



Contract research today: Where do we stand?

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ARTICLE INFO

Article history:

Received 1 November 2012

Accepted 25 June 2013

Available online 31 August 2013

Keywords:

Relational contracts
Incomplete contracts
Framework contracts

ABSTRACT

New insights of empirical studies in contract research do not always conform to those that might be expected as a result of these theoretical studies. Much of the research into the nature and form of contracts has been of a theoretical nature and it is often referred as 'relational contract' or 'incomplete contract' theory. In comparison, a limited number of empirical studies have been undertaken. This paper will set out the findings of these two major streams of theoretical analysis of contracts and then contrast them with recent empirical research into 'framework contracts'.

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1. Introduction

A great deal of contract research has been of a theoretical nature and it is often referred as 'relational contract' or 'incomplete contract' theory (Baker, Gibbons, & Murphy, 2002; Blois, 2002, 2003; Furlotti, 2007; Harrison, 2004). Contract research today can be considered as an attempt to a) explain exchange behaviour by taking into account circumstances of continuing relationships or b) investigate efficiency of governance forms of these exchange relationships. A recent review (Ford, Gadde, Håkansson, Snehota, & Waluszewski, 2010) of the Industrial Marketing Purchasing (IMP) model comments that "business activities, actors and resources take their form and are defined by the interactions in which they are involved". The present article seeks to make a contribution to the understanding of business interactions by considering one distinctive form of contracts that is increasingly used in practice – namely framework contracts. Within a world of exchange relationships, understanding the nature and form of contracts is an important issue (Argyres & Mayer, 2007; Baker, Gibbons, & Murphy, 2008; Faems, Janssens, Madhok, & Van Looy, 2008; Heide & John, 1990; Poppo & Zenger, 2002; Reuer & Arino, 2007; Roxenhall & Ghaur, 2004). Such understanding allows us to look at manifestations of agreements and, hence, to examine how contractual decisions are reached, expressed and enforced.

Despite the relevance of nature and form of contracts in today's business landscape, only a limited number of empirical studies have been undertaken. We find this surprising considering the evidence that businesses are moving away from immediate contractual decisions to arrange new forms of contracts known as framework contracts or

umbrella agreements (Crone, 1993; Mouzas, 2006; Mouzas & Ford, 2006, 2007; Mouzas & Furmston, 2008). Framework contracts are manifestations of agreements that define the fundamental principles upon which companies wish to work together. These new forms of contracts can be found in all sorts of business alliances, strategic partnerships, collaborations or other 'give-and-take' exchange processes between individuals or companies.

In a business context characterized by rapid change, companies enter into framework contracts for the benefits that derive from facilitating the whole process of exchange relationships. Framework agreements a) reduce the costs in terms of time and effort to select, manage and oversee single exchanges; b) provide certainty regarding the conditions under which exchanges may take place; and c) reduce information asymmetry by providing a platform for continuing interaction and coordination. In this way, framework contracts take the form of 'constitutions' of contracts (Mouzas & Furmston, 2008). The paper examines the theoretical perspectives of relational and incomplete contracts, considers the empirical evidence of framework contracts, and draws conclusions about future contract research.

2. Relational and incomplete contracts

The idea of relational contracts was developed by Macneil (1974, 1975, 1980, 1983, 1985, 2000), who observed that the applicable common contract norms (see Campbell, 2001) determine how contracts operate. The argument for relational contracts is grounded in the claim that because contract theory fails to adopt a relational paradigm "it is bound to remain out of touch with reality and riddled with fiction, and thus fail to explain precisely what it sets out to explain" (Kimel, 2007, p. 250). Kimel summarizes Macneil's approach commenting that: "parties to certain types of contract do not see the contract to which they are party as a conclusive list of fixed rights and obligations, but rather as a starting point for re-negotiation and adjustment when

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circumstances change or difficulties arise; parties in practice not insisting on their contractual rights and not taking too seriously the option of litigation, but rather exhibiting the ongoing willingness to make the necessary adjustments in order to continue to cooperate" (2007, p.250). Relational contract analysis has been highly influential in management literature and contributed to the recognition that it is not only discrete transactions that are covered by contracts. Management studies approached relational contracting as a governance mechanism (Williamson, 1985; Leblebici & Shalley, 1996; Poppo & Zenger, 2002) that involves long-term highly specific investments (Ring & Van de Ven, 1992); fosters inter-firm trust (Das & Teng, 1999, 2000; Zaheer & Venkatraman, 1995) and minimizes the risk of opportunistic behaviour (Carson et al., 2006). The influence on management studies might be attributed to the seminal work of Macaulay (1963) that drew the attention of management research to non-contractual relationships in business. Nonetheless, the applicability of relational contracts to business relationships in the real world remains limited¹ and some scholars (e.g. Bernstein, 1992; Barnett, 1992b; McKendrick, 2002) question the assumptions of relational contract approaches. While relational governance and formal contracts do not function as substitutes but as complements (Poppo & Zenger, 2002), a contract is per se relational because it establishes a relation of recognition and respect among those who decided to participate (Markovits, 2004). The idea of relational contracts is based on an essential misunderstanding as the particularities of relational contracts derive from the specific function of the contractual arrangement and not from the fact that a contract is relational (Eisenberg, 2002; McKendrick, 2002; Mouzas & Furmston, 2008).

In comparison, the idea of *incomplete contracts* was developed by organizational economists who argue that while some elements of a contract can be certain, for two reasons "complete, fully contingent, costlessly enforceable contracts are not possible" (Klein, 1980, p. 356). First, contingencies exist and it may be costly or impracticable to specify responses to all of them (Maskin & Tirole, 1999). This source of contractual incompleteness is also attributed to bounded rationality (Segal, 1999; Tirole, 1999). Second, transaction costs may make it expensive or effectively unfeasible to measure some types of contractual performance. Transaction Cost Analysis is very useful in the investigation of inter-firm arrangements, including those categorized as 'hybrids' (Williamson, 1985) as well as corporate finance decisions (Hart, 1995; Hart & Moore, 1998). Nonetheless, these studies' rigorous assumptions mean that their conclusions have to "be applied with caution to the actual world of contracts and judicial practice" (Shavell, 2006, p. 292).

3. Research methods

This research was inspired by a joint Research Seminar in April 2008 between Lancaster University's Law and Marketing faculties to honour Macneil's contribution to our understanding of business contracts. Following this event, empirical research was conducted between September 2008 and March 2011 in the context of multinational firms in Germany and the United Kingdom involving manufacturers of consumer and pharmaceutical products, service providers and grocery retailers. A realist epistemological stance guided our empirical research endeavours (Sayer, 2000; Tsang & Kwan, 1999). We considered the existence of framework contracts as real and independent of us as observers. The real world of inter-firm contracts, however, was not given to us transparently; in a dialectical way, we needed to use conceptual tools and empirical data to

describe and explain cause-and-effect links of the phenomena that we observed (Tsoukas, 1989). After the research event in April 2008, we realized that we needed to engage in a longitudinal data collection exercise that captured inter-firm contracts in their temporal and spatial context (Pettigrew et al., 2001) and simultaneously overcome the initial reluctance of firms to reveal sensitive information about their contractual arrangements. We identified expert interviewees and develop insights into the history and characteristics of relevant business-to-business relationships. In addition to these interviews, publicly available information in the form of 241 press releases and 32 annual reports were collected representing a total of compilation of 864 pages. Within a period of 2 1/2 years, in March 2011 the pool of interviewees reached 83 decision makers. Interviewees included Corporate Lawyers, Sales Directors, Marketing Directors, Key Account Managers, Category Managers, Purchasing Managers, Financial Managers, Trade Marketing Specialist and Logistics Specialists. Each interview was face-to face in the native language of the interviewee and lasted about 45 min. Obtaining contemporary inter-firm contracts was a novel method to move beyond subjective views obtained through interviews and examine objectified records and manifestations of consent between firms. Furthermore, data collection placed emphasis on obtaining organizational procedures, archival records, reports prepared for key accounts, e-mails as well as protocols. Field observations were classified, catalogued and entered into a "chronological events list" and served as a filter or index to the wider set of observations. This was crucial in the collection of primary data because it helped us carry out a closer examination and triangulation of the data and allowed us to examine the prior and current context of inter-firm contracts.

4. The empirical evidence

Framework contracts are not concerned with immediate contractual decisions and are in fact 'framework' contracts that provide a set of clauses which regulate the conclusion of future contracts. This does not imply that framework contracts are necessarily long-term business contracts. What differentiates framework contracts from other contractual agreements is, therefore, not the time horizon of the contractual arrangement but its function; and the function of a framework contract is to supply clauses that can be used in a defined set of transactions.

The parties to a framework contract are usually not required to specify new terms in their future transactions nor are they required to refer to the pre-existence of a framework contract. The advantage for buyers is that if they need a particular product or service, they only need to specify the quantity and price or arrange continuous stock replenishment. For this reason, framework contracts are often encountered in regular, stable and established business relationships such as manufacturer-retailer relationships, manufacturer-supplier relationships, agency relationships (e.g. service providers in banking, consulting, technology or advertising) as well as in business-to-business co-operations, strategic partnerships and alliances. In these established relationships, contracting parties acknowledge and recognize their interdependence and seek to articulate the basic norms that could pave the way toward a jointly decided action.

In drafting framework contracts, purchasing managers and key account managers draw on the expertise of other experts or staff departments, such as the legal, marketing or production departments. Termination clauses or exit scenarios are usually inserted as pre-packaged 'boilerplates' carefully drafted with the help of corporate lawyers. In practice, however, framework contracts do not constitute any obligation to buy or sell anything. For example, during the annual negotiations of framework contracts, contracting parties may agree on the listing of products or services e.g. shelf space and on the framework terms e.g. trade allowances which are the fees to obtain distribution.

¹ See Schwartz, 1992, for an analysis of relational contracts in US courts. See also Baird Textile Holdings Limited and Marks & Spencer plc, 2001 para. 16 for a legal dispute where senior English judges vigorously rejected any attempt to make use of a 'relational' argument.

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