



# Contract design capability as a trust enabler in the pre-formation phase of interfirm relationships

Lu Shen<sup>a,\*</sup>, Chenting Su<sup>b</sup>, Xu Zheng<sup>b</sup>, Guijun Zhuang<sup>c</sup>

<sup>a</sup> Department of Business Administration, Dalian Maritime University, Dalian 116026, China

<sup>b</sup> Department of Marketing, City University of Hong Kong, Kowloon, Hong Kong

<sup>c</sup> Department of Marketing, Xi'an Jiaotong University, Xi'an 710049, China

## ARTICLE INFO

### Keywords:

Contract design capability  
Trust  
Contracting  
Dependence asymmetry

## ABSTRACT

Moving beyond the prevalent notion that relational trust is cultivated through repeated transactions, we argue that relational trust can also be engendered by a partner's contract design capability revealed in the contracting process preceding relationship formation. We conceptualize contract design capability as a dual-dimensional construct, comprising safeguarding capability and coordination capability, which enables firms to design effective contracts befitting transaction attributes. The survey and the scenario-based experiment data, collected from information technology service industry in China, show that both dimensions of a firm's revealed contract design capability can function to engender trust, including goodwill trust and competence trust. Additionally, when the firm's dependence advantage increases, the effects of its revealed contract design capability on goodwill trust decrease but those on competence trust increase. Overall, this paper enriches the trust literature by ascertaining whether and how relational trust can be generated in the pre-formation phase of interfirm relationships.

## 1. Introduction

As a relational governance mechanism, trust is considered to promote interfirm cooperation (Cao & Lumineau, 2015), lower transaction cost (Gulati & Nickerson, 2008), and lead to better exchange performance (Poppo, Zhou, & Li, 2016). The significance of trust in driving cooperation has yielded a robust body of research on examining the formation of trust. Scholars have agreed that a general form of trust is needed before transactions take place, which is typically a result of the reputation of the trustee or the institutions it is affiliated with (Rousseau, Sitkin, Burt, & Camerer, 1998). However, relational trust, which pertains to a specific interfirm relationship, is considered to be cultivated by familiarity through repeated transactions (Gulati, 1995). Scholars posit that “the formation of trust is negligible, if not non-existent” prior to a history of repeated transactions (Gulati & Sytch, 2008, p.184), and trust is accumulated as a result of the affirmation of both parties' observance of equity norms and their expanded relational embeddedness (Inkpen & Currall, 2004; Lioukas & Reuer, 2015; Ring & Van de Ven, 1992).

While familiarity breeds trust (Gulati, 1995), one question remains unanswered: can familiarity develop prior to transactions? For example, firm may get familiar with each other through repeated

contracting activities. Therefore, one researchable question emerges: can relational trust be provoked preceding the formation of interfirm relationships? This question is intriguing as recent research hints that trust may be engendered through *sensemaking* in the contracting process (Blomqvist, Hurmelinna, & Seppänen, 2005; Lumineau, Frechet, & Puthod, 2011; Mayer & Argyres, 2004; Vlaar, Klijn, Ariño, & Reuer, 2010). For example, firms may articulate their expectations, assumptions, and concerns of the relationship, which generates cues for their counterparts to make sense of their competence and professionalism as well as their intentions and hidden agendas during the lengthy contracting process (Blatt, 2009; Lumineau et al., 2011). As such, through perceiving and interpreting cues revealed in the contracting process (Adobor, 2005; Doney & Cannon, 1997), firms are likely to develop trust on the competence and goodwill of their counterparts. Prior research seems to have neglected such a contracting process that precedes transactions and breeds familiarity through sensemaking, which may result in trust (Ariño & Ring, 2010; Lumineau et al., 2011; Vlaar et al., 2010).

This study attempts to address this issue by looking at contract design capability, which refers to firms' expertise to design an effective contract that is consistent with transaction attributes through deploying individuals' specialist knowledge (Argyres & Mayer, 2007). We surmise

\* Corresponding author.

E-mail addresses: [shenlu925@dlnu.edu.cn](mailto:shenlu925@dlnu.edu.cn) (L. Shen), [mkctsu@cityu.edu.hk](mailto:mkctsu@cityu.edu.hk) (C. Su), [zhgj@mail.xjtu.edu.cn](mailto:zhgj@mail.xjtu.edu.cn) (G. Zhuang).

that the contracting process represents a context in which firms make sense of their partners' competence and goodwill toward the cooperative relationship through their interpretation of the partners' revealed contract design capability. Because contracts perform both safeguarding and coordinating functions (Lumineau, 2017; Reuer & Ariño, 2007), we conceptualize contract design capability as a two-dimension construct, consisting of safeguarding contract design capability and coordinating contract design capability (i.e., safeguarding and coordination capability hereafter). Both dimensions of the construct, embodied in firms' practices in selecting and designing these two types of clauses, shed light on firms' experience and professionalism and their reliability (Vlaar, Van Den Bosch, & Volberda, 2006), and may subsequently influence their counterparties' evaluations of their trustworthiness.

Additionally, the relationship between contract design capability and trust is subject to the relationship structure between business partners. According to sensemaking theories, people's initial expectations affect their sensitivity to cues and their interpretation of the cues (Adobor, 2005). Following this logic, dependence asymmetry, a determining feature of relationship structure that bears on business partners' initial expectations (Shen, Wang, & Teng, 2017), is likely to affect their sensitivity and interpretations of similar contract design capability revealed in the contracting process.

This study addresses these research gaps by examining the following two questions: (1) how do the two dimensions of contract design capability revealed in the contracting process affect trust production, including both competence and goodwill trust preceding the formation of interfirm relationships? (2) How are these baseline effects contingent upon levels of dependence asymmetry? Integrating insights from the literature on contract design capability, trust development, and sensemaking, we hypothesize that firms can develop trust through revealed contract design capabilities contingent upon their dependence state before they formally unfold their business cooperation. We tested the hypotheses using both survey and scenario-based experiment data collected from information technology (IT) industry. The results show that both of the two dimensions of contract design capability can function to engender trust, including goodwill trust and competence trust. When a firm's dependence advantage increases, the effects of its revealed contract design capability on goodwill trust decrease but those on competence trust increase.

The current study makes three contributions to the literature. First, it extends the current trust literature by theorizing that relational trust can be engendered through sensemaking in the contracting process. Specifically, we identify contract design capability as the new antecedent of trust in this less-attended preformation phase. Second, by examining the moderating effects of dependence asymmetry, this work reveals the important role of initial expectations in affecting trust formation. Third, this work enriches the concept of contract design capability by defining and providing measures for its two constituent dimensions. Such multi-dimensional conception of contract design capability accords with the literature on contractual governance (e.g., Lumineau, 2017).

## 2. Research background

### 2.1. Trust generation in the preformation phase

Trust is a psychological state depicting the willingness to be vulnerable based on positive expectations of the intentions or behaviors of another (Rousseau et al., 1998). This multidimensional concept comprises goodwill trust (i.e., the expectation that a party has moral obligations and responsibility to care for the other's interests) and competence trust (i.e., the expectation that a party has the technical skills, experience, and reliability necessary to fulfill its obligations) (Nooteboom, 1997).

Much of the theorizing of interfirm trust contends that trust is

negligible in earlier relationship phases because of the lack of cognitive, relational, deterrent, and calculative bases for trust assessment (e.g., Gulati & Sytch, 2008; Inkpen & Currall, 2004; Ring & Van de Ven, 1992). Cognitively, because exchange partners lack a refined understanding of each other's routines, capabilities, and reliability at the outset of the relationship, they are not sure whether the other party can carry out the entrusted task properly (Gulati & Sytch, 2008; Lioukas & Reuer, 2015). Relationally, the formation of trust should be preceded by a period when mutual commitments are tested and relational norms are internalized (Gulati, 1995; Ring & Van de Ven, 1992), which is less likely in nascent relationships. From a deterrence-based view, the deterrents to self-interest-seeking behaviors are less sufficient in initial phases because of the minimum levels of specialized investments and switching costs (Rousseau et al., 1998), and even if the deterrents can be installed, it also takes time to assess a party's determination in enforcing punishments for untrustworthy behavior (Gulati & Sytch, 2008). From a calculus-based view, a lasting history of interfirm interactions is needed to configure effective safeguards and reward systems and thus enable rational benefit-cost calculation (Gulati & Sytch, 2008). While reputation may be necessary for breeding calculative trust, it is not sufficient (Ring & Van de Ven, 1992). As such, Nooteboom (1997: 314) posits that “trust requires familiarity and mutual understanding and, hence, depends on time, on habit formation, and on the positive development of a relationship.”

Little attention, however, has been paid to the pre-formation phase of interfirm relationships in which trust may emerge (Arino & Ring, 2010; Lumineau et al., 2011; Vlaar et al., 2010). Particularly, the contracting process is a vital process preceding interfirm relationships that sets a footstone for future relationship development (Ring & Van de Ven, 1994). A party's willingness to formalize its obligations symbolizes its willingness to act in a cooperative and trusting manner, and the process of crafting mutually beneficial agreements can lead to deeper and more enlightened understanding of the party's perspective, goals, and concerns (Blatt, 2009). Therefore, it is likely that business partners can generate trust before the relationship formation through their revealed contract design capabilities in the contracting process. Previous research tends to dilute the significance of the contracting process in trust generation. Our research, thus, intends to fill in these research gaps by examining the linkage between contract design capability and trust.

### 2.2. Conceptual development of contract design capability

In management research, Argyres and Mayer (2007) were the first to conceptualize the concept of contract design capability, and they have proposed a dual alignment principle for understanding this concept. According to the first “alignment,” contract design capability entails an ability to align the structure of provision types with transaction attributes (Argyres & Mayer, 2007). Particularly, contracts are a multifunctional governance strategy that functions as both safeguarding mechanism against relational risks and coordination mechanism against operational risks (Lumineau, 2017; Reuer & Ariño, 2007). Therefore, firms with superior contract design capability should be able to anticipate the combination of relational and operational risks ahead and decide on an equilibrium structure of safeguarding and coordinating provisions. The second “alignment” refers to aligning the specialist knowledge of individuals to various provision types (Argyres & Mayer, 2007). The extant literature has indicated that managers and engineers are more experienced in crafting coordinating clauses, such as the specification of labor division and working procedures, whereas lawyers are better at specifying safeguarding clauses, such as the allocation of control and decision rights (Argyres & Mayer, 2007; Duplat & Lumineau, 2016; Vanneste & Puranam, 2010). Therefore, firms with superior contract design capability should be able to effectively configure individual's knowledge to design those different types of provisions.

Download English Version:

<https://daneshyari.com/en/article/11009873>

Download Persian Version:

<https://daneshyari.com/article/11009873>

[Daneshyari.com](https://daneshyari.com)