible to recognize. A similar effect occurs when "teams" within an organization coordinate their work activities (Alchian & Demsetz, 1972).

The nature of the activities covered in the agreement will have a great impact upon the agreement itself. For example, if partners develop a contract to produce a new product or technology, performance by each of the partners might be difficult to recognize. If partners develop a contract to market existing products, then performance

of activities should be easier to identify. Therefore, those partnerships that develop contracts that cover activities in which performance is relatively easy to identify and understand will tend to emphasize contract provisions that emphasize general conditions as opposed to specific activities. Outcome provisions will be emphasized in contracts where performance is relatively easy to identify.

On the contrary, contracts developed to govern partnerships that are, for example, attempting to develop new technologies or products, often have difficulty defining the scope of performance making collaboration increasingly difficult. In the study conducted by Faems et. al. (2008), researchers found that a second contract was more effective at governing a cooperative business relationship attempting to develop new printer technology because the contract was increasingly specific regarding the inter-firm activities.[101] Therefore, contracting parties that have difficulties defining performance will tend to emphasize process provisions in order to generate greater detail.

Independent Variable:			Process Provision	Outcome Provision
Performance Measurement	+	Transparent performance		P-5
	-	Performance difficult to measure	P-6	

Proposition #5
Collaborative business partners contracting within activities that are relatively transparent regarding performance will tend to emphasize the addition of outcome provisions to the contract.

Proposition #6
Collaborative business partners contracting within activities that are relatively difficult to measure regarding performance will tend to emphasize the addition of process provisions to the contract.

Uncertainty often increases the transaction costs and is often considered an independent variable in transaction cost literature. Uncertainty creates an "adaptive, sequential decision problem." (Williamson, 1985). Williamson (1985) argues that the sensitivity to uncertainty tends to increase as the level of specific investments increase. Uncertainty about future events often requires extensive costs for due diligence studies and the use of protective mechanisms. These mechanisms often attempt to protect existing investments in capital in a specific market. Uncertainty can be affected by issues such as general economic conditions, market specific competitive conditions, and simple variances in sales. Uncertainty is created when the ability to predict future market

[101] Faems et. al. (2008) studied a collaborative effort by two partners to develop components in printing technology. The first contractual effort failed to produce the desired technology. A second contractual effort was designed with more specifics regarding the collaborative activities and responsibilities of each firm. The second contract resulted in a successful venture and the added detail of the contract was no doubt the result of what the parties learned from their first effort.

conditions becomes cloudy and distorted to the point of representing a real risk to existing capital investments.

As the level of uncertainty was to increase, the expectation would be that the parties would mold the contract to protect "conditions", especially those that may be threatened. Provisions that present agreed conditions would be emphasized in an environment characterized by "unstable conditions". Therefore, parties faced with uncertainty are most likely to focus on outcome provisions.

Reductions in the level of uncertainty will most likely have the opposite effect. The ability to generally predict future conditions, stable conditions, allows the parties to focus on interfirm activities. Therefore, stable market conditions should motivate attorneys to increase their focus on interfirm activities and emphasize process provisions.

Independent Variable:			Process Provision	Outcome Provision
Market Uncertainty	+	Stable conditions	P-7	
	-	Unstable market conditions		P-8

Proposition #7
Collaborative business partners contracting within activities that are relatively transparent regarding performance will tend to emphasize the addition of outcome provisions to the contract.

Proposition #8
Collaborative business partners contracting within activities that are relatively difficult to measure regarding performance will tend to emphasize the addition of process provisions to the contract.

2. Survey Omissions.

The survey does present several challenges that need to be addressed. First, rarely is a contract provision described through one clause. Provisions often have several clauses that give important detail to the agreement. The provisions selected for the panel and eventually included in the survey are all described with one clause (See Appendix 1 & 3). Second, the eight scenarios described in the survey are illustrated with only a few sentences. (See Appendix 3) An enormous amount of potentially important detail is omitted. An attempt was also made to present the independent variables as isolated in terms of their effect. However, these variables are rarely found in isolation. For example, Alchian (1984) finds that the investment is specific assets and the information asymmetries described as performance measure difficulties are "often inseparable".

The omission of detail in both the scenarios and the contract provisions was based upon a calculated decision concerning an apparent trade-off. The addition of added detail in both the scenarios and the contract provisions would increase the reading

and time required from the respondent to complete the survey. Attorneys appear to have a general dislike of surveys and asking for more of their time would have made the effort to enlist participants more difficult. Reducing the verbiage also produced more opportunities for the participants to make decisions, resulting in more data points. For these reasons, omissions were made relative to the detail of both the contract provisions and the scenarios representing the independent variables.

B. Administering the Survey.

Once the survey had been completed, it consisted of general instructions, eight scenarios and five pairs of contract clauses listed after each scenario. (See Appendix #3) No definitions were given relative to the provisions. Attorneys would have to choose between two contract provisions, five times for each of the eight scenarios presented. The survey did not provide any means for respondents to explain their responses in a "qualitative" manner. The respondent was forced to make a selection for all five pairs of contract provisions before the survey would allow the respondent to go to the next scenario.

Before the survey was released, a pretest of the survey was conducted. Two of the attorneys on the panel were selected to take the survey and provide feedback regarding its content. This was the first time any members of the panel had seen the eight scenarios. Several recommendations were made to clarify the facts communicated within each scenario. Changes were made until both members of the panel were satisfied that the content within each scenario communicated its intended message.

The survey was designed to be administered through an online medium. "SurveyMonkey.com" provides support for online surveys. Participants were sent an e-mail containing an active link from the email directly to the survey. The online survey provider collected all the responses and provided limited analysis of the data.

Attorneys tend to be very difficult to access for interviews or survey information. Attorneys that specialize in contracts tend to work for large companies as general councils, or they tend to work for larger law firms. General Counsels are very difficult to access since rarely is their contact information public. Access to most of those attorneys that work as general council was attained through contacts with business professionals. Attorneys, specializing in contracts, working at larger law firms are not much more accessible. It is understandable why researchers have so little information from attorneys which, in turn, have such an important impact on business. Access is very limited and, as a group, they tend not to want to answer questions regarding their work. I was generally able to use personal contacts to gain access to those attorneys represented in this study. These personal contacts became advocates that were able to forward the website link to other attorneys they deemed qualified to participate in the survey. This is often referred to as a "snowball" effect.

VI. RESULTS

A. Findings of the Survey.

The survey information was collected by surveymonkey.com for later analysis. By completion of the study, 58 contract attorneys had responded to the survey. Each survey contained 40 responses to questions containing a choice between one of two contract provisions. Eight scenarios (four contrasting scenarios) were introduced to respondents, who were then presented with five pairs (one provision each representing either process or outcome) of contract provisions. The contrasting scenarios were followed by the same set of pairs of provisions, although the order of the questions was changed. Out of 58 responses, 82.5% of the surveys were entirely completed. The raw data indicated the following results: (table #7)

Table #7

Independent Variables:	**Dependent Variables: (Provisions)**	
	Process	Outcome
No Past Experience as Partners	185	75
Extensive Past Experience as Partners	33	202
Clear Performance Measures	88	172
Vague Performance Measures	107	128
Extensive Specific Capital Investments	46	199
Minimal Capital Investments	177	58
Stable Market Conditions	179	56
Unstable Market Conditions	73	172

The survey information was then coded for analysis. Each question with a response indicating a "process" clause was coded as "1". Each question with a response indicating an "outcome" clause was selected coded as "0". Each scenario presented to the respondent was followed by five questions regarding the appropriate provision to be included in the contract. If the respondent answered with all "process" provisions for a specific scenario, the resulting score would be 5. If the respondent answered the questions with all "outcome" provisions for a specific scenario, the resulting score would be 0. The following descriptive statistics are a result of this coding: (table #8)

Table #8					
Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
No Prior Experience	53	0	5	3.49	1.527
Prior Experience	48	0	3	.71	.944
Clear Performance Measures	53	1	5	2.49	1.339
Vague Performance Measure	48	0	4	1.94	1.549
Extensive Capital Investments	50	0	4	.96	1.428
Minimal Capital Investments	48	0	5	3.75	1.246
Stable Environment	48	2	5	3.81	.960
Unstable Environment	50	0	4	1.50	1.055

The statistical test used to test the expected effects is known as the Cochran-Mentel-Haenszel test. This test is designed for data that is represented in a series of two by two tables.[102] In addition, the Cochran-Mentel-Haenszel test analyzes the data with fewer assumptions regarding the population and weights the responses appropriately across individual measurements. This analysis provides an opportunity to adjust for potential confounding effects without having to estimate the parameters. The contrasting scenarios will act as a treatment from which to observe the effects. For example, those questions under the scenario describing partners having extensive prior experience together are compared to the scenario in which is a partnership is described as having no prior experience together. The data collected from each of the contrasting scenarios was then compared and tested for differences. If significance is found, the interpretation is that changes in one variable are associated with changes in the other. These changes, if significant, are greater than what would be expected by chance of random sampling. Each of the four independent variables will be reviewed.

1. Prior Experience.

It was expected that prior experience between the collaborating business partners would motivate attorneys, while developing formal cooperative agreements, to place a higher emphasis upon the use of "process" provisions. It was also expected that a lack of experience between the collaborating business partners would motivate attorneys to emphasize "outcome" provisions.

Table #9 C-M-H Statistical Test (Prior Experience)						
Odds Ratio	Value	95% Confidence Limits		Chi-Square	DF	Sign.
	10.6575	6.8998	16.4617	106.534	46	<.0001

[102] For each two by two tale, the adjusted log-odds ratio and the weight are calculated. After calculating these values, 0.5 is added to each frequency as a correction. The weighted mean of the log-odds ratio is calculated. Then the weighted squared deviations are calculated and the summed. This weighted sum of the squared deviations is chi squared distributed and the degrees of freedom equals the number of two by two tables minus one.

The results of the test (table #9) demonstrate that this test was extremely significant which supports the argument underlying the proposition and demonstrates that there is a strong divergence between when process provisions are recommended by attorneys and when outcome provisions are recommended. It can be inferred from the test that attorneys faced with a partnership between partners that have extensive collaborative experience would tend to emphasize process provisions when making additions to a contract.

2. Performance Measures.

It was expected that the existence of ambiguous performance measures between the collaborating business partners would motivate attorneys, while developing formal agreements, to place a higher emphasis upon the use of "process" provisions. The addition of process provisions would increase information important to allocate responsibilities regarding activities and harmonize complementary expertise. It was also expected that clear performance measures between the collaborating business partners would motivate attorneys to emphasize "outcome" provisions.

Table #10 C-M-H Statistical Test (Performance Measurement)						
Odds Ratio	Value	95% Confidence Limits		Chi-Square	DF	Sign.
	.6269	.4425	.8881	113.2142	46	<.0001

The results of the test (table #10) demonstrate that the test was extremely significant which supports the argument underlying the propositions concerning performance measures and demonstrates that there is a divergence between when process provisions are recommended by attorneys and when outcome provisions are recommended. It can be inferred from the test that attorneys faced with a partnership with vague performance measures tend to emphasize process provisions when making additions to a contract.

3. Relationship Specific Capital Investments.

It was expected that partnerships that do not require extensive investment in relationship specific assets would motivate attorneys, while developing formal cooperative agreements, to place a higher emphasis upon the use of "process" provisions. These firms attempt to create value through their activities and take an interest in coordinating their actions. It was also expected that extensive investment in relationship specific assets, that retain their value due to the continued existence of the partnership, would motivate attorneys to emphasize "outcome" provisions.

Table #11 C-M-H Statistical Test (Specific Investment)						
Odds Ratio	Value	95% Confidence Limits		Chi-Square	DF	Sign.
	8.1429	5.3353	12.4277	130.7461	45	<.0001

The results of this particular t test (table #11) demonstrate that this test was extremely significant which supports the argument underlying the propositions

concerning specific investments and demonstrates that there is a difference between when process provisions are recommended by attorneys and when outcome provisions are recommended. It can be inferred from the statistical test that attorneys faced with a partnership that requires minimal investment in relationship specific assets would tend to emphasize process provisions when making additions to a contract.

4. Market Uncertainty.

It was expected that collaborating business partners that exist in stable market environments would motivate attorneys, while developing formal cooperative agreements, to place a higher emphasis upon the use of "process" provisions. It was also expected that collaborative business partners that exist in unstable or less certain markets would motivate attorneys to emphasize "outcome" provisions.

Table #12 C-M-H Statistical Test (Capital Investment)						
Odds Ratio	Value	95% Confidence Limits		Chi-Square	DF	Sign.
	8.1429	5.3353	12.4277	130.7461	45	<.0001

The results of the t test (table #12) demonstrate that the test was extremely significant which supports the argument underlying the hypothesis and further demonstrates that there is a difference between when process provisions are recommended by attorneys and when outcome provisions are recommended. It can be inferred from the statistical test that attorneys faced with stable market conditions would tend to emphasize process provisions when making additions to the contract.

B. Implications for Theory.

The contribution of this study has little to do with the notion that the four independent variables selected in this study have an impact on the governance of the relationship. Prior research has already demonstrated that prior relationships, performance measures, specific-investments and general market uncertainty do impact governance systems between partners conducting numerous transactions. If anything, this study has assumed the existence of these effects to be accurate. The question in this study turns to whether those independent variables can have an impact on the characteristics of formal contractual agreements developed to govern cooperative business relationships.

The several corporate and contract attorneys that were interviewed over the entirety of this study all strongly agreed that contracts, designed to govern inter-firm cooperative activities, are unique. These agreements tend to have distinct characteristics and do not typically succumb to the use of "boiler plate" contracts. Business leaders and their attorneys can have enormous impact on the unique characteristics of their formal agreements. In spite of all this, contracts have been generally treated as relatively homogenous governance mechanisms by researchers. Past researchers have rarely moved beyond making reference to a contract's complexity, which sometimes does little more than count the number of clauses in the formal agreement.

In order to enable researchers to understand fundamental differences in contract characteristics, there is a need for tools or constructs that help to dissect and categorizes contract components. As previously discussed, numerous references have been made to contract provisions in an effort to develop insightful categories. While these have been helpful, they have come short of developing constructs to be used in statistical tests. This study of contracts would be otherwise included as one of several research studies that have developed categories for contract provisions if not for one aspect; an attempt to operationalize those categories and develop discriminate and convergent validity relative to the constructs. The development of these constructs will help researchers move beyond the case studies that have generally dominated the research of governance mechanism relative to longer-term cooperative relationships.

After the constructs describing contract provisions are developed, they can then be used to test contracts. This will not only allow researchers the ability to generate insights into the make-up of these agreements, but also allow researchers the ability to understand the surrounding circumstances that help create these agreements. For example as was shown in this study, extensive investment in specific assets to a partnership does affect the type of provisions preferred in a partnership. Future classifications of the construct do not have to reflect the "outcome" and "process" provision developed in this study. Future categories may even be more numerous. Once these constructs are developed and tested over a larger set of contracts, theory relative to contracts as governance mechanisms can begin to develop.

VII. CONCLUSION

The purpose of this study was to: 1) review existing research regarding the governance mechanisms developed for cooperative business relationships and add a legal perspective with the intent to glean new insights, 2) conduct a case study regarding a contractual arrangement, and 3) develop constructs that represent distinct categories of contract provisions and test them relative to external conditions to verify whether the these conditions have an effect on the contractual make-up. Each of these should be reviewed briefly.

Contracts have become an indispensible part of the business landscape. Contractual obligations are present in almost every set of organized transactions, with or without the benefits of a formal contractual agreement. A review of legal research and relevant case decisions has demonstrated that implied obligations and responsibilities not addressed by contract are routinely applied to parties by the courts. The evolution and acceptance of the Uniform Commercial Code demonstrates a general willingness to accommodate private governance systems in the midst of incomplete contracts. In addition, courts have taken opportunities to "fill in" apparent gaps found within agreements. However, while it may appear as if the legal system is willing to accommodate most any agreement, recent research (Scott, 2003) has also demonstrated

the court's persistence in the application of traditional contract law and insisting upon legal requirements such as "definiteness".

Governance systems based upon trust appear deficient in three ways. First, with the application of traditional contract theories developed under a "formalist" perspective, a contract purposely left incomplete runs the risk of violating rules such as definiteness allowing the partnership to possess a contract that has no hope of being enforced. Second, incomplete contracts risk the application of implied obligations of the party's past performance and industry standards. Third, purposely incomplete contracts risk allowing courts to "fill-in" terms and obligating the parties to responsibilities not intended. All these potential "costs" should be considered within research discussing relational governance systems based upon trust.

In addition to providing documents and information rich interviews, the case study allowed the opportunity to verify whether the conclusions of the Macaulay study can be generally applied to current cooperative business relationships. The general consensus of the interviews conducted in the case analysis is that the conclusions generated by Macaulay (1963) do not hold, or at least may not be applicable in a more formalized economy. Economic actors, both business executives and attorneys facing the reality of transactions with costs (Coase, 1992), seem openly concerned with the development of appropriate contractual relationships, as opposed to arrangements organized around trust. The followers of the Macaulay perspective assume the implications of the logic of transaction costs economics. Participants of transactions will seek to economize or reduce the costs associated to those transactions. The Macaulay perspective demonstrates that those involved in transactions would attempt to economize their interactions and replace expensive contracts with governance structures based upon trust.

Regarding this topic, the case study makes two important points. First, while trust is an important component early in a collaborative relationship, its importance fades quickly. Executives are keenly aware of the costs associated with business relationships that involve incomplete contracts. They seem to be mindful of the costs of lawsuits, interrupted business transactions due to confusion in contract language, inefficiencies due to redundancies created by a lack of clarity within contracts, and damages due to implied obligations within their industries. In other words, in the minds of many executives, a governance structure based upon trust would serve only to increase potential transaction costs to such an extent that these structures appear to be largely unacceptable. While economizing the cost of transactions, the governance structures based upon trust does not appear to represent lower costs.

Second, research regarding contracts has not accounted for changes in "contract technology", or perhaps "legal astuteness" (Bagley, 2008). Those involved in contractual agreements are also aware of their responsibilities to economize the cost of transactions. The case study makes note of the bifurcation of the contractual agreement. The master agreement is developed to address more general representations and responsibilities. The sub-agreements, or orders, cover specific transactions and

activities. These orders simply make reference to the controlling master agreement. This arrangement allows for quick review of the orders, greatly reducing the costs of the transaction. Executives appeared aware of the interaction between the master agreement and order as evidenced by their constant reference to orders as "addendums". The perception was that each order was merely an extension of the overall contractual agreement between the parties. The long-term relationship is protected under the master agreement and the orders provide the efficiency needed to reduce transaction costs.

The survey process presented within this study represented an early attempt to operationalize constructs representing differing contract provisions. However, the success of the statistical tests to find differences between the categories of provisions selected provides hope for future efforts. Further study and testing will be required before any set of constructs can begin to generate theories regarding contracts governing cooperative business relationships. Certain limitations of the survey instrument were discussed previously. However, the survey instrument seemed to verify what several researchers have concluded over the years. The nature of those provisions used in the contract can give researchers information regarding the circumstances and the intent of the parties when the agreement was drafted. The development of "provision constructs" will help to develop an understanding of interactions between environmental conditions and the internal characteristics of the observed contracts.

If contract characteristics can be defined using constructs representing provisions, then unique differences between contracts can be detected in a wide variety of circumstances. The independent variables or circumstances presented in the survey are largely a reflection of those conditions presented in transaction cost economics. However, transaction cost economics "usually abstracts away from issues of market power, resource dependence…" (Shelanski & Klien, 1999). Future studies, armed with tools to assess differences in contractual agreements, can evaluate the effects of relationships representing asymmetric power between trading partners or those relationships structured around resource dependencies. Investigations into contracts over a broader set of circumstances will greatly contribute to the eventual develop of theory.

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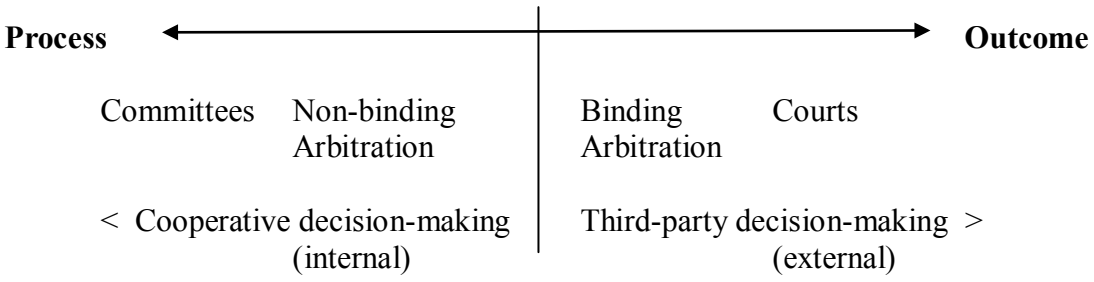
Appendix #1

Contract Provisions (Contracts for Longer-Term Cooperative Business Relationships)

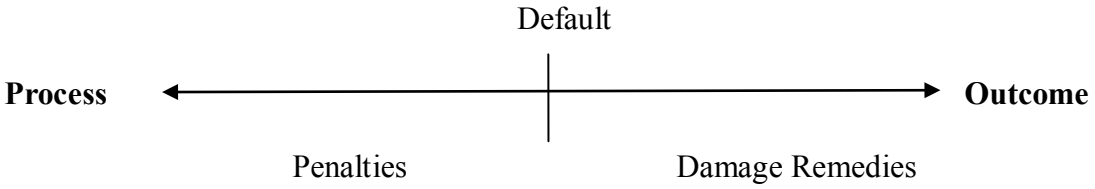
"**Process provisions**" are those formalized clauses that describe joint or complimentary ***operational activities*** existing as a direct result of the contractual agreement. These provisions include those expected under current assumptions and those expected under contingency assumptions (in response to "what if" scenarios). Process provisions codify and describe the "means" to which parties achieve contract objectives and outline "***how***" outcome conditions are realized. These descriptions outline operational and post-formation activities. To give a few examples, process provisions within a contract detail: resource accessibility, work schedules, time tables, transaction orders, pricing mechanisms, reports, pre-determined damages or fees, and necessary confidentiality disclosures.

"**Outcome provisions**" are those formalized clauses that describe ***conditions*** existing as a direct result of the contractual agreement. These provisions include those expected under current assumptions and those expected under contingency assumptions (in response to "what if" scenarios). Outcome provisions codify an understanding of "***what***" to achieve under the contract objectives. These conditions act as standards, concerning agreed upon events and circumstances. To give a few examples, outcome provisions within a contract can detail the particular: legal standards, product or service standards, confidentiality standards, representation and warranty standards, property standards and representations. Outcome provisions include both those representations of conditions prior and those conditions subsequent to the activities of the agreement.

Dispute provisions.
Dispute provisions are not intended to produce an entirely new set or category of contract clauses. These provisions provide a prescribed description of intended responses to contingencies; contingencies which occur as a direct result of disputes regarding the contractual agreement. The division between those dispute provisions considered "process" and those provisions considered "outcome" depends upon the level of control over the final decision. If the parties abdicate control of the dispute outcome to a third party as, for example, parties do in the courts and within binding arbitration, the provision is considered "outcome". If the parties do not abdicate control of the dispute outcome to a third party, as for example, non-binding arbitration or committees, the provision is considered "process".



Penalties vs. Remedy.
Performance of the contract is the primary method in which the parties fulfill their obligations and terminate their liabilities to a contractual agreement. Longer-term contracts are unique in that performance is often difficult to define, making fulfillment of contractual obligations difficult to judge. Therefore, parties to longer-term contracts often turn their attention from performance and instead emphasize contractual default. Contractual penalties incentivize parties to make payment, but keep the parties from contractual default and are consider "process" provisions. Remedies are often assessed after the parties experience contractual default and therefore are labeled "outcome" provisions.



Mark the following contract provisions as either (O) outcome provision or (P) process provision. Leave blank any provisions that do not fit into either category.

_____ Hazardous waste (Party A agrees to remove all hazardous waste);

_____ Notices (All notices issued hereunder must be in writing and will be deemed given five days after mailing.);

_____ Default (Party will be in default if payment is not received within 15 days after date it is due.);

_____ Property (Party A reserves the right to revoke any assignment, grant, conveyance or transfer due to non-payment.);

_____ Force Majeure (Party A shall not be liable if performance is delayed or prevented by a circumstance beyond its control.);

_____ Ownership of assets (Title to equipment acquired throughout this agreement will remain with party A…);

_____ Service level Guarantee (Party A will provide the service standards set forth in each order);

_____ Representations (Each party asserts that all current financial information is true and accurate and provides a good representation of their financial position.);

_____ Maintenance (Maintenance service will be provided during standard working hours.);

_____ Assignment (Party A may assign their interests in this agreement if approved by all parties.)
and /or workspace owned, leased rented, licensed and/or controlled);

_____ Warranty (Party A agrees to comply with internal policies of safety and security…);

_____ Prohibition to hire (Parties agree that neither party shall directly or indirectly, actively solicit the employment of members of the other party's staff.);

_____ Definitions (The term "equipment" is meant to include both hardware and software.);

_____ Pricing (Pricing shall be set forth in each order);

_____ Warranty (In no event will Party A be responsible for failures to perform based upon limited access to equipment.);

_____ Definitions (The term "deliverables" include, but are not limited to…);

_____ Pricing (Pricing set forth in an order is based upon shared information, believed to be complete and accurate.);

_____ Definitions (Staffing and management services and products are referred to collectively as "offerings".);

_____ Contract Term (This agreement shall commence on the date it is accepted by both parties…);

_____ Warranty of Third party product (If third party products are not in conformance, the exclusive remedy is the refund of any fees.);

_____ Voided Warranty (Party A will not warrant services and/or equipment in which Party A does not have proper access or information);

_____ Warranty (If a contracting party is not satisfied with any delivered equipment, party A will make replacement with the identical equipment at no additional charge.);

_____ Termination (With 90 days notice, each party may terminate any services without incurring early termination charges.);

_____ Arbitration (The parties agree to abide by the decision made under arbitration…);

_____ Pricing (Parties will negotiate in good faith to make appropriate adjustments to the order.);

_____ Payment (Invoices are payable upon receipt and all sums are due no later than 30 days.);

_____ Indemnification (Party A is not responsible for litigation expenses or settlements unless approved in writing.);

_____ Repairs (Party A will make all equipment repairs and adjustments necessary.);

_____ Resource Accessibility (Parties will permit each other and their agents to use or access, all hardware, software);

_____ Orders (Each offering and deliverables will be mutually agreed upon and signed by authorized signatories of both parties.);

_____ Arbitration (Substantive contractual disagreements will seek mediation through non-binding arbitration…);

_____ Default (The sole remedy of a party shall be to require the defaulting party to make payment, as liquidated damages and not as penalty…);

_____ Property (Party A agrees that, except as set forth expressly in this agreement, no other rights or licenses are granted.);

_____ Indemnification (Each party will defend the other from all claims of personal injury or tangible property damage.);

_____ Confidentiality (Each party will disclose to the other certain business information identified as confidential);

_____ Warranty (Party A represents and warrants that any services provided will be performed in a skillful and workmanlike manner.);

_____ Committee (All disputes are to be addressed first by the Committee…);

_____ Jurisdiction (The terms and elements of this contract will be guided and directed under the state laws of ___.);

_____ Term (The term of each offering shall commence on the installation of each product or beginning of service.);

_____ Orders (Orders may be submitted via hard copy or electronic means.);

_____ Confidentiality (Each party will make reasonable efforts not to disclose the other party's confidential information to any third party.);

_____ Property (Party A assigns, grants, conveys and transfers all rights to any output of services for an applicable order.);

_____ Payment (For any payment not received within 10 days of the due date, Parties agree to pay a late charge of 5% of the amount due);

_____ Indemnification (Excluded from Party A's obligation to defend and pay any settlement for products or services not provided by Party A, if such forms the basis of the claim.);

_____ Performance (Party A will continue to provide products under specifications outlined within this agreement.);

_____ Representations (Party A does in fact possess all the needed financing to purchase the necessary assets.);

_____ Representations (Party A certifies that all facts and reports presented during negotiations are true and valid and are a proper depiction of the firm.);

_____ Ownership (Party A retains ownership of all equipment, used and not used, relative to its resale and collection of residual proceeds.);

_____ Ownership (Party A retains 50% ownership interest in the development of software resulting as a direct result of this agreement.);

_____ Reports (Party A may collect from equipment certain data related to billing, supplies, support and service of designated equipment.);

Appendix #2

Contract Provision Results

P O

OUTCOME

0 8 Party A retains 50% ownership interest in the development of software resulting as a direct result of this agreement.

0 8 Excluded from Party A's obligation to defend and pay any settlement for products or services not provided by Party A, if such forms the basis of the claim.

0 8 Party A represents and warrants that any services provided will be performed in a skillful and workmanlike manner.

0 8 Party A agrees that, except as set forth expressly in this agreement, no other rights or licenses are granted.

0 8 The parties agree to abide by the decision made under arbitration…

0 8 In no event will Party A be responsible for failures to perform based upon limited access to equipment..

1 7 Title to equipment acquired throughout this agreement will remain with party A…

1 7 Party A shall not be liable if performance is delayed or prevented by a circumstance beyond its control.

1 7 Party A reserves the right to revoke any assignment, grant, conveyance or transfer due to non-payment.

1 7 Party A is not responsible for litigation expenses or settlements unless approved in writing.

1 7 Party A does in fact possess all the needed financing to purchase the necessary assets.

1 7 Party A certifies that all facts and reports presented during negotiations are true and valid and are a proper depiction of the firm.

1 7 Ownership (Party A retains ownership of all equipment, used and not used, relative to its resale and collection of residual proceeds.

1 7 The terms and elements of this contract will be guided and directed under the state laws of ___.)

1 7 Each party will defend the other from all claims of personal injury or tangible property damage.

1 7 If a contracting party is not satisfied with any delivered equipment, party A will make replacement with the identical equipment at no additional charge.

1 7 Party A will not warrant services and/or equipment in which Party A does not have proper access or information.

1 7 If third party products are not in conformance, the exclusive remedy is the refund of any fees.

1 7 Parties agree that neither party shall directly or indirectly, actively solicit the employment of members of the other party's staff.
1 7 Party A agrees to comply with internal policies of safety and security…

1 7 Each party asserts that all current financial information is true and accurate and provides a good representation of their financial position.

1 7 Party A agrees to remove all hazardous waste.

2 6 Party will be in default if payment is not received within 15 days after date it is due.

2 6 Party A assigns, grants, conveys and transfers all rights to any output of services for an applicable order.

3 5 Staffing and management services and products are referred to collectively as "offerings".

3 5 Party A may assign their interests in this agreement if approved by all parties.)
and /or workspace owned, leased rented, licensed and/or controlled.

PROCESS

8 0 Party A may collect from equipment certain data related to billing, supplies, support and service of designated equipment.

8 0 Orders may be submitted via hard copy or electronic means.

8 0 All disputes are to be addressed first by the Committee…

8 0 Substantive contractual disagreements will seek mediation through non-binding arbitration…

8 0 Each offering and deliverables will be mutually agreed upon and signed by authorized signatories of both parties.

8 0 All notices issued hereunder must be in writing and will be deemed given five days after mailing.

8 0 Parties will permit each other and their agents to use or access, all hardware, software.

8 0 Pricing shall be set forth in each order.

7 1 Each party will disclose to the other certain business information identified as confidential.

7 1 Parties will negotiate in good faith to make appropriate adjustments to the order.

7 1 Maintenance service will be provided during standard working hours.

6 2 This agreement shall commence on the date it is accepted by both parties…

5 3 For any payment not received within 10 days of the due date, Parties agree to pay a late charge of 5% of the amount due.

5 3 Party A will provide the service standards set forth in each order.

5 3 Each party will make reasonable efforts not to disclose the other party's confidential information to any third party.

5 3 Pricing set forth in an order is based upon shared information, believed to be complete and accurate.

NEITHER

4 4 Party A will continue to provide products under specifications outlined within this agreement.

4 4 The term of each offering shall commence on the installation of each product or beginning of service.

4 4 The sole remedy of a party shall be to require the defaulting party to make payment, as liquidated damages and not as penalty…

4 4 Party A will make all equipment repairs and adjustments necessary.

4 4 Invoices are payable upon receipt and all sums are due no later than 30 days.

4 4 With 90 days notice, each party may terminate any services without incurring early termination charges.

4 4 The term “deliverables” include, but are not limited to…

4 4 The term “equipment” is meant to include both hardware and software.

Appendix #3

Survey

Instructions.
This particular research is interested in the development and modification of contracts between cooperating business partners. Cooperating business partners are distinct from discrete transactions in that the partners are expecting to maintain a longer-term relationship with multiple sets of transactions. When choosing provisions for the contract, keep in mind that the purpose of the agreement is to maintain a positive, longer-term business relationship.

The conditions created for each set of questions are designed to portray conditions that may affect the partnership in different ways. Keep in mind the corresponding set of conditions as you choose the contractual provisions that would be most appropriate.

Survey Question #1.
Suppose that your firm, or the one you represent, must develop a contractual agreement with another firm. **Your firm has had extensive experience contracting with this partnering firm in the past.** This new effort will require a modification to any existing agreements. In order to encourage the best hope for a successful cooperative relationship between the firms, choose the contractual provision below you would most prefer to emphasize. It is understood that both provisions may be important, however, you are only required to designate the most important additions to the agreement given the circumstances:

A. Each Party represents that any services provided will be performed in a skillful and workmanlike manner.
B. Each Order may be submitted via hard copy or electronic means.

A. Each Party will retain 50% ownership interest in any software developed as a resulting of this agreement.
B. Each Party will disclose to the other certain business information identified as confidential.

A. All disputes are first reviewed by the Operations Committee.
B. The terms and elements of this contract will be guided and directed under the state laws of ___.

A. Parties will negotiate in good faith to make appropriate price adjustments to any orders.
B. The Parties agree to abide by the final decision rendered under arbitration.

A. Each party will defend the other from all claims of personal injury or property damage.
B. Maintenance service will be provided during standard working hours.

Survey Question #2.
Suppose your firm, or the one you represent, must partner with another firm in order to coordinate your marketing activities. **This new marketing effort will NOT require new investments of capital or time. Any minimal investments made could easily be re-allocated to other activities if the partnership were to dissolve.** This new effort will require a modification to any existing agreements. In order to encourage the best hope for a successful cooperative relationship between the firms, choose the contractual provision below you would most like to emphasize. It is understood that both provisions may be important, however, you are only required to designate the most important additions to the agreement given the circumstances:

A. The Parties agree to abide by the decisions made within arbitration proceedings.
B. All disputes are first reviewed by the Operations Committee.

A. Each Party may collect certain data related to supplies, support and service of designated equipment.
B. Title to equipment acquired throughout this agreement will remain with Party "X".

A. No Party will be responsible for failure to perform based upon limited access to equipment.
B. Parties will permit each other and their agents to use and access to all hardware and software.

A. Maintenance service will be provided during standard working hours.
B. Party "X" retains ownership of all equipment, used and not used, relative to its resale and collection of proceeds.

A. Each Party will retain 50% ownership interest in any innovations developed as a resulting of this agreement.
B. All notices issued must be in writing and will be deemed given five days after mailing.

Survey Question #3.
Suppose that your firm, or the one you represent, must partner with another firm to market an existing product. **The activities of these partnering firms are readily transparent and progress is relatively easy to assess.** A series of reports are generated which outline the activities of both partners. This new effort will require a modification to any existing agreements. In order to encourage the best hope for a successful cooperative relationship between the firms, choose the contractual provision below you would most prefer to emphasize. It is understood that both provisions may be important, however, you are only required to designate the most important additions to the agreement given the circumstances:

A. All notices issued hereunder must be in writing and will be deemed given five days after mailing.
B. Each Party certifies that all facts and reports presented are true and valid.

A. Pricing will be set forth in each order.
B. Each party will replace defective equipment with identical equipment at no additional charge.

A. Each Party agrees to comply with each other's internal policies of safety and security.
B. Maintenance service will be provided during standard working hours.

A. Each party will make reasonable efforts not to disclose the other party's confidential information to any third party.
B. Each offering will be mutually agreed upon and signed by authorized signatories of both parties.

A. Each Party may collect certain data related to billing, supplies, support and service of designated equipment.
B. Title to equipment acquired throughout this agreement will remain with Party "X".

Survey Question #4.
Suppose your firm, or the one you represent, must partner with another firm on order to coordinate activities. **The general environment of the market in which you compete is relatively stable. Market variables are easy to predict, even in the distant future. Extensive barriers exist to discourage new competition.** This new effort will require a modification to any existing agreements. In order to encourage the best hope for a successful cooperative relationship between the firms, choose the contractual provision below you would most like to emphasize. It is understood that both provisions may be important, however, you are only required to designate the most important additions to the agreement given the circumstances:

A. Each party will continue to provide products under specifications outlined within this agreement.
B. Parties will negotiate in good faith to make appropriate adjustments to the order.

A. All disputes are first reviewed by the Operations Committee.
B. The terms and elements of this contract will be guided and directed under the state laws of ___.

A. Parties will permit each other and their agents to use or access all hardware and software.

B. Each party will make reasonable efforts not to disclose the other party's confidential information to any third party.

A. For any payment not received within 10 days of the due date, Parties agree to pay a late charge of 5% of the amount due.
B. Each party will defend the other from all claims of personal injury or tangible property damage.

A. Party "X" retains ownership of all equipment, used and not used, relative to its resale and collection of proceeds.
B. Each Party may collect certain data related to billing, supplies, support and service of designated equipment.

Survey Question #5.
Suppose that your firm, or the one you represent, must partner with another firm to develop new and improved software. **This particular effort will require the development of new knowledge and it will be difficult to measure the performance of the partner.** This new effort will require a modification to any existing agreements. In order to encourage the best hope for a successful cooperative relationship between the firms, choose the contractual provision below you would most prefer to emphasize. It is understood that both provisions may be important, however, you are only required to designate the most important additions to the agreement given the circumstances:

A. All notices issued hereunder must be in writing and will be deemed given five days after mailing.
B. Each Party certifies that all facts and reports presented are true and valid.

A. Pricing will be set forth in each order.
B. Each party will replace defective equipment with identical equipment at no additional charge.

A. Each Party agrees to comply with each other's internal policies of safety and security.
B. Maintenance service will be provided during standard working hours.

A. Each party will make reasonable efforts not to disclose the other party's confidential information to any third party.
B. Each offering will be mutually agreed upon and signed by authorized signatories of both parties.

A. Each Party may collect certain data related to billing, supplies, support and service of designated equipment.
B. Title to equipment acquired throughout this agreement will remain with Party "X".

Survey Question #6.
Suppose that your firm, or the one you represent, must develop a contractual agreement with another firm. **Your firm has had NO past experience contracting with this firm.** In fact, there has been no working relationship between your firm and the new prospective partner. This contract is the first time your firm has cooperatively worked with this particular partner. In order to encourage the best hope for a successful cooperative relationship between the firms, choose the contractual provision below you would most prefer to emphasize. It is understood that both provisions may be important, however, you are only required to designate the most important additions to the agreement given the circumstances:

A. Each Party represents that any services provided will be performed in a skillful and workmanlike manner.
B. Each Order may be submitted via hard copy or electronic means.

A. Each Party will retain 50% ownership interest in any software developed as a resulting of this agreement.
B. Each Party will disclose to the other certain business information identified as confidential.

A. All disputes are first reviewed by the Operations Committee.
B. The terms and elements of this contract will be guided and directed under the state laws of ___.

A. Parties will negotiate in good faith to make appropriate price adjustments to any orders.
B. The Parties agree to abide by the final decision rendered under arbitration.

A. Each party will defend the other from all claims of personal injury or property damage.
B. Maintenance service will be provided during standard working hours.

Survey Question #7.
Suppose that your firm, or the one you represent, must partner with another firm in order to work on a large, capital intensive project. **Both partners will be required to make extensive investments in equipment. These investments will be made in equipment that will only retain its value if deployed within the partnership.** It is doubtful this equipment could be sold for anything close to its costs if the partnership were to dissolve. This new effort will require a modification to any existing agreements. In order to encourage the best hope for a successful cooperative relationship between the firms, choose the contractual provision below you would most like to emphasize. It is understood that both provisions may be important, however, you are only required to designate the most important additions to the agreement given the circumstances:

A. The Parties agree to abide by the decisions made within arbitration proceedings.
B. All disputes are first reviewed by the Operations Committee.

A. Each Party may collect certain data related to supplies, support and service of designated equipment.
B. Title to equipment acquired throughout this agreement will remain with Party "X".

A. No Party will be responsible for failure to perform based upon limited access to equipment.
B. Parties will permit each other and their agents to use and access to all hardware and software.

A. Maintenance service will be provided during standard working hours.
B. Party "X" retains ownership of all equipment, used and not used, relative to its resale and collection of proceeds.

A. Each Party will retain 50% ownership interest in any innovations developed as a resulting of this agreement.
B. All notices issued must be in writing and will be deemed given five days after mailing.

Survey Question #8.
Suppose your firm, or the one you represent, must partner with another firm in order to coordinate activities. **The general environment of the market in which your firm competes is such that it is difficult to predict market conditions, even in the near future.** Innovations are currently being developed and new competitors are entering the market making conditions appear very unstable. This new effort will require a modification to any existing agreements. In order to encourage the best hope for a successful cooperative relationship between the firms, choose the contractual provision below you would most like to emphasize. It is understood that both provisions may be important, however, you are only required to designate the most important additions to the agreement given the circumstances:

A. Each party will continue to provide products under specifications outlined within this agreement.
B. Parties will negotiate in good faith to make appropriate adjustments to the order.

A. All disputes are first reviewed by the Operations Committee.
B. The terms and elements of this contract will be guided and directed under the state laws of ___.

A. Parties will permit each other and their agents to use or access all hardware and software.

B. Each party will make reasonable efforts not to disclose the other party's confidential information to any third party.

A. For any payment not received within 10 days of the due date, Parties agree to pay a late charge of 5% of the amount due.
B. Each party will defend the other from all claims of personal injury or tangible property damage.

A. Party "X" retains ownership of all equipment, used and not used, relative to its resale and collection of proceeds.
B. Each Party may collect certain data related to billing, supplies, support and service of designated equipment.