

CONTRACT LAW, SOCIAL NORMS AND INTER-FIRM COOPERATION

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Abstract

This paper analyses the influence of the institutional framework for exchange upon inter-firm cooperation. The focus is on the relationship between contract law and less formal, social norms, with evidence drawn from a cross-sectoral, three-country study of contracting practice. Contrary to earlier empirical studies and to models drawn from transaction-cost theory, we find that contract law may play an important role in underpinning long-term, cooperative relationships and in fostering trust.

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1. Introduction

This paper is concerned with the influence on inter-firm relations of the *contractual environment*, or the social, institutional and organisational context within which contracts are embedded (cf. Granovetter, 1985). Evidence is drawn from a cross-sectoral, three-country study of relations between firms in vertical supply chains. We find that both the legal form of contractual relationships and the wider strategies adopted by firms with regard to their suppliers and customers are sensitive to differences in the institutional framework for exchange, as constituted by the system of contract law and by less formal, social norms governing business relations. Inter-country differences are particularly marked, by comparison to those between sectors. Contrary to earlier studies of a similar kind (Macaulay, 1963) and to models based on transaction-cost reasoning (Williamson, 1985), we conclude that contract law may play an important role in underpinning long-term relations based on cooperation and trust.

The paper is constructed as follows. After a review of conceptual issues concerning cooperation and trust and the economic role of contract law, we outline the principal institutional and organisational features of the sectors in the survey. We then analyse evidence relating to three dimensions of inter-firm cooperation: the form and duration of contractual agreements; the use of contract as a planning and incentive device; and firms' resort to the legal system to resolve disputes. The paper considers the role of institutional forces in shaping contractual strategies and concludes by reflecting on the significance of the findings for theories of contract and trust.¹

2. Inter-Firm Cooperation: Conceptual Issues

Cooperation, in the sense of the owners of different inputs working together, is clearly a technical necessity for the process of production, whether it is organised within a single firm or in the form of relations between firms in a vertical supply chain (for discussion, see Deakin and Wilkinson, 1996). However, the concept of *inter-firm cooperation* refers, more precisely, to

relations of mutual dependence between organisations which retain their separate identity as legal and/or economic entities. In transaction-cost terms, these relations are said to exemplify a distinct form of economic coordination which is 'neither market nor hierarchy' (Powell, 1990; Ring and Van de Ven, 1992). Examples of such 'hybrids' or 'networks' of firms include franchising, patent licensing, joint ventures and (the focus of the present study) customised subcontracting.

So defined, the concept of inter-firm cooperation is not adequately captured by the example of two firms simply engaging in repeated or recurrent trading with one another. Inter-firm cooperation implies a long-term orientation of some kind which is common to both parties. The act or sequence of exchanges could, in itself, induce a mutual expectation of continued trading in the future. At a higher level of formality, the parties could at some point consciously set out to foster a long-term relationship, that is to say, one which spans a sequence of exchanges, and this could be supported either by a long-term contract or by a looser agreement that the relationship will continue, or by a combination of the two.² Inter-firm cooperation in the sense used here also implies a degree of risk-sharing and exchange of information and expertise during performance, which may take such forms as the joint ownership or cross-ownership of patents and machines, the joint development of products and processes, the shared development of marketing strategies, or the exchange of staff. This distinction between merely recurrent trading and exchange within the context of a consciously cooperative relationship was reflected in the findings of our empirical study, and is analysed in further detail below.

Interest in the link between cooperation and economic performance has been stimulated by recent work on inter-firm networks. Networks are seen as a potential source of enhanced efficiency and competitiveness (Casson, 1993: chapter 3). Their success is said to depend on achieving a certain balance between competition and cooperation (Dei Ottati, 1994). On the one hand, competition between supplier firms produces a higher degree of specialisation and a more extensive division of labour, and hence a higher level of productivity, than is possible within the large, vertically-integrated organisation; on the other, cooperation between buyers and suppliers enables them to pool risks and draw on each other's distinctive capabilities in the form of specific skills, information and tacit knowledge of processes and

techniques (Loasby, 1994). It is conceivable, then, that the evolution of inter-firm relations towards cooperation of this kind is being driven by competitive forces, and above all by the intensification of competition in product markets which has accompanied increasing demands by buyers for greater customisation and flexibility in production and delivery of goods and services.

Evidence for the efficiency properties of this type of relation has been drawn from a wide range of sectoral, regional and national contexts (see Altmann and Sauer, 1989; Amin and Dietrich, 1991). At the same time, studies reveal the great variety of forms taken by inter-firm cooperation (Bureau of Industry Economics, 1994). While features of the 'Japanese' model of supplier relations, such as just-in-time delivery and joint control over product design and technology, have had a certain influence on business practice in north America and western Europe in particular sectors such as vehicle manufacturing (Helper, 1991) and consumer electronics (Morris and Imrie, 1992), it is an open question how far this pattern is replicated in other sectors. The widely analysed model of the Italian 'industrial district', which has been highly successful in sectors including footwear, clothing and parts of engineering (Sengenberger, Loveman and Piore, 1990; Pyke, Cossentini and Sengenberger, 1996; Dei Ottati, 1996), has little counterpart, it seems, in comparable British industries (Wilkinson, 1994). Sako (1992), similarly, draws a contrast between 'arms-length' and 'obligational' contracting in supplier relations in Britain and Japan respectively, although she also suggests that obligational contracting is not sufficient, in itself, to bring about greater competitiveness.

How far diversity in the form of inter-firm relations may be explained by the role of social institutions in sustaining cooperation, and what the links are between cooperation and competitiveness, are key issues. Our interest here is primarily with the former, although we also examine efficiency issues by providing evidence on the motivations given by firms for entering into cooperative activity. In this context, Dei Ottati (1994: 475) has suggested that 'the smooth functioning of a market economy necessitates the presence of formal and informal institutions, which permit the formation and permanence of an economic and social environment in which constructive forms of cooperation and competition can prevail over destructive ones'. This implies a closer focus on the role played by institutional forces which

remain largely specific to particular nations, regions or sectors, including the legal system, less formal 'social' norms and practices governing business practice, and prevailing notions of what constitutes ethical behaviour in business relations.

3. Institutions, Trust, and Contractual Performance

Although the institution of contract law is commonly thought to be one of the principal mechanisms for enhancing the security of business transactions in market economies (e.g. North, 1990: 14), its precise role in this respect remains somewhat obscure and in need of further investigation. Particularly unclear is the relationship of law to 'trust', the latter being understood as a means of reducing uncertainty and risk and enhancing cooperation in the context of business contracting.³

In principle, a dual role for contract law in supporting economic exchange may be identified: the law firstly creates a space within which the parties can plan the exchange, making due provision for future contingencies (the planning function), and secondly provides a set of sanctions aimed at inducing performance of the agreed obligations (the incentive function). A range of sanctions is available to courts including orders for payment of the agreed price, awards of damages to compensate for breach of contract and specific performance of contractual promises. Empirical research, however, has found the role of the law in commercial transactions to be marginal, at best. The predominant view is that of Macaulay, that 'many, if not most, exchanges reflect no planning, or only a minimal amount of it, especially concerning legal sanctions and the effect of defective performances' (1963: 60). Macaulay's study of inter-firm contracting in Wisconsin found that managers were uncertain about the point at which they entered into legal relations, were unsure about their responsibilities in the event of contingencies, and were highly sceptical about the value and relevance of breach of contract damages. Extra-legal sanctions and pressures, in particular the need to maintain the firm's reputation, were more important than the threat of legal action in inducing performance, and firms dealt with risk not by detailed legal provisions but by a variety of devices including purchasing business-loss insurance, making reserves for bad debts and placing orders with several suppliers. Conversely, resort to legal action carried a high price, particularly

in the context of a long-term relationship. Litigation raised implications of bad faith and, since it was likely to lead to an irrevocable breakdown of the relationship between the parties usually occurred only where a relationship had already ended, as in the case of terminated franchise or employment contracts.

Beale and Dugdale's parallel study of engineering contracts in Britain confirmed this basic picture, but also amplified Macaulay's findings in a number of significant respects. Their research highlighted the role of trade customs, 'unwritten laws' and repeat trading in providing a basis for contractual cooperation based on trust: 'besides there being a common acceptance of certain norms within the trade, there was a considerable degree of trust among firms... belief in mutual fairness was reinforced by the considerable degree of personal contact between officers, usually in the business context but sometimes on social occasions' (Beale and Dugdale, 1975: 47). They nevertheless also suggested that contract law provided a residual form of security for firms as well as offering a basis for systematic planning over risk in certain areas, in particular in the terms of payment and credit. Detailed contractual arrangements were also more likely in situations where there were no accepted trade customs, such as when two firms from different countries or from different sectors dealt with each other.

These empirical studies have been widely read as implying that the role of the law in contractual relations is inversely related to the need for or presence of cooperation (although whether this view is properly attributable to the Beale and Dugdale study is perhaps open to question). This viewpoint has found support in Williamson's much-analysed division of contractual types into 'classical', 'neoclassical' and 'relational' (Williamson, 1985; see Maher, 1997; Lyons and Mehta, 1997). 'Classical' contract law, based on full legal protection for the expectation or bargain interest of the promisee, is only of relevance for that (arguably limited) category of trades in which asset specificity and expected frequency of exchange are so low that the contract can be regarded as fully expressing all the future rights and obligations of the parties. In 'neoclassical' contracting, based on greater asset specificity but low frequency, court-based ordering is less important than arbitration (Macneil, 1978) or contractual clauses making express provision for flexibility, such as 'hardship clauses' whereby the parties agree to renegotiate

the contract in the event of a change of circumstances (see McKendrick, 1995). At the relational pole, where agreements not only have uncertain starting and finishing points but the relationship itself ‘develops obligations which may or may not include genuinely expressed, communicated and exchanged promises of the parties’ (Macneil, 1974: 739) the success of the exchange is ‘entirely dependent on *further co-operation* in both performance and further planning [emphasis added]’ (Macneil, *ibid.*; see also Goldberg, 1976; Campbell and Harris, 1993).

A relational perspective therefore suggests a need for flexibility in the legal enforcement of contractual obligations (Campbell and Harris, 1993). In particular, it points to circumstances in which it is not optimal to accord *full* legal protection to the bargain or expectation interest. The formal contract or agreement is now less important as a reference point for dispute resolution than the continuing relationship. The interest both parties have in maintaining the relationship, which derives from the absence of a viable substitute contract, means that contracting of the ‘neoclassical’ kind is, in one sense, unnecessary, since it is in the parties’ self-interest to adjust flexibly to changing circumstances; in another sense, neoclassical contracting is ineffective to resolve the disputes which arise in this situation since the generic mechanisms which it deploys, such as hardship clauses, are not sufficiently flexible to resolve the disputes which may arise in the course of a specific relationship (Williamson, 1985: 77).

The concept of bilateral governance in relational contracts predicts, then, a large role for self-enforcement, and the various means by which the parties can create their own incentive structure for performance through hands-tying, collateral and other forms of ‘credible commitment’ have been extensively analysed (Williamson, 1983; Kronman, 1985). The importance of reputation and repeat trading in building trust which is stressed in the empirical, socio-legal studies (Macaulay, 1963; Beale and Dugdale, 1975) has been given a ‘calculative’ explanation by game-theoretical accounts of strategic interaction (Kreps, 1990; Coleman, 1990). The implication here is that cooperation based on self-interest may emerge without the need for the intervention of the legal system.

Equally, those who stress the role of 'socially oriented' or 'goodwill' trust of the kind which rests on shared cultural values, close personal or family ties, or gift-exchange, also tend to see this as the antithesis of formal, legally-binding agreements (Sako, 1992; Lyons and Mehta, 1997). Sako's concept of *goodwill trust* refers to 'the expectation... that trading partners are committed to take initiatives (or exercise discretion) to exploit new opportunities over and above what was explicitly promised' (Sako, 1992: 39; similarly, Ring and Van de Ven, 1992: 488). Goodwill trust is diffuse, and essentially derives from personal interaction: according to Sako (1992: 38-38),

there are no explicit promises which are expected to be fulfilled, as in the case of 'contractual trust', nor fixed professional standards to be reached, as in the case of 'competence trust'... 'goodwill trust' is more contextual and therefore verifiable only in particularistic settings; a buyer and a supplier have to start trading and see if they entertain shared principles of fairness and convergent mutual expectations about informal obligations.

Not even 'contractual trust' involves much of a role for either contract formality or for legal intervention in Sako's account: contractual trust involves reliance on oral, rather than written agreements, and total reliance on legal sanctions would, she suggests, imply zero contractual trust (Sako, 1992: 43).

However, this point of view neglects a significant strand of the theoretical literature which maintains that it is also possible to search for the origins of trust and for the means of its reproduction in institutional normative structures of a more formal kind, including those of the legal system (Zucker, 1986; Luhmann, 1979: 40). Both contract law doctrine and the more complex types of contractual agreement may provide a foundation for *systems trust*, by formalising shared expectations and assumptions of what constitutes accepted behaviour (Lane and Bachmann, 1996; Deakin and Wilkinson, 1996; Wilkinson and Burchell, 1996). This perspective, rather than viewing contractual behaviour in isolation from the institutional framework, sees the relationship between formal institutional structures, informal social norms and contractual behaviour as being of central importance.

4. Diversity in the Contractual Environment: Sectoral and Institutional Factors

A comparative empirical study was undertaken to assess the impact on contractual relations of institutional and market conditions which were specific to a given industry as well as those operating more generally within a given region or country. The concept of the *contractual environment* adopted here refers to the 'broad normative framework of laws, customs and assumptions within which inter-firm relations are embedded' (Deakin, Lane and Wilkinson, 1994: 330), as well as other factors which might affect the form and contents of contracts including the available state of know-how, technology and the structure of the markets concerned. This definition is wider than the notion of the 'institutional environment' given by Davis and North (1971: 6-7), for example, in that it makes reference to market structure as an important potential influence on contract form (Maher, 1997), as well as to other constituents of supply and demand. For present purposes the *institutional framework* for exchange is seen as only one aspect of the environment in which firms operate, and the extent to which it interacts with product-related and technical factors in influencing firms' contracting strategies is an important focus for the research.⁴

The subject-matter of the study consisted of relations between buyer and supplier firms in Britain, Germany and Italy. A random sample of firms from two sectors (mining equipment and kitchen furniture manufacturing) was drawn from lists of organisations obtained from trade sources in the three countries; of those firms initially contacted, around 40 per cent agreed to be interviewed. 62 firms were interviewed in all. The respondents included 14 main or buyer firms (6 German, 4 British and 4 Italian) and 48 suppliers (17 German, 16 British and 15 Italian), spread more or less evenly over the two sectors concerned. Interviews were carried out, using a semi-structured questionnaire, between November 1993 and December 1994, providing extensive qualitative and quantitative data on contractual practice. Those interviewed almost invariably occupied a senior position in the company in question, and included managing directors, purchasing and sales executives and legal officers. Information in the form of contracts and other legal documentation was also obtained from firms.

The sectors were chosen in order to assess the extent to which inter-firm cooperation was becoming more common in industries with little exposure to the Japanese-style practices which have been the focus of much attention in the literature, but which are not necessarily typical. The two sectors also possess contrasting features in terms of stability of demand, entry and exit costs, the intensity of competitive pressures, the degree of concentration of market power, and the extent of involvement by the state.

In Britain and Germany mining equipment manufacturing is a traditional sector with high start-up costs in the form of investments in physical assets and skills, an important role for the state through energy policy, and, until recently, a dominant position for large monopsony buyers, the coal producers, at the end of the supply chain (British Coal and Ruhrkohle AG respectively). For most of the post-war period a stable if gradually declining domestic market was ensured in each country, largely as a consequence of state support for the coal industry as a major supplier of national energy needs. Relations in the industry were highly organised and competition subject to a comparatively high degree of regulation through standards of various kinds. Typically, the coal production companies would buy machinery from manufacturers of integrated machines such as coal shearers and conveyors; these 'original equipment manufacturers' (OEMs) in turn subcontracted to producers of specialised parts, such as belting, cowls and electrical parts, and to steel producers. It was also common for both British Coal and Ruhrkohle to buy parts direct from subcontractors, and then transfer them to the OEM with which they had contracted for the final machine. The coal production companies thereby ensured that their preferred standard contract terms prevailed at each point in the chain and that their choice of subcontractor would be respected. Even where this practice was not followed, it was common for standard terms influenced by the coal producers to be observed throughout the respective industries (Interview Notes).

However, in both Britain and Germany the industry has faced a severe crisis in the 1990s as a result of the decline in coal production in western Europe, forcing manufacturers to shift their attention from previously stable domestic markets to overseas markets where demand is currently increasing (these include China, Iran and the former Soviet Union). In Britain, the privatisation of electricity and then of the coal industry itself meant that the upheaval was

exceptionally intense (Robinson, 1995), whereas in Germany the effects of change have been cushioned somewhat by long-term contracts for the supply of coal to the steel and electricity industries which are subsidised by the state (Kienitz, 1987). In Italy, by contrast, equipment manufacturers' dependence on the coal sector was much more limited (Interview Notes). The lack of a sizeable domestic coal market long ago led to firms moving into alternative markets such as quarrying, mineral extraction and the building industry. The Italian equipment companies in our survey had not, as a result, faced a situation of such close dependence on one ultimate buyer, nor had they been so adversely affected by the decline of coal production in Europe.

Kitchen furniture manufacturing is an industry which has grown steadily in recent years in each of the countries studied, as customer demand for fitted kitchens has increased. Start-up costs are comparatively low, there are large numbers of buyer and supplier firms at most points in the vertical chain, few organisations possess any degree of market power, and state involvement in the industry is minimal. The supplier firms in our sample produced components ranging from hinges, plastic verges for doors, cupboards, sinks and various other items of kitchen furniture. Buyer firms produced fitted kitchens according to a variety of techniques. A form of continuous-flow mass production was used for the supply of standardised items to large retailers, for sale to end-users in the form of self-assembly packs. Small batch production was used where firms sold direct to building firms which required kitchens for a set of newly-constructed properties, while at the higher-quality end of the market firms would produce what were in effect bespoke or one-off designs for existing properties, customised to the needs of a particular household. Production for the high-quality, customised segment of the market was the norm in Italy and to a lesser degree in Germany; in both these countries the industry was concentrated in a few regions with close links between firms at local level. In Britain there was less regional concentration and, despite a rapidly-growing sector of firms engaged largely in customised production, there was a large number of firms using less expensive forms of production and techniques and skills which were perceived to be generally available.

In principle, sectoral conditions might be expected to influence the form of inter-firm relations in a number of different ways. Highly stable conditions such as those which prevailed in mining machinery prior to the upheavals of

the early 1990s, could be seen as providing firms with the necessary protection from short-term pressures in which to develop cooperative relationships. However, cooperation could also arise as a response to increasing competitive intensity, as firms decide to collaborate in the development of new products and processes in response to demands for greater customisation. Mining machinery therefore represents an important case-study of how firms in a once-stable industry respond to the extreme uncertainty induced by a major external shock. In the case of furniture equipment, the sources of uncertainty are different; they derive principally from the large numbers of potential competitor firms at most points in the chain, and from the short-term instability of demand caused by fluctuations in housing markets and in patterns of consumer spending. An atomistic market structure provides scope for alternative sourcing, and is one of the factors enabling firms to arrive at efficiency through arms-length contracting (Sako, 1992: 239). On the other hand, an important issue in an industry such as this is whether demands for greater customisation go unmet because the turbulence and instability of the sector makes it too risky for firms to make investments in long-term relationships.

Differences in the institutional framework between countries can also be identified. For present purposes we will focus on the relationship between contract law doctrine and its links to social norms and other, more informal elements in the institutional framework (for a more general Anglo-German comparison, see Lane, 1996, and on Italy, Pyke *et al.*, 1996). At the level of legal doctrine, the most obvious element of divergence is that English contract law is based on the common-law system of precedent, whereas both German and Italian contract law are the product of the civil law process of codification. In itself, this distinction in terms of sources of law has not prevented there being considerable continuity in terms of the substance of legal rules between the common law and civil law systems, with substantial borrowing from one to another (Gordley, 1991). While there are substantive legal differences between the systems, these are a matter of degree rather than being fundamental in nature. However, a major point of divergence which is highly relevant for present purposes is that in both Germany and Italy, contract law doctrine formally places greater stress on the value of cooperation than is the case in the English common law. This is reflected above all in the legal concept of *good faith* which, as contained in article 242 of the German Civil Code

(the *Bürgerliches Gesetzbuch* or *BGB*), has come to have an extensive influence throughout the body of commercial contract law, and beyond. The immediate aim of article 242 is ‘to spell out what performance entails, for example, to show that one need not accept delivery at an inconvenient time...’ (Leser, 1982: 135) but through the interpretations of the courts its function has become one of ‘giving legal force to broad ethical values’ (Leser, 1982: 138). One of the most important areas in which article 242 has been applied is to excuse parties from performance in long-term contracts which have been subject to an unanticipated event, such as an unexpected rise in prices or fall in demand, in such a way as to go far beyond what would normally be permitted by the common law doctrine of frustration of contracts (Dawson, 1983; 1984). In Italian contract law, similarly, the application of the notion of good faith means that performance of contractual obligations ‘must take place with the loyal and honest cooperation of the parties to achieve the reciprocal benefits agreed in the contract. Only in that way can the contract play its part as a useful private mechanism in the context of the “social solidarity” which is the inescapable duty of all citizens under article 2 of the [1949] Constitution’ (Criscuoli and Pugsley, 1991: 142). The English common law, by contrast, has rejected the notion of a *general* duty of good faith in commercial contracts, and the courts have also refused to enforce explicit agreements to negotiate (or renegotiate) contractual undertakings in good faith, on the grounds that the notion is too vague (see McKendrick, 1995, for discussion). This position is not shared by other common law systems, including most US jurisdictions, and there is some countervailing evidence of the growing use of contractual good faith by the English courts in certain contexts (Brownsword, 1997); however, at present the concept lacks the central importance which it has as a guiding norm in the civilian systems.

The study of comparative law emphasises the need for caution when assessing differences in formal legal doctrine between systems, since systems may use different language to reach a similar result; moreover, ‘often a solution is provided by custom or social practice, and has never become specifically legal in form’ (Zweigert and Kötz, 1992: 32). In this case, however, the structure of social and informal norms if anything reinforces the absence in the English common law of contract of a general doctrine of good faith, rather than compensating for it. As Lane (1996) explains, German inter-firm relations are in general characterised by a high degree of institutional

regulation through trade associations at the level of the sector and chambers of commerce at the level of the locality; the promulgation of technical standards by official, state-sponsored bodies, most notably the *Deutsche Institut für Normen*; and by an active role for federal and regional state bodies in the formulation and conduct of industrial policy, which in our study was particularly relevant for the mining equipment sector.

In Britain the role of collective institutions is weaker; trade associations play a more limited role and in some sectors membership is very low. This was the case, for example, with the kitchen furniture sector in our own study; in mining equipment there had been a tradition of strong, industry-level organisation, but with privatisation and the rapid decline in the market for coal the role of the trade association had considerably diminished (see Lane, 1996). Technical standards of a substantive kind, while by no means absent and particularly important, in our study, for mining equipment, are on the whole given less emphasis than process-related standards designed to enhance quality assurance within organisations, BS 5750 and its international equivalent, ISO 9000.

In Italy trade associations are weaker than in Germany and firms' planning is adversely affected by an expectation of macroeconomic instability and uncertainty (Interview Notes). The role of central government in economic regulation is, on the face of it, highly extensive, but its practical impact is limited by what is seen as the undue rigidity of the state bureaucracy. However, there is a greater stress than there is in Britain on quality standards in respect of certain regions, localities and products; however, in contrast to Germany, there is less of a tendency for these standards to be supported by law or otherwise backed up by the state.

The most important differences in the institutional framework relate, then, not so much to the weight or quantity of state intervention, but to the relationship between the different levels of normative regulation. In Germany there is a high degree of interdependence between the separate levels, so that contract law doctrine, for example, recognises the importance of industry-level regulation through the notion of legally-binding general conditions of business. The content of the latter, in turn, is affected by the overarching legal requirement of good faith as well as by specific legislation regulating

the terms of standard form contracts (Lane and Bachmann, 1996; Lane, 1996). A key feature of the concept of good faith, then, is its use as a bridge between formal contract doctrine and informal norms and standards in the commercial community (Brownsword, 1997). This effect of mutual reinforcement between formal and informal norms has lent a degree of stability to industry-level norms which is lacking in Britain, where legal regulation of standard form contracts is less extensive and where changes to industry-level norms are frequently made to suit the interests of the more powerful party (Interview Notes; see further below). In Italy, notions of good faith are important at the level of legal doctrine as they are in Germany, in contrast to Britain. However the perceived inefficiency of the court system and the weakness of intermediate institutions such as trade associations appear to have contributed to a low degree of juridification of social relations, so that the impact of legal concepts on commercial practice is slight compared to Germany.

5. The Nature of Inter-Firm Cooperation: Empirical Findings

We are now in a position to assess the nature and quality of inter-firm cooperation in the different sectors and countries. We will consider, in turn, the contractual form of long-term trading relationships, firms' use of contract as a planning and incentive device, and firms' resort to legal enforcement to settle disputes.

5.1 The contractual form of 'supplier partnerships'

A set of questions was first of all put to test for a link between asset specificity and customisation, by asking firms whether production of their customised products required specialised investments of various kinds. On this basis, asset specificity was found to be significantly lower in Italy than in Germany or Britain in relation to machines and staff skills, and significantly lower than in Britain in relation to know-how (Figures 1-4). Firms were then asked whether there were any circumstances under which buyers had ownership rights over the patents of customised products or of the machines or machine tools used to make them, or provided specialised training to the staff of their suppliers. This was found to be the case in around half the German firms and a quarter of the Italians, in contrast to only small numbers of UK firms (Figure 5). When each of these questions was analysed by sector, on the other hand, no statistically significant differences were found.

Movement towards the establishment of specialised inter-firm linkages, such as the use of computerised links between departments of buyer and supplier firms, in response to greater customer pressure, was observed in only one third of all the firms in the sample. There were no significant sectoral differences in the incidence of computerisation, but there was a marked country difference, with significantly fewer Italian firms having such links. Only one Italian firm in the survey reported having put computerised links in place, compared to 8 UK firms and 9 German ones.

Firms were then asked a set of questions about the normal form and duration of the *contracts* which they had in long-term *relationships* with buyers and/or suppliers. Firms were asked, first, whether their contracts in this situation were normally on a repeat or continuing basis, and questions were put about the more precise nature of agreements. The replies were then classified under three headings. The first is that of *continuous contracts*, that is to say, legal agreements spanning a series of separate exchanges, under which the buyer agreed to take a certain quantity of supplies over a period of time, either for an indefinite duration or, more usually, for a fixed period of one year or more.⁵ The second category is that of *framework or requirements contracts* under which the supplier agreed to make and deliver goods on demand, but with the precise quantities being left up to the buyer when it put each order in. A schedule of prices would typically be agreed in advance, subject to renegotiation each year. The legal status of the 'framework' was often unclear; only the individual orders were clearly seen as giving rise to legal commitments of payment and performance, but there was a mutual understanding that the buyer would place a certain number of orders and that the supplier would be ready to supply. In this sense, the parties acknowledged that the contract created some kind of guarantee over quantities, if not necessarily a legal one. Finally, there were relationships in which exchange took the form of a series of *repeated orders*, but with neither side entering into any commitment, formal or informal, concerning the future volume of business. Legal obligations here were understood as only arising when each order was placed or, possibly, even later, when the work was completed and payment fell due.

As Figure 6 shows, nearly all the German firms replied that they normally used continuous contracts, compared to around a quarter of the UK firms

and none of the Italian firms. Framework contracts, by contrast, were reported as normal in over half of the Italian firms, around a quarter of the UK firms and less than a fifth of the German firms. Repeat orders were the norm for around half the UK firms and half the Italian firms surveyed, but no German firms fell into this category. These differences are also reflected in firms' responses to a question about supply guarantees (whether legally binding or not). German firms were significantly more likely to have such guarantees, with the UK firms unlikely to have them and the Italian firms occupying a position roughly between the other two (Figure 7).

Firms were asked a series of more open-ended questions about the respective merits of long-term and short-term relationships. A majority of all firms saw long-term relationships principally in terms of the opportunity to get repeat orders from a customer. These firms tended to contract on an order by order basis or alternatively through a framework or requirements contract which was either regarded as not legally binding or whose legal status was not thought to be particularly relevant by the parties concerned. A commonly expressed view was that the success of the relationship depended on how well the exchange proceeded from the point of view of the parties, and not on the form of the agreement: *'we don't have long-term contracts. We do have long-term relationships'* (UK mining equipment supplier); *'a long-term relationship is established spontaneously over time if both sides are satisfied'* (Italian mining equipment supplier); *'the long-term relationship is a matter of fact, occurs over time, is not a specific goal of the firm'* (Italian kitchen furniture supplier); *'trust may mean "we won't let you down if you don't let us down", and it may help to keep that as an implicit assumption: that is why contracts generally remain on an order by order basis rather than being long-term'* (UK mining equipment supplier).

Several firms also stressed the advantages in terms of flexibility and commercial freedom of having short-term contracts: *'short-term contracts allow us to exploit short-term opportunities'* (Italian kitchen furniture supplier); *'by putting the suppliers into competition, you can achieve the most profitable conditions'* (Italian kitchen furniture buyer); *'there is the possibility of changing customers without difficulties and costs'* (Italian kitchen furniture supplier). Another reason for having short-term contracts lay in the volatile and changeable trading conditions facing many firms.

Rapidly changing demand, fluctuations in prices and the one-off nature of some kinds of project work were given as reasons for the infeasibility of long-term commitments. As figure 8 shows, the idea that there could be inherent advantages to short-term relationships was particularly prevalent in the Italian sample.

On the other hand, a significant minority of all firms thought that long-term relationships could be pursued not just as a means of obtaining repeat business, but as a way of achieving a closer form of cooperation with another firm; most of these firms also thought that a long-term contract containing mutual performance guarantees was an important aspect of this process. One advantage of long-term contracts lay in providing increased certainty and predictability, as a response to heightened volatility in product markets; several firms reported that for this reason, the incidence of long-term contracting was increasing:

Recently we entered into a long-term contract with [a customer], the first contract we had had for more than a year in length. This was in the mutual interest of us and [the customer], given the volatility of the industry. [The customer] guaranteed us a certain volume of sales, allowing us to make forward purchase of raw materials and to enter into long-term relationships with our suppliers. In return [the customer] got very good prices (UK mining equipment buyer)

As a result of a long-term agreement with an important customer, we have developed a set of specific products which do not need additional engineering investment and which can be made in production without delay and further expense (Italian mining equipment supplier).

Some German firms had an established pattern of contracting only on a long-term basis: *'we only have long-term contracts: they assure quality, delivery performance, and guarantee supplies'* (German mining equipment buyer). Other advantages included the possibility of mutually advantageous trade-offs, such as price discounts being offered in return for guarantees on quantity: *'sometimes we give guarantees on purchases to get a price reduction... We get purchase guarantees as far as customer specific products are concerned'* (German kitchen furniture buyer); other firms mentioned economies of scale,

the matching of batch sizes more precisely to demand, and savings on the costs of repeated tendering (*'it raises costs, if we don't have big batch sizes placed in one year contracts'*) (German kitchen furniture supplier). The more dynamic nature of long-term contracts was also stressed by respondents who saw them as providing a basis for the effective realisation of relation-specific investments:

We don't accept one-off orders. In the first batch, even if it is a relatively big one, we cannot recover all the costs we sustained in designing the product for the customer. So we accept orders only in the perspective of a long-term relationship. After the first order, the customer doesn't squeeze us because he knows that we will not cooperate in designing the next product (Italian mining equipment supplier).

Several respondents emphasised the importance of long-term agreements for fostering the exchange of know-how, enhancing quality and innovation in production and design and promoting customisation. A UK mining equipment buyer identified a move towards long-term supply agreements with an element of increased dependence, as *'part of a strategy whereby OEMs are reducing their supplier base, stressing quality with their remaining suppliers'*, while according to a UK supplier,

Short-term relationships are only advantageous if it was a one-off sale: then you can charge a one-off price and cream off the profit. But this is not possible for high value production where you need repeat orders and the expenditure makes it worthwhile to foster long-term links which you cannot do by creaming off... We would like longer-term ties, elements of mutual dependence and exclusivity, because that would enable us to customise the product more easily.

Equally, the lack of a long-term commitment could be a disadvantage from the point of view of a firm in a weak bargaining position: *'customers don't like long-term contracts because they like to have the chance to go back and forth and keep the price down'* (UK mining equipment supplier).

These findings suggest that a large number of firms placed emphasis on close inter-firm cooperation as a means of enhancing quality. They also indicate

that firms saw some form of legally-binding contract as an important means of enhancing this form of inter-firm cooperation. Firms who were interested in maintaining close relations did not, on the whole, see repeated orders on the basis of discrete contracting as sufficient. More precise information on the role of contract in this context was supplied by responses to a set of questions concerning the legal form and content of agreements.

5.2 The use of contract as a planning and incentive mechanism

Firms were asked whether their agreements were normally put into writing and whether the agreements were regarded as legally binding, and what were the reasons for this in each case; what use was made of gentlemen's agreements (or legally unenforceable agreements), and for what purpose; and what were the sources and substance of the terms normally contained in agreements with other firms with whom they had a long-term relationship. The planning and incentive functions of contract were regarded as important by many firms, but the use of contract for these purposes varied according both to sector-specific and, in particular, to country-specific conditions.

Most firms had written contracts of some form or another, and most regarded their contracts as legally binding either all or some of the time (Figures 9-10). The major exception was a group of firms in the UK kitchen furniture sector. Here it was found to be common for firms to take an order over the telephone; alternatively, some firms would make an agreement on the basis of an order form or invoice which was not regarded as having contractual force. The attitude of a UK kitchen furniture buyer was that *'in a commercial situation both customer and supplier must make their own decision'*. Letters were exchanged but these were not legal contracts, simply gentlemen's agreements whose function was one of 'comfort': they were *'as near as you can get to a legal agreement'* without actually being one. This respondent saw the firm as having continuing, loose commitments, akin to a situation of permanent negotiation, with its regular customers, for whom prices would be reviewed once a year. Similarly, a UK kitchen furniture supplier claimed to have no written contracts at all, even with its sole customer for one of its items of business with whom it had a long-standing and very close trading relationship. Other UK firms were sceptical of the importance of contract formality - *'long-term relationships have very little to do with pieces of*

paper...we like to have agreements, not "contracts" (UK mining equipment supplier) - and some insisted that carefully worded contracts were of negative value: 'if you have to have resort to the precise wording of a contract, the relationship is beyond the point of no return' (UK mining equipment supplier).

This approach, which Macaulay (1963) suggests is common in inter-firm relations, was however atypical of our survey as a whole. The vast majority of firms saw both the use of writing and the attachment of legal force as important means of clarifying the agreement and providing for security in the event of a dispute. The 'comfort' effect of legal enforceability was important even, or especially, for firms who would only contemplate going to court as a matter of last resort, since it could be used to protect them against opportunistic litigation by another party. Numerous respondents saw contract formality as an essential aspect of doing business. Legally-binding contracts were, in the view of one respondent, *'the only way to do business and avoid misunderstandings'*. This company never entered into gentlemen's agreements: *'they are never an agreement and they are never made by gentlemen'* (UK mining equipment supplier).

In particular, formal contracts were widely relied on as risk allocation mechanisms in long-term relationships: *'long-term contracts are more detailed than the short-term ones. We need additional safeguards since the possible damage is greater'* (Italian kitchen furniture supplier); *long-term contracts are more detailed, you need renegotiation clauses* (German kitchen furniture buyer). On the whole, contracts tended to be more formal in the mining equipment industry than in kitchen furniture. Mining equipment firms were almost invariably likely to make use of exclusion or limitation clauses to cover themselves against the risk of extensive liability for the costs of lost production if one of their machines broke down: this clause was *'a tablet of stone'* (UK mining equipment supplier). Few furniture firms were faced with potential costs of this kind, and use of exclusion clauses and other complex risk allocation devices was rare.

Analysis of the findings also indicates an important cross-country difference, in that the use of clauses indicating a high level of inter-dependence and of formal planning for contingencies was particularly high in Germany and low in Italy. In relation to formal dependence, German and British agreements

were significantly more likely than Italian ones to contain clauses providing for a degree of exclusive dealing, protection of intellectual property rights, and retention of title over property after sale. In relation to planning, German firms were most likely to have hardship clauses requiring the parties to renegotiate the contract in the event of an unforeseen contingency (Figures 11-15). By contrast a common UK view of hardship clauses was that *'these could be confusing'* (UK mining equipment supplier). German firms were also more likely to have clauses governing the duration of the contract and allowing for termination for breach of condition or by way of notice; as all these are terms which are only necessary in contracts of a certain duration and covering more than one exchange, their presence is an indicator of the greater length and complexity of German contractual arrangements. Numerous German companies also reported making use of gentlemen's agreements; but their function was one of supplementing the more formal agreements. No German respondents reported using non-binding agreements or understandings to the exclusion of a formal agreement. Italian firms reported the lowest level of formality of contract terms, with little provision for contingencies and very little use of terms indicating a high degree of interdependence. The UK firms occupy a middle position; however, this is largely accounted for by an important difference between the two sectors, with the kitchen furniture firms relying on contract formality far less than firms in mining equipment.

5.3 Dispute resolution and legal enforcement

In Macaulay's study, firms' lack of awareness of or interest in the legal framework for contracting was explained by reference to their unwillingness to go to court for fear that this would jeopardise the continuation of the trading relationship, as well as by the availability of less expensive extra-legal sanctions, and this finding has often been taken to indicate that legal formality is irrelevant or possibly even inimical to 'trust' between organisations. Our findings suggest, however, that the presence of a formal legal contract may be highly compatible with 'trust' and with a reluctance to make use of the courts and that, conversely, a strategy of basing the exchange on loose, interpersonal understandings may lead both to distrust and to frequent recourse to the courts. The taking of legal action against customers or supplier was much more likely in the sample of British firms than in either of the other

two (Figure 16). German firms, whose contractual relations were the most highly formalised, were also the least likely to take legal action for breach of contract, even to recover debts. By contrast, legal action for non-payment of the price was regarded as highly likely in the UK, in particular in the kitchen furniture sector which exhibited the lowest level of contract formality of any of the sectors studied. A number of UK firms in both sectors complained about the practice of late payment of debts and many looked on legal action to claim the price as a matter of first, rather than last, resort.

The survey also found evidence of significant differences in respondents' attitudes in general towards the legal system, trading standards and the role of trade associations in the sectors and countries studied. In Germany, a number of respondents mentioned the role of the *BGB* in shaping their agreement as well as their use of the 'general conditions of business' applying in their industry. Both the Code and the general conditions were seen to apply 'as a matter of course', as did quality standards laid down by the *Deutsche Institut für Normen* (DIN) and by trade associations. German firms were significantly more likely to be clear about the costs and/or outcomes of legal action than UK and, in particular Italian firms (Figure 17); German firms were also more likely to carry insurance against legal liability. These findings, when taken together with the results of the questions on contract form and duration, indicate a high level of awareness on the part of the German firms of the legal and regulatory framework for exchange, as well as a high level of stability within the framework of norms operating at both sectoral and national level. There is a strong contrast here with Italy, where firms were unable to estimate the costs and outcomes of legal action and did not rely extensively on contractual form to shape their relationship. This appears to reflect a system in which the court system is seen as slow, expensive and uncertain in terms of outcome. In addition, the impact of formal standard setting and regulation by the state and by sectoral bodies alike was seen as limited.

In Britain, quality standards set by trade associations and technical organisations were not insignificant as sources of normative regulation; standard form contracts also played a role. However, their role in regulating exchange cannot be equated to that of similar institutional factors in Germany. Indeed, a significant minority of British firms, particularly in the kitchen

furniture sector, expressed strong scepticism about the value of standards, and in that sector the role of the trade associations in standard setting was negligible. We also found evidence that the use of standard form contracts negotiated by or under the auspices of trade associations in mining equipment, which had been strong in the past, was now weakening in Britain. A number of mining equipment companies had ceased to operate under the standard terms of the mining equipment trade association, ABMEC, and supplier companies operating in the electrical engineering sector were facing pressure from customers to accept new and onerous conditions, again leading to decline in the use of the terms set by the electrical manufacturing trade association (BEMA). Customers were introducing new forms of their own on a frequent basis, and some of these contained exceptionally wide indemnity clauses which opened the supplier to a potentially limitless liability for consequential losses; as a result, suppliers had to devote a great deal of time and effort to scrutinising the terms they were offered:

We see some horrendous conditions. Then you have to weigh up the risks. We might turn down business if the terms were excessively onerous... Litigation is becoming more common in general; people are prepared to rush off to court, US style. The battle of forms is a very real problem and you've got to be smart (UK mining equipment supplier).

There has been a fundamental change. In the old days of standard form conditions it was easy to place subcontracting work. Now that customers are varying their terms and conditions so quickly, there are enormous costs of monitoring this and of customising terms with our own subcontractors as a result. The whole process is much more difficult and twice the cost of before (UK mining equipment supplier).

6. The Influence of Institutions on Cooperative Strategies

The evidence outlined above suggests more precisely some of the ways in which the evolution of inter-firm relations towards closer, long-term cooperation may be influenced by the institutional framework for exchange. In the case of the German sample, the high degree of juridification, as indicated by respondents' knowledge of contract law and awareness of the normative force of quality standards and general business conditions, reduced uncertainty

by enabling firms to calculate the costs and outcomes of legal action; it was these very factors which made *actual* recourse to law unnecessary except in very unusual cases. In this system it would be wrong to see legal sanctions as providing an *immediate* incentive to contractual performance; it cannot be said that trust rested on the threat of litigation. The importance of the institutional framework lies instead in providing a powerful set of incentives for the maintenance of stable, long-term relations, which serve to enhance quality. Commercial contract law, the setting of quality standards by the DIN and the activities of trade associations are each important in providing a source of reference for one what firm referred to as '*correct behaviour*'. Membership of the trade association entails a guarantee that firms comply with certain minimum standards and practices as a condition of membership, and while membership is not compulsory, non-membership carries a price: '*if you leave such associations competitors and customers would ask why. Therefore we stay in*' (German mining equipment supplier). But nor is such a framework incompatible with flexibility. The very stability of the underlying relationships and the expectation that potential contracting partners will respect general norms orientated towards cooperative behaviour creates substantial scope for what we may call *flexibility beyond contract* in the form of ad hoc understandings, close personal ties and give-and-take in the resolution of disputes. In other words, the flexibility here is not achieved in spite of or regardless of the contract, but on the contrary is built on a foundation of formalised contractual understandings, which are underpinned in turn by the stable systems of norms external to the contract.

In Italy, by contrast, a much more changeable and volatile environment makes this kind of strategy too risky for many firms to pursue. The volatility in the environment derives both from the often unstable macroeconomic conditions and from the relative absence of 'hard' standards of quality assurance and from the high costs and unpredictable outcomes of court action. The contracts of the firms studied tended to be short-term, even in the context of long-term relationships; repeat trading was common, and more formal cooperation, although by no means unknown, was more limited than in the German sample. The degree of asset specificity was very low: firms appeared actively to avoid a situation of close dependence in which customers owned the productive assets used by suppliers, or in which suppliers made investments in machinery, skills and know-how which are specific to a particular relationship.

The advantage of such a system is that a high level of performance is built in through the rigid insistence on *strict contract adherence*. At the same time, it is relatively open and flexible, by comparison to the German model, and does not depend on a heavy system of regulatory control. The Italian experience comes closest, perhaps, to the model of cooperative contracting through self-enforcing contracts which is stressed in many of the game-theoretical accounts in this area: in a world where the full contents of the exchange cannot be completely specified and the legal system cannot be relied on to provide cheap and effective third party enforcement, successful forms of cooperation can nevertheless emerge through spontaneous action. However, it should be stressed that rather than being a universal model as game theoretical accounts sometimes imply, this form of contractual cooperation is specific to a particular set of institutional conditions for exchange, as just explained. The role of norms at a regional or local level was important, including a perception that framework contracts had a quasi-legal status which made more formal, longer-term contracts unnecessary. At the same time, the need to insist on strict adherence to agreed terms meant that there was little scope for give and take in performance, so that one important form of *flexibility beyond contract* was lost. Overall, fewer Italian firms in the sample had achieved the kind of intensive cooperation which was common in the case of the German sample.

The experience of the British firms in our sample was different again. Many openly expressed doubts about the benefits of longer-term relationships, or saw them simply in terms of repeat trading. There was nevertheless a minority of firms who were actively planning formal 'partnership' agreements or who had already entered into arrangements of this kind as a response to pressures for increased quality and reliability. In these respects, the picture is similar to that of the Italian sample. A major difference, however, is the more sceptical attitude of British firms towards contract adherence. An attitude of give-and-take was much more prevalent, and less stress was placed on strict contract performance: the attitude could be described as one of flexible pragmatism. This aspect of our research confirms the picture presented by previous empirical studies of UK (and US) commercial contracting. However, we would be far less positive about the advantages of *flexibility outside contract* of this kind, in the sense of flexibility achieved without regard to the underlying agreement. In the absence of strong external standards governing

contractual performance, the failure of the parties themselves to accord full significance to strict compliance has a harmful impact on the quality of many relationships. The result is the high rate of non-payment or late payment of debts and the extensive resort to the courts that results from it. British respondents in the kitchen furniture sector, who placed the least emphasis on contract from the point of view of planning, were also the most likely to have to go to court to enforce their agreements.

The British sample also contained an important difference by sector which reflects on the role of institutional factors. The picture of informal relations which was prevalent in kitchen furniture does not adequately describe the position in mining equipment where contracts were highly formal. In the same way as many of the German respondents, British mining equipment companies were using a formal agreement as a foundation for long-term cooperation. An important aspect of this process, however, had been the role played by British Coal in organising the sector (as Ruhrkohle had also done in Germany). A number of respondents told us that BC had played an instrumental role over many years in encouraging the wide adoption of quality standards, supporting the trade association for the industry and, more latterly, in promoting long-term ties both between itself and the OEMs and between the OEMs and their own suppliers. In the absence of a strong normative framework at the legal level, a similar effect was achieved by the intervention of a monopsony buyer which, thanks to its dominant position at the end of the supply chain, was able to structure the relations between the firms which directly or indirectly supplied it. Whether arrangements of this kind can easily be replicated in the post-privatisation period remains to be seen. In some cases, the stimulus given to firms by the collapse of the domestic market had led to the implementation of strategies designed to foster closer collaboration, within the framework set by longer-term contracting. But in other cases, the survey found evidence of electricity privatisation having already led to substantial disruption of supplier relations, with some buyers abandoning the use of long-standing standard term contracts and imposing harsh new terms on their suppliers, causing those suppliers to turn the screw on their own subcontractors. Here, the 'flexibility' of the UK system was synonymous with the destructive use of contractual power.

7. Conclusions

Our conclusions may be stated under three headings.

7.1 Transaction-cost explanations of contractual form

The study provides some qualified support for explanations of contract form derived from transaction cost economics. Where firms made use of long-term contracts, heightened uncertainty, in the form of intensified pressures for innovation and customisation, and the need to realise relation-specific investments were important influences. Even firms with no commitment to long-term relations were looking for the possibility of repeat business with a particular buyer or supplier. There was, however, a clear distinction between this form of repeated trading, which did not involve cooperation in the extended sense associated with 'networks' and 'hybrids', and situations where the parties consciously used the relationship to engage in joint product development or the exchange of ideas and information. In the latter case, we found that a more formal arrangement was likely, even if it was only a framework contract whose legal status, between specific orders, was unclear. 'Trilateral governance' or the possibility of third party intervention was important in 'neoclassical' contracting which involved the use of more complex risk allocation devices; few firms in this position relied solely on gentlemen's agreements. But on the evidence presented here, 'relational' contracting, involving higher frequency of contracting as well as asset specificity, may also be associated with a formal agreement and with the use of legal enforceability as a form of security. The role of the legal system in underpinning relational contracting is arguably greater than has been previously allowed for; certainly, there can be no assumption that the role of the law necessarily decreases as cooperation grows in importance within a relationship.

7.2 Institutional origins of trust

It has been suggested that institutional norms are an important feature of the processes by which trust is developed and reproduced: 'institutional' or systems trust plays an important role in offsetting asymmetries of power between contracting parties, promoting stability in trading relationships and

decreasing uncertainty. Rather than seeing institutional forces as *constraining* individual agency, they should be viewed as *channelling* contractual behaviour in the sense of opening up options for cooperative behaviour which would not otherwise be feasible. This perspective opens up a number of issues for future research. In particular the precise means by which trust is reproduced through normative structures of varying degrees of formality and rigidity needs to be more closely analysed. While a rational-choice framework may be useful, at one level, in explaining how trust can contribute to the reduction of uncertainty, it may be less helpful in explaining how institutions and norms themselves evolve.⁶

7.3 Supplier partnerships as a route to economic competitiveness

We found no *inevitable or universal* movement towards closer, dependent relations between firms. The evidence on respondents' perceptions of the advantages of long-term versus short-term relationships suggests that those firms consciously entering into supplier partnerships did so in order to realise certain advantages in terms of enhanced competitiveness: these included price reductions, increased customisation of products, and enhanced collaboration over the development of new products and processes. Moreover, longer-term contracts were seen as a means of cementing such relationships into place. Although this form of contracting was found to be increasing in importance, it was only *firmly* established in a minority of the relationships studied; some firms expressed a preference for developing relations of this kind but were unable to do so because of the lack of potential 'partners' and the volatility and turbulence of the trading conditions facing them. Moreover, there was still a large segment of firms with little or no experience of or interest in customising their products, and for which both short-term contracts *and* short-term relations were the norm. In some cases, increases in the intensity of competition arising from external shocks (mining machinery) or low entry costs (kitchen furniture) had led not to improved quality of performance, but to the imposition by buyers of oppressive terms and conditions and a concentration on cutting prices at all costs, a process which threatened to undermine the quality provided by suppliers.

Closer cooperation between firms may not be enough in its own right if, as Sako suggests, other mechanisms, such as rank ordering of suppliers, are not

in put in place to maintain competitive prices; conversely, arms-length contracting of a more adversarial kind may be superior in efficiency terms under certain conditions, for example, an atomistic market structure which provides contracting parties with the option of exit (Sako, 1992: 239). A broader evaluation of the implications of longer-term contracting for competitiveness would clearly benefit from additional evidence of the kind provided by longitudinal research at the micro level of inter-organisational relations (Buckley and Chapman, 1997a, 1997b) and by larger scale surveys of contractual practice (Sako and Helper, 1996). The present study has provided evidence for a reassessment of the role of so-called 'rigidities', such as trade associations, quality assurance organisations and the legal-regulatory system, in contributing to competitive advantage. Systems built up around rigid forms of normative regulation may seem to carry a short-term cost in terms of their inflexibility and lack of responsiveness to external change, by comparison to systems which are more open to entry and where the impact of competitive forces is more immediate. But equally, this very rigidity and permanence of institutions may be a source of competitive advantage: in the longer-run it may be that strong and stable institutional mechanisms are needed to promote dynamic efficiency, in terms of the capacity of a productive system to adapt to a changing environment.

Notes

1. A companion paper arising from the same research project (Wilkinson and Burchell, 1996) analyses trust in greater detail.
2. To clarify this point: we are not suggesting that a long-term relationship must be one of a certain duration, rather that it is a relationship which is orientated towards repeated exchange in the sense referred to in the text.
3. A fuller account of definitions of trust is provided by Wilkinson and Burchell, 1996; see also Deakin, Lane and Wilkinson, 1994; Lane and Bachmann, 1996; Deakin and Wilkinson, 1996.
4. While contract law should be thought of as part of the institutional framework, contractual agreements are better thought of as *organisational arrangements* adopted by the parties to exchange. On the distinction between the institutional framework or environment, on the one hand, and arrangements on the other hand, see Davis and North, 1971: 6-7.
5. Contracts for more than a year were highly unusual; this appears to be typical for engineering, as opposed to the much longer contracts which tend to be found in the energy sector (Maher, 1997).
6. One possibility which should be explored is the possibility of integrating modern economic analyses of evolution (see Hodgson, 1993) with theories of institutional autopoiesis, or self-reproduction (Teubner, 1993). See Deakin and Michie, 1997 for discussion.

FIGURES

Figures

The analysis of significance is based on a Chi-square test using Fisher's exact test where appropriate for small sample sizes. The procedures were carried out under SPSS for Windows Version 6.0. Differences between countries on a pairwise basis are significant at:

*** 1% level

** 5% level

* 10% level

N/S not significant at any of the above levels

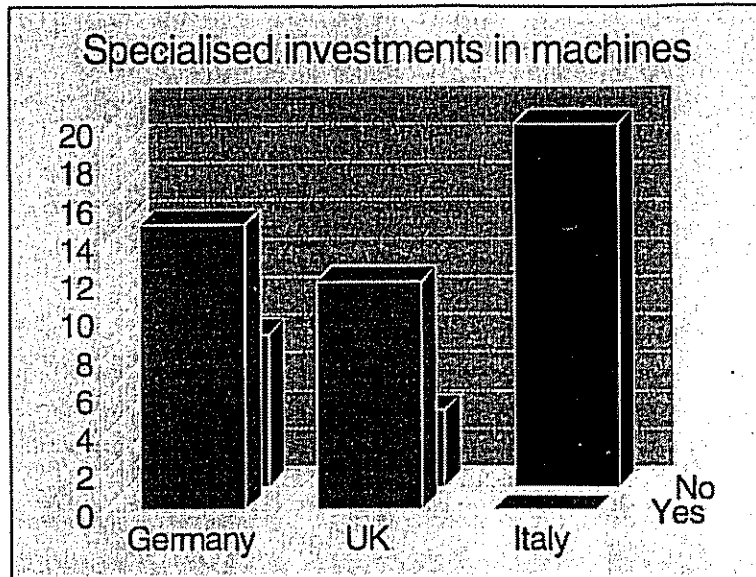


Figure 1: Do your customised inputs require specialised investments in machines?

Germany:Italy ***
 Germany:UK N/S
 UK:Italy ***

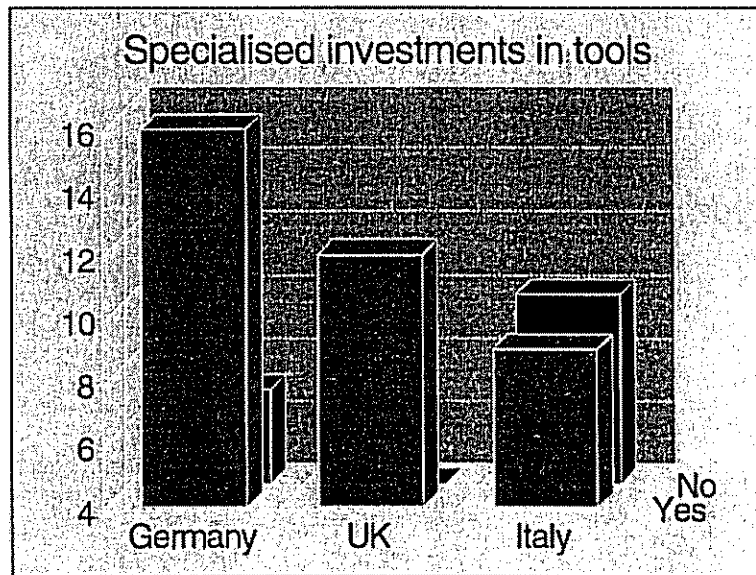


Figure 2: Do your customised inputs require specialised investments in tools?

Germany:Italy N/S
 Germany:UK N/S
 UK:Italy *

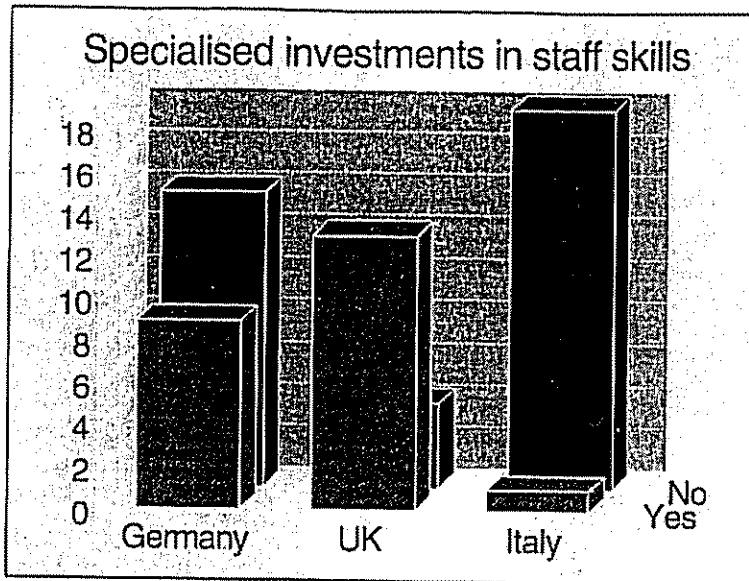


Figure 3: Do your customised inputs require specialised investments in staff skills?

Germany:Italy **
 Germany:UK **
 UK:Italy ***

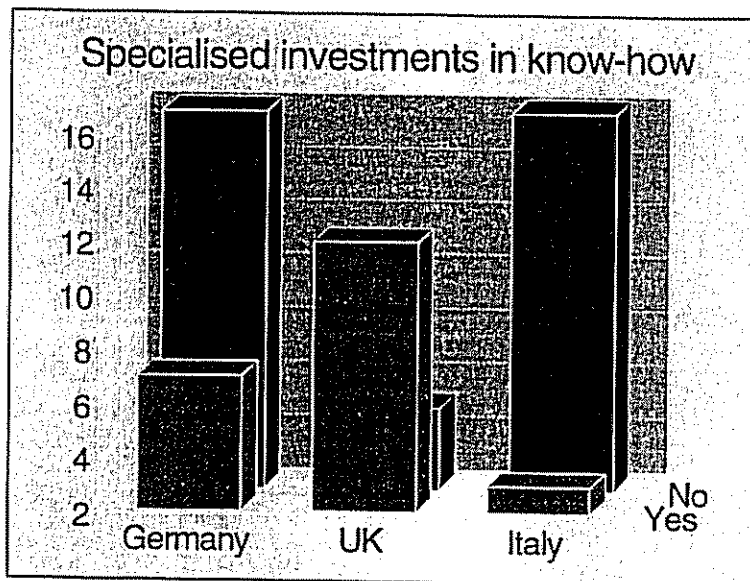


Figure 4: Do your customised inputs require specialised investments in know-how?

Germany:Italy N/S
 Germany:UK **
 UK:Italy ***

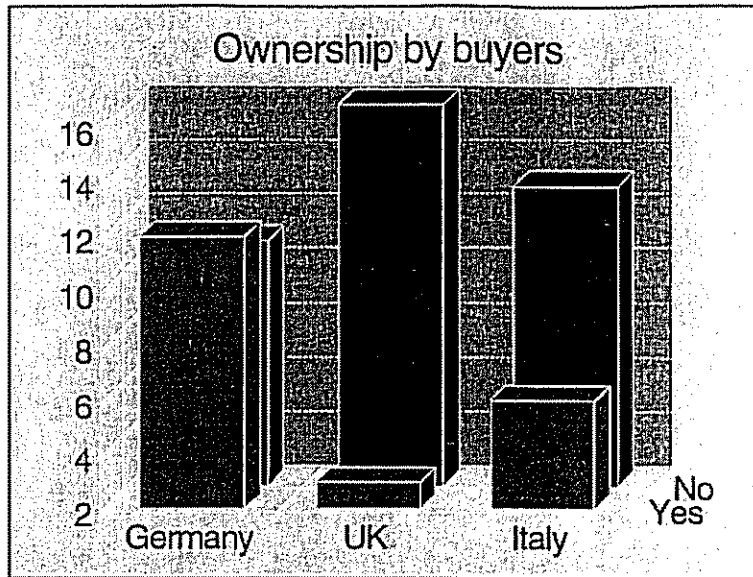


Figure 5: Do you own your suppliers' machines, tools etc.?

Germany:Italy N/S
 Germany:UK **
 UK:Italy N/S

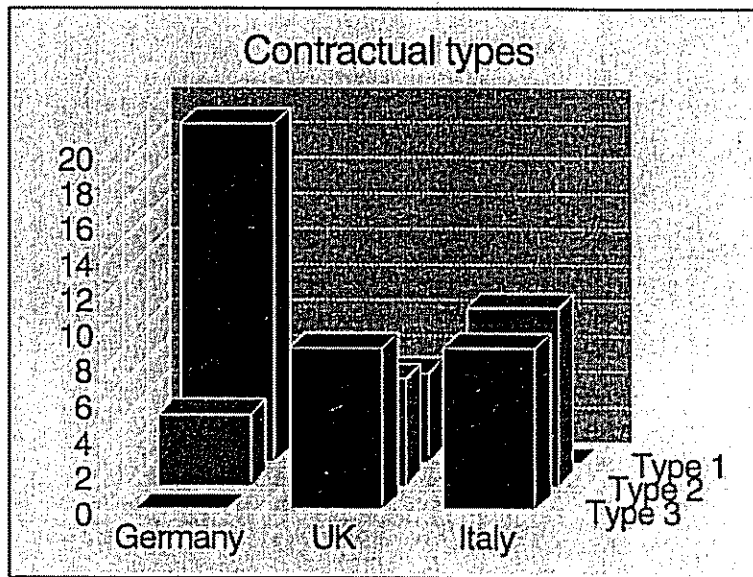


Figure 6: Distribution of contractual typologies

Germany:Italy ***
 Germany:UK ***
 UK:Italy N/S

Type 1 = Continuous
 Type 2 = Framework
 Type 3 = Repeated

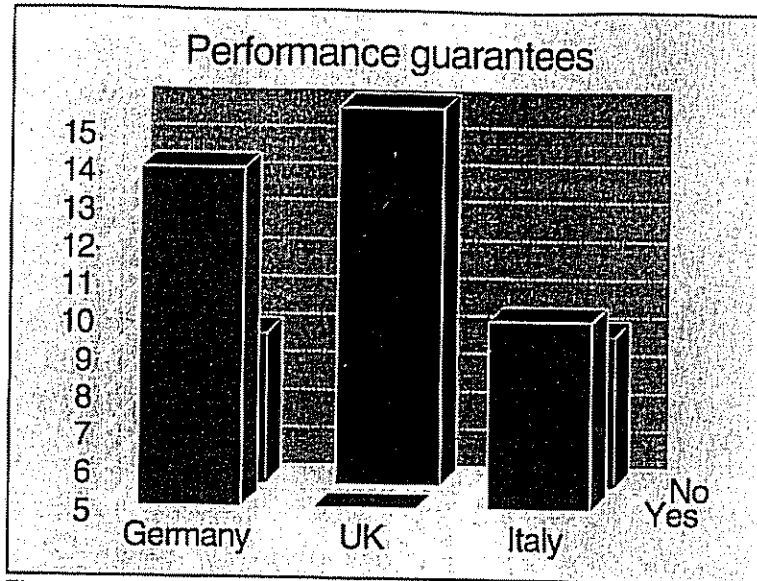


Figure 7: Do you give guarantees to your suppliers regarding quantities to be supplied?

Germany:Italy N/S
 Germany:UK **
 UK:Italy N/S

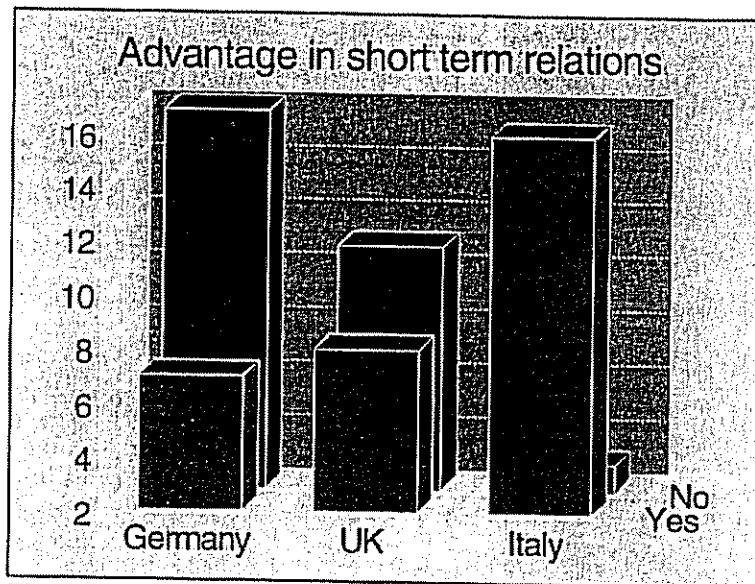


Figure 8: Are there advantages in short term relationships?

Germany:Italy ***
 Germany:UK N/S
 UK:Italy ***

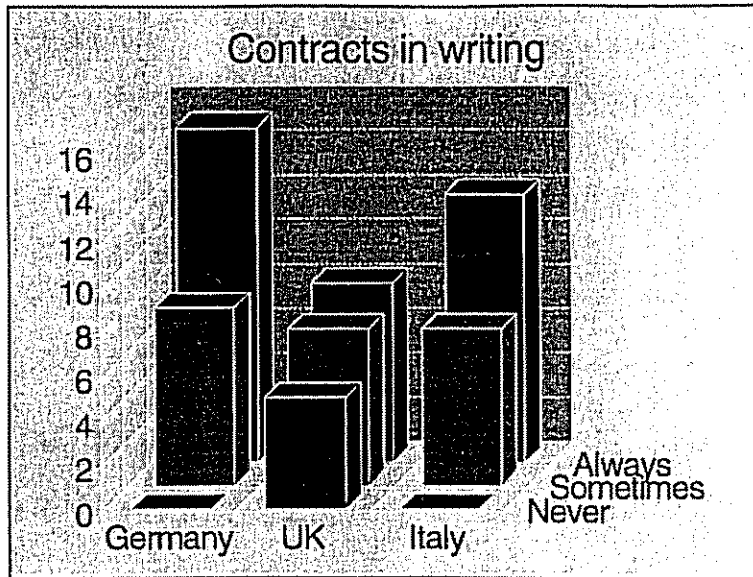


Figure 9: Do your agreements take the form of written contracts?

Germany:Italy N/S
 Germany:UK **
 UK:Italy *

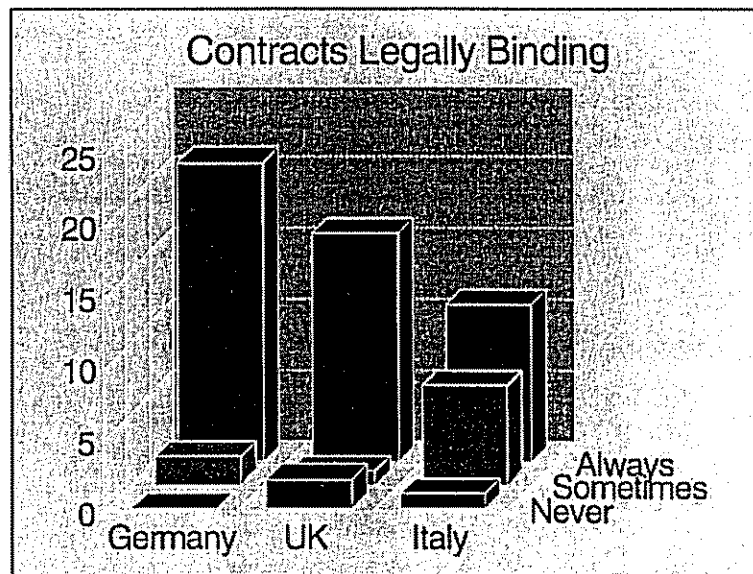


Figure 10: Are your contracts legally binding?

Germany:Italy **
 Germany:UK N/S
 UK:Italy *

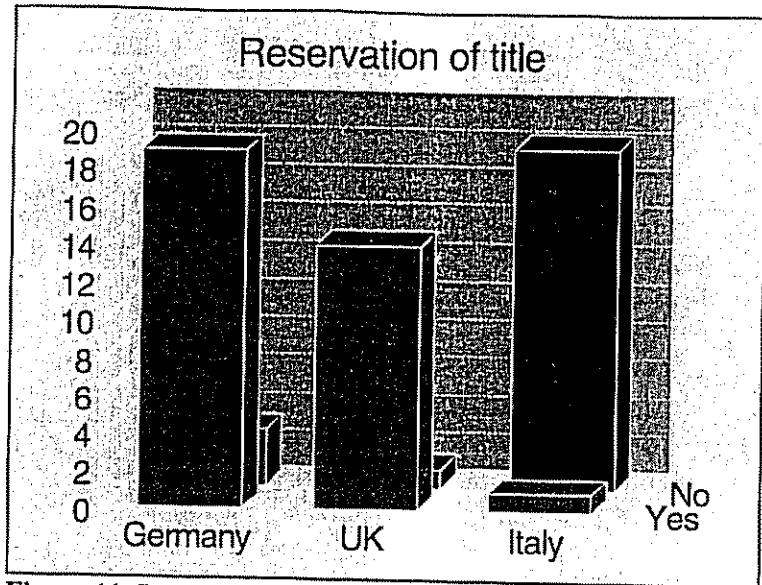


Figure 11: Do your contracts contain retention of title clauses?

Germany:Italy ***
 Germany:UK N/S
 UK:Italy ***

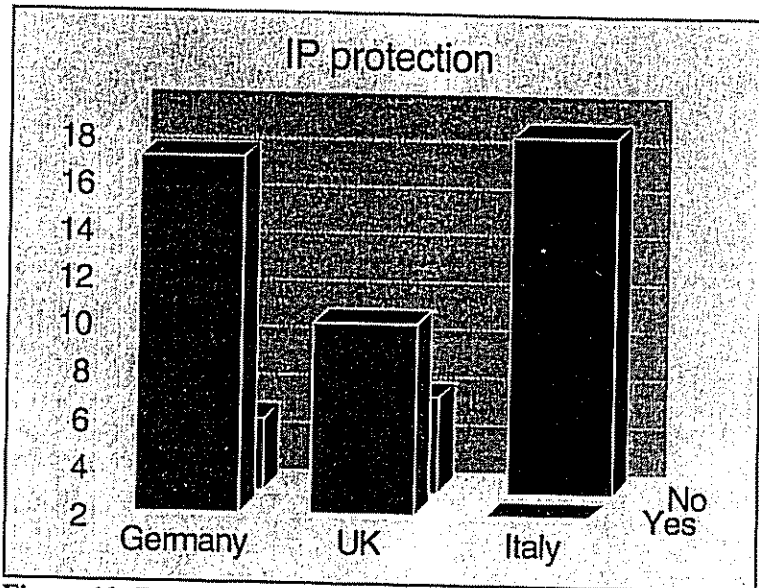


Figure 12: Do your contracts have clauses protecting intellectual property?

Germany:Italy ***
 Germany:UK N/S
 UK:Italy ***

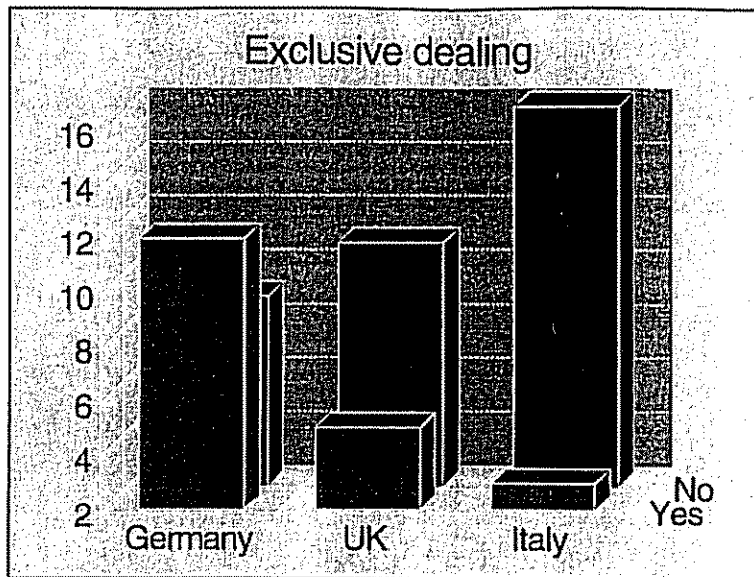


Figure 13: Do your contracts have exclusive dealing clauses?

Germany:Italy ***
 Germany:UK N/S
 UK:Italy N/S

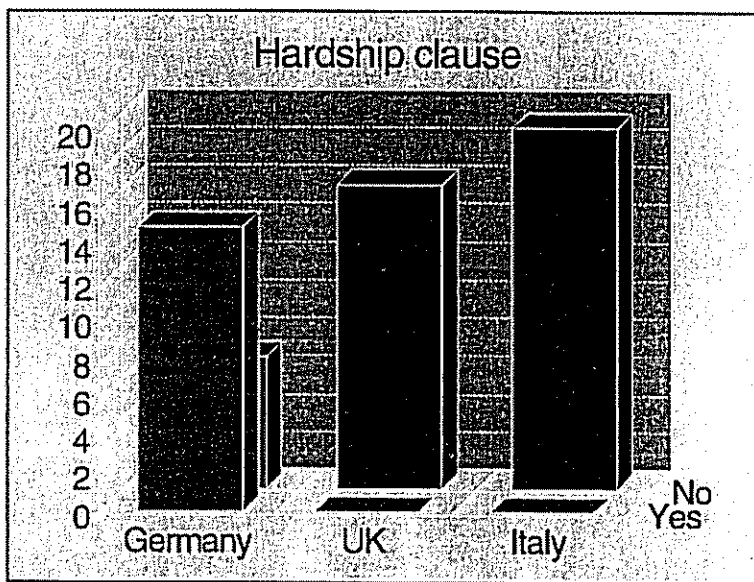


Figure 14: Do your contracts have "hardship" clauses?

Germany:Italy ***
 Germany:UK ***
 UK:Italy N/S

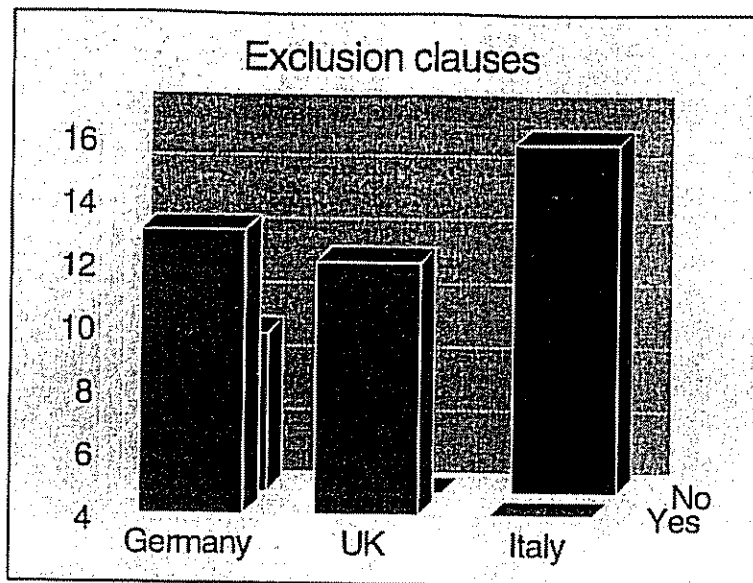


Figure 15: Do your contracts have exclusion clauses?

Germany:Italy **
 Germany:UK N/S
 UK:Italy ***

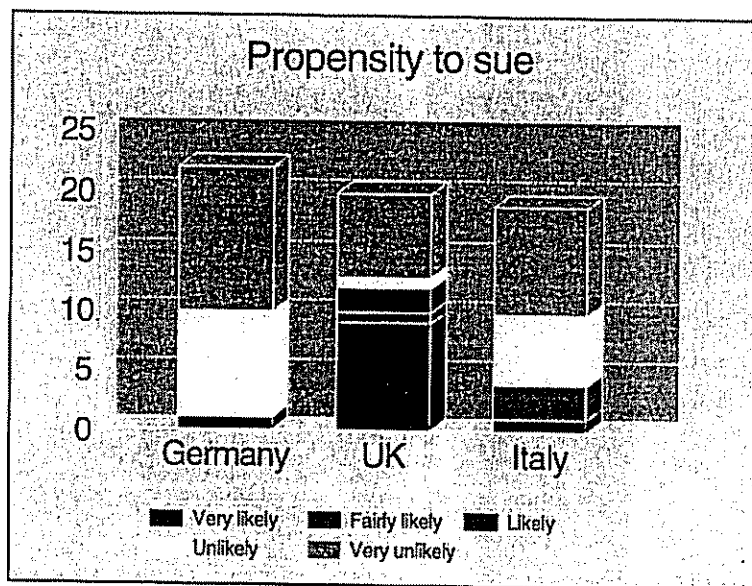


Figure 16: How likely are you to take legal action against a customer or supplier?

Germany:Italy N/S
 Germany:UK ***
 UK:Italy **

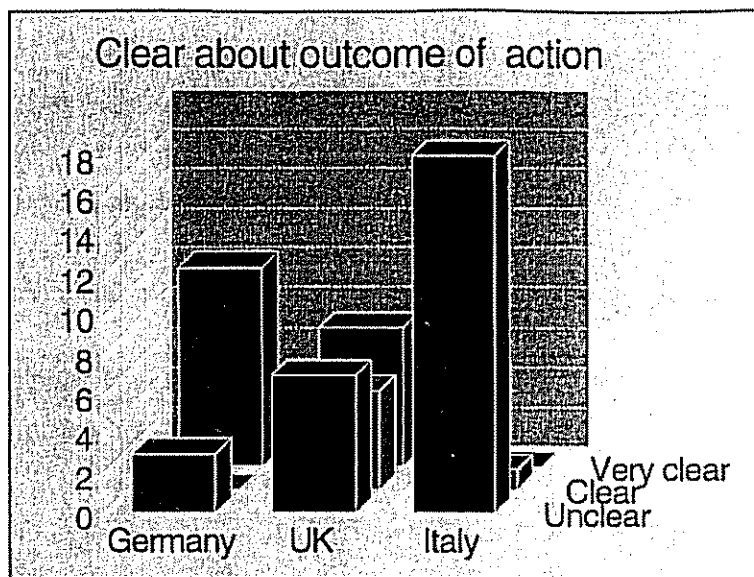


Figure 17: How clear are you about the costs and outcomes of legal action?

Germany:Italy ***
 Germany:UK **
 UK:Italy ***

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