



Why the proposal of a complex contract may harm or foster a partner's trust[☆]

Sandra Praxmarer-Carus^{*}

Universität der Bundeswehr München, 85577 Neubiberg, Germany
University of Wollongong, NSW 2522, Australia



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ABSTRACT

Extant literature suggests, but has not tested, explanations as to why the proposal of a complex contract, compared to a simple contract, may harm or foster a new business partner's trust. This paper uses qualitative interviews to confirm four explanations that the literature suggests and to identify an additional explanation that the literature has not considered. Then, the paper presents an experiment with scenarios in three countries to determine whether the explanations (mediators) prove relevant. Each of the explanations proved relevant in at least one of the countries. The findings demonstrate that (1) the mediators this paper tests are useful in explaining the effects of contract complexity on a partner's trust, and they suggest that (2) culture moderates how individuals interpret complex contracts and build trust. For future research, the mediation model this paper proposes provides a basis for detailed tests of relevant moderators.

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1. Introduction

When initiating complex business relationships with new partners, firms must determine the intended level of detail (complexity) of their contracts (Mouzas & Ford, 2006; Wuyts & Geyskens, 2005). High contract complexity is not mandatory because studies demonstrate that most individuals do not behave opportunistically when a contract leaves some aspects open (Mahoney, Huff, & Huff, 1994).

In determining contract complexity, firms should consider that the complexity of a contract that a firm proposes to its partner may affect the partner's trust (Poppo & Zenger, 2002). However, existing literature does not indicate whether this effect is positive or negative (Klein Woolthuis, Hillebrand, & Nooteboom, 2005). Why is it relevant to understand how contract complexity affects trust? In complex business interactions, trust is crucial for successful and sustainable cooperation, whereas even the most complex contract is unable to address all eventualities of the future relationship and therefore cannot substitute for trust (Gundlach & Achrol, 1993; Klein Woolthuis et al., 2005).

This paper focuses on the effects of a complex contract, compared with a simple contract, on a new partner's trust at the beginning of a relationship. Ferrin, Bligh, and Kohles (2008: 175) emphasize that the development of a trusting relationship is “fundamentally affected by partners' initial moves.” The proposal of a complex contract, compared to a simple contract, may be one such move. Thus, by proposing a

more complex or less complex contract, a firm may influence the initial trust of its partner and thus influence how the relationship develops.

Some authors theorize that complex contracts are more likely to foster a partner's trust than are simple contracts (e.g., Bennett & Robson, 2004; Sitkin & Roth, 1993), whereas other researchers argue that complex contracts may damage trust between partners (e.g., Lewicki, McAllister, & Bies, 1998; Mahoney et al., 1994; Poppo & Zenger, 2002). In addition, empirical studies report both positive and negative relationships between contract complexity and trust (Table 1 provides examples). As a consequence, it is necessary to obtain a better understanding of when positive and negative effects arise from the use of a complex contract. However, for a meaningful test of potential moderators, one must first understand the paths that link contract complexity with trust, that is, the perceptions that complex contracts may evoke and that may mediate their effect on trust. The present paper aims to determine these paths. The paper uses qualitative interviews to identify the positive and negative perceptions that complex contracts, compared with simple contracts, evoke to influence individuals' trust in their partners. The paper then tests these explanations (mediating variables) with an experiment. The mediation model that this paper proposes contributes to a better understanding of how and why contract complexity affects a partner's trust. Previous research has not tested such explanations. Future research may utilize the mediation model for a systematic test of moderating variables.

This study focuses on the beginning of a relationship and a new partner's immediate reaction to a contract because trust/distrust in the early stages of a relationship fosters/hinders the development of mutual success (Adobor, 2005; Malhotra & Murnighan, 2002). Previous studies have examined the relationship between contract complexity

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^{*} Universität der Bundeswehr München, Fakultät für Wirtschafts- und Organisationswissenschaften, Werner-Heisenberg-Weg 39, 85577 Neubiberg, Germany. Tel.: +49 89 6004 4211.

E-mail address: Sandra.Praxmarer@unibw.de.

Table 1

Studies on the relationship between contracts and trust or related constructs.

Authors, country	Variables	Relationship
Dwyer and Oh (1987), US	Level of formalization	Relationship quality (trust is a component)
Ivens and Pardo (2005), Germany	Usage of complex contracts	Customer trust
Möllering (2002), Great Britain	Usage of complex contracts	Perceived trust-worthiness
Mooi and Ghosh (2010), The Netherlands	Contract specificity	Reduction of ex post transaction problems
Brown et al. (2006), US	Extent of govern. by explicit contracts	Satisfaction, conflict
Gundlach and Achrol (1993), US	Complex contractual regulations	Relational social norms (including trust)
Jap and Ganesan (2000), US	Level of formalization	Commitment
Malhotra and Murnighan (2002), US	Existence of contracts	Partner trust

^a Insignificant.

and trust (or related constructs) in established relationships (without investigating the black box of mediators as this study does). The studies asked respondents to identify the type of contract in a certain relationship and measured their trust in their partners. Although valuable, such surveys merely report relationships; they cannot test whether different levels of contract complexity cause certain reactions (e.g., Liu, Li, & Zhang, 2010; Mooi & Ghosh, 2010). To examine whether variation in contract complexity affects individuals' perceptions of and trust in a partner, experiments are useful. Thus, to test the mediating variables, this study utilizes an experiment with scenarios that randomly assigns participants to a complex contract or a simple contract.

The following section defines the relevant concepts. Section 3 draws upon the relevant literature and open-ended interviews to identify the perceptions (mediating variables) that complex contracts may evoke and that may explain the effect of these contracts on trust. Section 4 describes tests of the relevance of the explanations in an experiment in which the participants experienced a simple or a complex contract. Finally, Section 5 discusses the results.

2. Contracts and trust in this research

2.1. Contracts

The literature demonstrates that firms use different forms of business agreements with their partners (e.g., Mouzas & Ford, 2006). In established relationships many firms use umbrella agreements that provide “a set of rules” (Mouzas & Ford, 2012a: 155) designed to help partners to reach mutual consent in upcoming interactions but that do not regulate immediate contractual specifications (Mouzas & Ford, 2006). However, in new relationships firms often use contracts that focus on immediate contractual regulations. Such contracts are studied here.

Contracts are written agreements between two or more parties that the parties perceive as (or intend to be) binding (Lyons & Metha, 1997). Complex contracts contain numerous clauses that specify details and precisely record the parties' obligations (e.g., including the specifications of sanctioning), whereas simple contracts convey only the broad lines of the exchange and contain few or more general clauses (Klein Woolthuis et al., 2005: 817; Wuyts & Geyskens, 2005: 103). Simple and complex contracts, as studied here, do not differ with regard to the obligations and behaviors to which partners may have verbally agreed. The difference lies in the proportion of the obligations that the contract explicitly records. It is also important to note that the complexity of a contract is independent of its fairness. The conditions that a company proposes in a complex contract may be as fair as the conditions in a simple contract (and vice versa).

Anderson and Dekker (2005) and Mooi and Ghosh (2010) observe that firms are more likely to use highly complex contracts for larger transactions, more specific assets, and more complex products. However, the complexity of the contracts that firms use varies even when such characteristics are comparable and a similar level of risk is involved

(Anderson & Dekker, 2005; Klein Woolthuis et al., 2005). Thus, in practice, both complex and simple contracts exist, and a firm must decide on the intended level of detail of its contracts.

2.2. Trust and the trusting parties

This study utilizes the understanding of trust that Mayer and Davis (1999: 124) suggest: Trust is a psychological state comprising the “will- ingness to engage in risk-taking with the focal party.” Mayer and Davis (1999) argue that, for instance, perceived ability and benevolence are not trust but rather factors that influence trust. Consistent with this study's definition of trust, there are no different forms of trust; there are only different reasons that individuals develop trust.

“Trust is an anthropocentric notion” (Mouzas, Henneberg, & Naudé, 2007: 1017) because “it is individuals as members of organizations, rather than the organizations themselves, who trust” (Zaheer, McEvily, & Perrone, 1998: 141). Therefore, the trustor (that is, the research entity who trusts) in this study is an individual who may react with trust or distrust to a certain contract that a partner firm proposes. Individuals may trust a person or an organization (Currall & Inkpen, 2002; Mouzas et al., 2007). This research studies individuals' trust in a partner organization because contracts are more likely to affect trust in the partner organization rather than trust in a single member of that organization. Contracts bind organizations, not individuals, and contracts are typically influenced by several members of an organization and are thus more likely to evoke perceptions of the organization than perceptions of individuals.

The theoretical explanations that this study proposes may apply to both buyers and suppliers. The major precondition for the explanations' relevance is that the exchange relationship involves risk and interdependence for both parties. However, in the experiment (Section 4) that tested whether the alternative mediating variables proved relevant, the trustor was a supplier, and the trustee was a buyer.

3. Alternative explanations for the effects of complex contracts on a partner's trust

What perceptions does a complex contract that a partner proposes, compared with a simple contract, evoke in the minds of individuals and thus influence their trust? This study employs a two-step process to answer the above question. The first step describes explanations that the literature suggests. In the second step, this study uses open-ended interviews to gain additional insights into positive and negative perceptions that complex contracts, compared with simple contracts, evoke in individuals' minds.

3.1. Explanations in the relevant literature

This section introduces four of the five paths (i.e., mediating variables) that Fig. 1 depicts. The perspective that the paper adopts is that party (A)

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