Legal and Social Safeguards Against Opportunism in Exchange

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A considerable literature in marketing, economics, and law has emphasized the organizational structures and governance approaches employed by participants to enhance their exchange relationships and safeguard against the hazards of opportunism. The age-old mechanism of protecting against opportunism is the legal contract. Various literatures have attacked the inadequacies of contract in the context of complex, modern day exchange relationships. Some theorists have argued for the superiority of social mechanisms of control while others have been skeptical towards their use. This paper proposes that both legal contracts and social safeguards are useful means of mitigating opportunism. However, they rarely occur in isolation in modern exchanges and the interesting questions about their governance properties have to do with their interaction effects. This article employs a behavioral simulation to empirically examine the individual and combined effects of contract and relational norm safeguards against opportunism directly and in the context of asymmetric commitments by exchanging parties.

Scholars of exchange have long been interested in the design of interfirm management structures, e.g., governance mechanisms that promote coordination and deter opportunism. Opportunism involves the deceit-oriented violation of implicit or explicit promises about one's expected behavior (Williamson, 1985). Such behavior can include conduct in violation of the law, but is most often associated with lesser forms of deception that nevertheless

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undermine the foundation for long-term exchange. Interest in mitigating opportunism has been bolstered by the proliferation of marketing exchanges described as "relationships" extending beyond distribution arrangements to include partnerships with suppliers, strategic alliances and the like. Unfortunately, the repertoire of available theory to address interfirm governance has been rather meager. This article focuses on the theoretical processes underlying the problem of opportunism. It is set in an exchange context general enough to have relevance in most contexts of interfirm governance.

The classical explanation is that parties structure complex contracts and rely upon legal rules, standards and remedies implied in the law to protect themselves against opportunism. In modern terms, Williamson (1996, p. 239) contends contingent claims contracts can be written to govern exchange, and that these contracts represent a consensual agreement among "farsighted" actors able to perceive and price the hazards of exchange or provide for suitable safeguards. Others, however, have questioned the efficacy of the law, and most notably contract law, for governing modern exchange relations. Macneil (1980) argues that the classical law of contract views exchange as a discrete one-time event, whereas many exchanges involve far more complex associations. Robison (1983, p. 699) concludes: "Unfortunately, the simple black-letter model of the structure called 'contract law' very often neither serves nor reflects reality...unforeseen changes in the world...all too often act to make the model seem ridiculous in practice."

Because of the conceptual and pragmatic limits of the law, social means of governance have been receiving increasing attention in the literatures of marketing, sociology, organization theory and law (e.g., Achrol, 1997; Granovetter, 1985; Macneil, 1980; Podolny, 1994). According to the social relations school, the social network in which exchange participants are embedded yields a fuller explanation of economic behavior than the formal contract structure. In other words, social structure matters more than institutional structure. The utility of safeguards that rely on the power of social conformity and sanctions, however, have also been questioned. Because social standards tend to be broadly defined and subject to varying interpretations such standards can be manipulated to the advantage of one party. Carney (1993, p. 904) argues: "Open definitions lead to opportunistic behavior in which claimants may take positions that were not contemplated at the time of the initial bargain [and] allow one party to a bargain to hedge against the risk of error."

The lack of theoretical consensus and empirical evidence regarding the relative efficacy of and interrelationship between legal and social safeguards represents a significant gap in the literature. Indeed, given such safeguards rarely occur in isolation, the more interesting questions may have to do with their combined or interaction effect in mitigating opportunism. This paper investigates the individual and combined governance properties of legal and social governance mechanisms in relationship to controlling opportunism. It follows Gundlach, Achrol and Mentzer (1995) in focusing on opportunism directly and as motivated through asymmetric commitments of specialized resources in an exchange. Findings by these authors suggest that opportunism increases where parties invest asymmetrically in an exchange, however, they conclude that the relation of comparative commitment and opportunism may be moderated by various governance safeguards. The current research develops certain theoretical arguments regarding the safeguarding role of legal contracts and relational norms and tests them using a simulation methodology. Results of the study are discussed and key implications for management and future research derived.
BACKGROUND AND HYPOTHESES

Modern business transactions involve complex exchanges of products, services, technology, information, expertise, and human and capital resources over a period of time. Tasks often call for highly specialized resource applications and thus commitments of specialized investments. Many exchanges, such as distribution and supply arrangements, involve ongoing relationships in which one party relies continuously on another for the performance of critical functions in the development and marketing of its products. Further, because consumer preferences, technologies and competition are increasingly turbulent, the resources being exchanged and functions to be performed are subject to significant modification over time.

The complex and dynamic nature of modern transactions poses a peculiar problem in the performance of exchange obligations. Parties are expected to make valuable commitments before tangible results and benefits are likely to flow from an exchange. Often these commitments are borne asymmetrically by one party or in a sequence that leaves the first party vulnerable to opportunistic behavior by the other (cf. Das, Sen, and Sengupta, 1998).

While opportunism may occur for various reasons, it is more likely where one party has taken affirmative, costly steps involving the asymmetric commitment of specialized investments, or has foregone unique exchange alternatives (Shell, 1991). The less committed party enjoys a dominant advantage and is confronted with mixed incentives, which, in the absence of mitigating forces, makes cooperative exchange more difficult and increases the propensity for opportunism (Lindskold, 1978, p. 772). The more committed partner is vulnerable and, therefore, less likely to find opportunism advantageous. Following Gundlach, Achrol, and Mentzer (1995), we hypothesize:

H1: In the absence of appropriate safeguards, an increase in comparative commitment by one party in an exchange will yield conditions likely to promote opportunism by the other party.

LEGAL SAFEGUARDS: CONTRACTS

According to the logic of transaction cost economics, firms tend to internalize, via vertical integration, those transactions marked by specialized resource commitments which expose the firm to the risks of opportunism (Williamson, 1985). A number of scholars (cf. Grossman and Hart, 1986) contend, however, that the benefits of integration in mitigating opportunism derive from the ability to control decisions rather than from ownership per se. An alternative mechanism thought to facilitate decision control without integration is legal contract (Stinchcombe, 1985). Contracts can be written to include control over critical decisions as well as provide mechanisms for flexibility and adjustment of performance, considered essential for recurrent exchange (Williamson, 1985). As Stinchcombe (1985) observes:
A structure with legitimate authority, with a manipulable incentive system, a method for adjusting costs, quantities, and prices, with a structure for dispute resolution, and with a set of standard operating procedures, looks very much like a hierarchy...these features are routinely obtained by contracts between firms (p. 126).

Where contracts provide a relatively high level of decision control by one party over another, an increase in comparative commitment by one party is unlikely to invite opportunism by the other. Combining the logic of those theorists who contend contracts may be written to serve as governance safeguards and the argument that asymmetric commitments provide an incentive for opportunistic behavior, we hypothesize:

H2: In an exchange, higher levels of decision control granted to one party through contractual safeguards will lead to lower levels of opportunism by the other.

H3: When an exchange is governed by contractual safeguards, an increase in comparative commitment by one party will not lead to opportunism by the other.

Despite opportunities to structure complex legal contracts, some scholars are skeptical of even the most elaborate contracts as safeguards (Macneil, 1980). In Macneil's terms, exchange contracts are constrained in their ability to "presentiate" or foresee and account for future contingencies. Consequently, the theory of relational exchange (Macneil, 1980; Scott, 1987) emphasizes the role of social mechanisms of governance, especially relational norms in providing effective safeguards.

Social Safeguards: Relational Norms

The relational norms framework emphasizes the positive motivations that follow from mutually oriented behavior. The core idea is to create a social environment, which discourages self-interested behavior in favor of mutual interest seeking. It includes the various components of behavior required to build trust and maintain solidarity within a social order. In general, parties that wish to participate in such relationships are expected to demonstrate loyalty to each other (i.e., solidarity), a concern for the common good (i.e., mutuality), a willingness to assume multiple responsibilities (i.e., role integrity), make good faith adjustments (i.e., flexibility), and a propensity for the harmonious resolution of differences (i.e., harmonization of conflict).

The safeguarding effects of relational norms have been demonstrated in a number of studies (Gundlach, Achrol, and Mentzer, 1995; Heide and John, 1992; Lusch and Brown, 1996). Combining the arguments that asymmetric commitments provide an incentive for opportunistic behavior with the evidence that relational norms are capable of safeguarding exchange, we hypothesize:
**H4:** In an exchange, relational norms promote higher levels of mutual interest seeking behavior and thus lead to lower levels of opportunism.

**H5:** When an exchange is governed by relational norm safeguards, an increase in comparative commitment by one party will not lead to opportunism by the other.

**Combining Legal and Social Safeguards: Contracts and Relational Norms**

Testing the propositions that contractual and relational norm safeguards are individually effective for controlling opportunistic tendencies, including those triggered by asymmetric commitments, provides interesting but partial information. Indeed, the more intriguing questions may have to do with the inter-relation between the two types of safeguards. In particular, how does combining contractual and relational norm safeguards affect opportunistic behavior, directly as well as in the face of asymmetric resource commitments by the parties?

The various theories of exchange offer conflicting interpretations about the interaction effects of contracts and relational norms. On the one hand, there is evidence about the incompatibilities between legal and social mechanisms from the macro-social literature. In his analysis of society's efforts at regulating deviant conduct by individuals, Black (1976) argues that "law varies inversely with other social control." Likewise, Macaulay (1963) concludes that reliance on the law lessens the chance of future exchange and that parties often choose to rely on social based assurances, e.g., a person's word, handshake, or common honesty and decency.

An alternate perspective is that contracts and relational norms are not really incompatible, but rather, each cures the inevitable imperfections of the other. Williamson argues that contractual incompleteness notwithstanding, an ex post maladaptation problem will not arise—i.e., all gaps, omissions, errors, etc., can be cured—if (1) the parties promise to disclose all relevant information and behave cooperatively during contract execution and renewals, and (2) these promises are self-enforcing (Williamson, 1993, p. 97). Williamson is skeptical of the enforceability of these promises. Indeed, enforceability is a serious problem unless the exchange is embedded in a relational culture with significant incentives for cooperative behavior and/or sanctions against opportunism. Thus, it would seem that for any contingent claims contract to be truly effective, it must be complemented by minimal levels of social reinforcement. The noted legal scholar, Karl Llewellyn (1931, pp. 736-737) may have stated it best:

The major importance of a legal contract is to provide a framework...a framework highly adjustable, a framework which almost never accurately indicates real working relations, but which affords a rough indication around which such relations vary, an occasional guide in case of doubt, and a norm of ultimate appeal when the relations cease in fact to work.
From this perspective, contracts and relational norm structures complement one another in a kind of flexible way (cf., Gulati, 1995; Ring and Van De Ven, 1994; Allen and Lueck, 1992). The legal structure provides a broad framework defining the relationship and an authoritative safeguard of last resort. Day to day performance is governed by the more general safeguards that characterize relational norm based systems of exchange. The exchange is erected upon a comprehensive structure of understanding and simultaneously enjoys the social values and beliefs whereby frictionless adjustments within and to the structure can occur. As Hadfield (1990, p. 929), puts it: "...when a contract is embedded within an identifiable [supportive] relationship...contractual obligations are often modified, supplemented or completely supplanted by the norms of the ongoing relation." Accepting the view of contracts and relational norms as complementary safeguards against opportunism, we hypothesize:

**H6:** In an exchange higher levels of decision control granted to one party through contractual safeguards, in combination with higher levels of mutual interest seeking furnished through relational norm safeguards will lead to lower levels of opportunism by the other.

**H7:** When an exchange is governed by a combination of contractual and relational norm safeguards, an increase in comparative commitment by one party will not lead to opportunism by the other party.

**METHOD**

**Research Setting**

A commercially available simulation depicting contractual and social exchange relationships between organizations in a vertical setting and involving non-business participants was selected for the study (Cadotte, 1990). See Appendix A. As a research setting, simulated gaming techniques have been used extensively in the behavioral sciences (cf. Schlenker and Bonoma, 1978). In marketing, simulations involving organizational role playing and laboratory games have allowed researchers to study a variety of phenomenon involving exchange relationships under controlled conditions (cf., Dant and Young, 1989). Plott (1989, p. 1112) cogently sums up the benefits:

While laboratory processes are simple in comparison to naturally occurring processes, they are real processes in the sense that people participate for real and substantial profits and follow real rules in doing so. It is precisely because they are real that they are interesting. General theories must apply to special cases, so models believed to be applicable to complicated naturally occurring processes should certainly be expected to help explain what occurs in simple, special-case laboratory markets. Theories which do not apply to the special cases are not general theories and thus cannot be advocated as such.
Schlenker and Bonoma (1978) conclude such methods are suitable for theory testing where the games and social phenomena of interest share similar structural characteristics. Isomorphic requirements include that game participants, as in life, be confronted with choices that have uncertain and interdependent outcomes in settings where the outcomes, the choices, nor the rules are perfectly clear. Additionally, the game should provide a sufficient context in which these concepts and theories may occur and operate. These conditions were present in the simulation.

Data

Data on contracting was objectively recorded via analysis of contract terms. Data on behavioral variables were collected via questionnaires completed by participants. To avoid bias from initial simulation learning, game-ending tactics, and to insure time for key construct development, all data were obtained at the completion of the third period of play. For the questionnaire data, key organization informants were identified within each organization through asking only participants with actual contact with an exchange partner during the preceding two periods to complete questionnaires regarding their partner interactions. Key informant identities were then confirmed through ratings by exchange partners of each informant’s degree of interaction with their organization (“had no contact” - “had extensive dealings with,” 7-point). After deletions for minimal interaction and missing data, the final sample yielded 101 usable observations.

Measures

Commitment and Comparative Commitment

Self-report items (see Table 1) measuring resource commitments specifically benefiting a partner, exclusive representation, dedication of resources or assistance and disclosure of confidential and proprietary information were employed in a summed-scale. The items were written so that the information, resources, support or assistance were identified as the kind which, once committed to a relationship, were impossible or costly to redeploy to other relationships. To obtain the comparative level of commitment across an exchange, measures incorporating observations from each party to an exchange were compared and assessed from the perspective of each (i.e., A’s comparative commitment measured as A’s commitment less B’s commitment and vice-versa).

Contractual Safeguards

The extent to which an exchange relationship was governed by legal safeguards was measured via thematic content analysis (Holsti, 1968). Two judges were indoctrinated in
### TABLE 1

**Measurement Analysis**

<table>
<thead>
<tr>
<th>Measure</th>
<th>Factor Loadings</th>
<th>Coefficient Alpha</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commitment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• We agreed to make decisions that would specially benefit this partner.</td>
<td>.79</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• We promised to dedicate specific resources and support.</td>
<td>.82</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• We agreed not to deal with any other manufacturer/distributor.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• We disclosed confidential information about industry/market conditions, competitors, channel partners, etc.</td>
<td>.84</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• We provided proprietary information about firm decisions and strategies.</td>
<td>.82</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Percent variance:</td>
<td>.83</td>
<td>3.57</td>
<td>1.41</td>
<td></td>
</tr>
<tr>
<td>Relational Norms</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Staying together in the face of adversity/challenge.</td>
<td>.86</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Relationship is based on mutual benefit and trust.</td>
<td>.88</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Flexible in accommodating one another if special problems/arise.</td>
<td>.91</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Relationship extends across many complex responsibilities and multiple tasks.</td>
<td>.82</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• When disagreements arise, we reassess all the facts and try to reach a mutually satisfactory compromise.</td>
<td>.82</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Percent variance:</td>
<td>.91</td>
<td>3.89</td>
<td>1.13</td>
<td></td>
</tr>
<tr>
<td>Opportunism (by partner)*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Exaggerated needs in order to get what they desired.</td>
<td>.86</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• They were not always sincere.</td>
<td>.86</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Altered facts in order to get what they wanted.</td>
<td>.90</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Good faith bargaining was not a hallmark of their negotiation style.</td>
<td>.84</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Provided a completely truthful picture when negotiating (K).</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Breached formal or informal agreements to benefit themselves.</td>
<td>.61</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Percent variance:</td>
<td>.88</td>
<td>1.64</td>
<td>1.36</td>
<td></td>
</tr>
<tr>
<td>Legal Contract</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Content analysis (decision control)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Percent variance:</td>
<td></td>
<td>3.64</td>
<td>4.37</td>
<td></td>
</tr>
</tbody>
</table>

Notes:  
1. Measures slightly abbreviated.  
2. Responses were recorded by circling a number on the following scale:  
   Strongly disagree 0 1 2 3 4 5 6 Strongly agree  
   (R) indicates item was reverse coded.  
   — indicates deleted item

contract terminology and trained using contract data obtained from a previous simulation. Each was instructed to identify and tally supplemental terms contained in contracts between organizations that granted one the ability to exercise decision control over the other. A greater frequency of terms was viewed as reflective of more decision control held by the organization. Interclass correlation was used to assess the reliability of the judge’s tallies (Hughes and Garrett, 1990). A high degree of convergence (.96 p < .00) between the judges was found which were then averaged to obtain useful data.
Relational Norm Safeguards

Each of five facet norms believed to combine to govern exchange relations—solidarity, mutuality, flexibility, role integrity, and harmonization of conflict—were measured with the items shown in Table 1. To derive the measure of relational norm safeguards, a composite scale comprising the sum of the five component norms was employed (cf., Gundlach, Achrol, and Mentzer, 1995).

Opportunism

A view of opportunism consistent with the nature of long-term exchange was employed. Items (see Table 1) were developed which measured the falsity and alteration of facts, distortion, exaggeration of needs, sincerity, truthfulness in dealings and good faith bargaining, and breach of agreements engaged in by an exchange partner. A summed-scale measure was employed.

Measure Assessment

Measures of all multiple item scales were developed employing standard psychometric scale development procedures. Three ill-fitting items were deleted on the basis of item to total correlations and other measurement criteria. Final coefficient alphas and factor loadings via principle components factor analysis for each scale are shown in Table 1. Alphas for each of the scales exceed .70 and suggest a satisfactory level of internal consistency. Factor loadings employing a single factor solution are also generally high and provide some evidence of the unidimensionality or convergence among the scale items.

Validity

Evidence of nomological validity was obtained through correlation with other measures. Because commitment involves exchange-specific resources that are difficult to redeploy, their deployment suggests their importance and reduces the alternative relationships a firm may engage in (Anderson and Weitz, 1992). Firms committing resources should report higher importance levels for these relationships and greater difficulty in developing alternative and/or substitute relationships. To assess this, measures of the importance of an exchange partner and the difficulty of replacing the partner were developed. Correlation coefficients of these measures and measures of commitment exceeded .48, suggesting a moderate degree of convergence.

Evidence of convergent validity for relational norms was also sought through correlational means. Because of the dyadic nature of social norms, participants to an exchange should share similar assessments of these norms. The cross-dyadic correlation of partici-
TABLE 2

Regression Analysis for Opportunism

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Standardized Coefficient</th>
<th>t-value</th>
<th>R²</th>
<th>F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comparative commitment</td>
<td>.23</td>
<td>2.55**</td>
<td>.43</td>
<td>9.84***</td>
</tr>
<tr>
<td>Contract</td>
<td>-.08</td>
<td>-.56</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Relational norms</td>
<td>-.74</td>
<td>-7.44***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contract x relational norms</td>
<td>.01</td>
<td>.21</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Comparative commitment x contract</td>
<td>-.02</td>
<td>-.99</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Comparative commitment x relational norms</td>
<td>-.02</td>
<td>-1.26*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Comparative commitment x contract x relational norms</td>
<td>-.01</td>
<td>-1.32*</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes: *One-sided test
* p ≤ .10
** p ≤ .01
*** p ≤ .001

pant observations for the relational norms scale was .42 (p < .00) suggesting a moderate degree of convergent validity.

Finally, evidence of discriminant validity among commitment, relational norms and opportunism was sought. Employing a 3-factor solution and orthogonal rotation, Principal Component Factor Analysis was performed. Factor loadings for each of the items loaded highest on their respective factors with lower comparative loadings on others. The pattern and magnitude of loadings provided reasonable evidence of discrimination among the measures.

ANALYSIS AND RESULTS

Beyond direct effects, our hypotheses contend that the relationship between the comparative level of commitment and opportunism is moderated by the level of contract and relational norm safeguards—individually and in combination. These predictions were tested using multiple regression analysis employing product terms (Jaccard, Turrisi, and Wan, 1990). To avoid multicollinearity concerns, all variables were centered prior to the regression analysis (Cronbach, 1987). Table 2 reports the results.

Commitment and Opportunism

Asymmetry in commitment in an exchange increases the likelihood and motivation for opportunism by a less committed partner. Thus, in the absence of appropriate safeguards H1 predicts an increase in comparative commitment by one party will yield opportunism by the other. The regression coefficient (.23, p ≤ .01) relating comparative commitment and opportunism is positive and significant providing statistical support for H1 (See Table 2).
Legal and Social Safeguards Against Opportunism

Contract Safeguards

Legal contracts may be fashioned in exchange to deter opportunism through granting one party control over another's decisions. Thus, H2 predicts a negative main effect for the relationship of contractual safeguards and opportunism. H3 predicts a moderating effect (interaction) for contractual safeguards on the relationship of comparative commitment and opportunism. For both hypotheses, the regression coefficients (-.08 p = n.s.; -.02 p = n.s.) are negative, but nonsignificant (see Table 2). Neither, therefore provides statistical support for the predicted relationships of H3 and H4.

Relational Norm Safeguards

Relational norms create a social environment that discourages individualistic behavior in favor of mutual interest seeking therefore deterring opportunism. H4 predicts a negative main effect for the relationship of relational norms and opportunism. H5 predicts a moderating effect (interaction) for relational norms on the relationship of comparative commitment and opportunism. The regression coefficients (-.74 p ≤ .001; -.02 p ≤ .00) for both hypotheses are negative and significant (see Table 2). Thus, the results provide statistical support for H4 and H5.

Contract and Relational Norm Safeguards in Combination

A key question involves the safeguarding properties of contracts and relational norms in combination. Adopting the view of these safeguards as compatible and complementary in their relationship to opportunism, H6 predicts their interaction effect in mitigating opportunism. H7 examines the extent to which their interaction moderates the positive effect of comparative commitment on opportunism. The regression coefficient (.01 p = n.s.) for their interaction effect on opportunism (H6) is positive and nonsignificant, failing to support the hypothesis. However, the regression coefficient (-.01 p ≤ .10) testing their moderating effect on the relationship of comparative commitment and opportunism (H7) is negative and significant. See Table 2. Though, the magnitude of effect is small and not highly significant, the results provide some support for H7.

DISCUSSION AND CONCLUSION

The governance of exchange relations has acquired critical attention in recent years as firms have downsized and outsourced core functions to independent firms. More and more these critical boundary spanning relationships cross international borders and cultures and
involve complex forms of governance. Unfortunately, the theory available to address inter-firm governance has not kept pace with these developments. On the one hand, there is the transaction costs model founded on assumptions of bounded rationality and the opportunistic man (Williamson, 1985). Williamson maintains that economic agents are able to perceive the hazards of exchange and provide suitable safeguards (Williamson, 1996, p. 239). Thus, in the ordinary course, sufficiently elaborate contingent contracts can be written to facilitate efficient exchange where, presumably, neither market nor hierarchy is feasible (Stinchcombe, 1985). On the other hand, there is the sociologically oriented school that believes that contractual devices and legal remedies are inadequate mechanisms for organizing modern commerce. These authors believe that a richer understanding of interfirm organization is available through studying the social embeddedness of economic actors rather than the structure of their contractual relations (Achrol, 1997; Granovetter, 1985; Macneill, 1980).

In this study, we examine key premises originating from both these schools of thought as well as the interactions among them. The basic argument follows Gundlach, Achrol, and Mentzer (1995) in assuming that the asymmetric commitment of valuable resources in exchange creates the propensity for opportunism by the less committed party. Whether opportunism occurs, however, is contingent on the governance mechanisms employed in the relationship. The mechanisms studied include contractual and relational norm safeguards. Each is examined for its ability to mitigate opportunism directly and as induced through asymmetric commitments. Their combined effect in mitigating opportunism is also investigated.

A number of important findings and implications follow from the study results. First, asymmetric commitment of resources by one party in an exchange does create an incentive for opportunistic behavior by the other. Though opportunism has been thought by some to be a basic characteristic of economic exchange (cf. Williamson, 1985), others have challenged this assumption as unrealistic in favor of a more deterministic view of such conduct (cf. Granovetter, 1985). The findings of this study provide some evidence of the factors that promote opportunism.

Second, whether opportunism occurs in an exchange depends on the mechanism of governance found in the relationship. In this study, decision control afforded through legal contracts and mutual interest seeking brought about through relational norms were investigated. Focusing on legal contracts, the results from this study suggest these documents are largely ineffective in mitigating opportunism as studied directly and as brought about through asymmetric commitments. Ordinarily contracts are not written with a specific view to threats of opportunism. However, the results indicate even when it might be expected that contracts would be drafted to include adequate decision controls to thwart opportunism e.g., when asymmetric commitments are involved, the results do not show a statistically significant moderating effect of contracts on opportunism. In general, the results suggest the skepticism of various scholars about the effectiveness of contracts alone as documents of governance may be well founded—at least with respect to mitigating opportunism through decision control.

In contrast to contracts, social mechanisms of control appear to show a marked ability to control opportunism in exchange. This safeguarding effect is especially pronounced in direct relation to opportunism. Relational norms also show a statistically significant effect
in controlling opportunism as induced through asymmetric commitments, but the magnitude of effect is somewhat small. Together, these results suggest that through providing for a social environment that encourages mutual interest seeking, exchanging parties can mitigate opportunism directly and to a lesser extent opportunism motivated through asymmetric commitments. The recent emphasis placed on the positive governance benefits of the social structure in which an exchange takes place appears to have merit. Comparing the findings for relational norms against those for contract, the social network in which an exchange is embedded as reflected through relational norms yields a fuller explanation of governance versus the formal contract structure.

Third, while it was expected that contracts in combination with relational norms would yield the most effective safeguards through complementing one another in mitigating opportunism, the results do not provide strong support for their combined effect. Though the study found a statistically significant three-way interaction between comparative commitment, contracts and relational norms, the magnitude of effect was very small. The result for the combined effect of contracts and relational norms on opportunism directly was not significant. The lack of supporting evidence for the combined effect of contract and relational norms suggests additional research is needed to fully understand the interrelationship of these governance approaches. In the world of commerce, most exchanges are backed by contracts as well as generally accepted standards of behavior. The key question is just how these safeguards work together in governing exchange. The thesis advanced in the current study is that social safeguards complement the governance role of contracts. Other explanations may also have merit and deserve inquiry.

Other directions for future research are suggested by the limitations of this study. Although the simulation setting can offer unique advantages in internal validity, measurement, and data cost and quality, it trades off on external validity. Some question may regard the isomorphic quality of the constructs and theoretical processes within the simulation. Future studies should examine the generality of the results obtained here across different settings and populations. Further, in this study, contract safeguards were made operational in terms of provisions, which granted one party the right to participate in the decisions of the other party. This is a stringent definition and alternative definitions should be studied. Extensions might focus on the nature of decision control obtained in terms of the extent, domain and duration of control. Capturing these dimensions should provide a more elaborate view of contracts as safeguards. In addition, for the study, the conception of comparative commitment focused on was the degree of asymmetry of commitments. While considered an important factor in motivating opportunism, this approach does not capture the overall level of commitments in the relationship, e.g. magnitude of commitments. Future research may wish to incorporate the role that this structural dimension plays in mitigating opportunism (cf. Gundlach, Achrol, and Mentzer, 1995). Finally, the regression analysis method employed in the study relied on simple product terms and therefore tests for only one functional form of interaction. The failure to obtain statistically significant interactions using this traditional approach may reflect the presence of an alternative functional form rather than the absence of a moderated relationship. Future studies may wish to examine more complex forms of interactions that may be suggested by theory.

Future research may also wish to study other combinations of governance mechanisms beyond contracts and relational norms. In this context, it may be useful to integrate these
study findings with those of Lusch and Brown (1996) and examine the relative effectiveness of combinations of contracts, norms, power-dependence, as well as market mechanisms (such as multiple sourcing) for mitigating opportunism. In a narrow sense, the current study may account for some effects of dependence through the commitment construct. Future research might formally examine these effects and the governance implications of differing dependence structures.

Finally, there are directions for future research which emerge from potential extensions of the theories underlying this study. There is now substantial evidence in the marketing literature that norms play an important role in mediating and governing effective exchange relationships. But there is little theory or evidence regarding the conditions which foster the formation of norms. Some authors argue that norms are the product of a network of relationships. What are the theoretical and conceptual requirements of moving to a network level of studying exchange, contracts, norms, opportunism, etc.? Are there other, even higher level theoretical frameworks that work to fashion norms of exchange, such as ethics and moral ideology (Gundlach and Murphy 1993) or generalized reciprocity (Bagozzi, 1995)? Researching addressing these questions would add substantially to our understanding of exchange governance.

APPENDIX A

Simulation Exercise

A capstone marketing strategy course held at a private, midwestern university provided the setting and participants for the study. The 15-week undergraduate course was devoted entirely to the computer simulation exercise that comprised ten quarters or decision periods. Grading was based entirely on performance in the simulation yielding considerable involvement and motivation. For the exercise, participants were randomly organized into teams of four to five members, and allowed to self-select into the functional responsibilities of president, finance, marketing, research, and sales/purchasing. Each team was randomly assigned the role of either a new venture manufacturer or distributor of microcomputers. Manufacturer and distributor teams were then randomly assigned to 10-member industries (5 manufacturers and 5 distributors). In total, four simulated industry settings were conducted yielding the prospect of 100 potential dyadic relationships and potentially 200 data observations (from each side of the dyad).

Each decision period involved interactions among the channel organizations leading to business strategy decisions and performance outcomes. Marketing and financial information regarding performance outcomes were provided to organizations each period (e.g., sales and financial data, marketing research feedback, etc.). While possessing individual performance goals, channel member organizations were responsible for a variety of exchange functions which directly and indirectly affected the success of the others. For example, a distributor could alter a manufacturer's brand demand through pricing, shelf location, point-of-purchase promotion, and sales force allocation decisions. Similarly,
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Manufacturers affected distributor performance by controlling access to highly sought-after brands, wholesale prices, and advertising support in cities carrying the brand. This dependence provided the impetus for mutual interaction and the development of behavioral expectations between the partners across a broad array of decision areas as well as the opportunity for opportunism due to differing goals and exchange attitudes.

Both manufacturers and distributors were able to deploy resources in a manner specialized to specific exchange partners. For example, manufacturers negotiated with distributors to develop product models with characteristics specialized to market segments targeted by a particular distributor. Advertising copy and media strategy were often developed in conjunction with distributors and tailored to complement their segmentation strategy. Conversely, distributors cooperated by opening stores in markets containing segments targeted by specific manufacturers. Distributors could dedicate salespersons within these stores to a manufacturer’s products, give favorable shelf space, and develop cooperative local advertising. Complicated capital arrangements were also commonly made, including prepayment for orders, sharing of R&D expenses for future product innovations, loans for expansion of production capacity, consignment selling, etc.

Throughout the simulation, manufacturer and distributor representatives negotiated, interacted, and contracted on a continuing basis. Each team was free to establish its own “style” of negotiation and governance approaches with channel partners. Written contracts specifying basic terms such as product quantity and price were required for the transfer of inventory and funds. Participants were also free to create additional contracts detailing other exchange terms and decisions or to supplement their contractual agreements with other forms of governance to achieve their objectives. Each team could develop, terminate, or reinitiate channel relationships over the course of the simulation. Together, these elements were evaluated as sufficiently meeting the criteria suggested by Schlenker and Bonoma (1978) for testing the theoretical predictions of interest in the study.

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NOTES

1. A common theme in the prior literature has been that given the opportunity and circumstances, exchange partners will behave opportunistically whenever such behavior is feasible and profitable. This assumption extends mainly from research addressing opportunism from an economic perspective (Williamson, 1985). In contrast, a considerable body of research into human interaction challenges that unrestrained self-interest maximization is not characteristic of human behavior, particularly in modern exchange relationships. This view follows the sociological perspective that exchange is embedded within a social structure in which opportunism is the exception rather than the rule and that its occurrence is brought about through identifiable circumstances (Granovetter, 1985). Behavioral research in marketing (Gundlach, Achrol, and Mentzer, 1995) and its related fields (Shell, 1991) has sought to understand these circumstances.

2. A common assumption is that the use of business managers would provide a more realistic and, therefore, more appropriate participant population. As Zelitch and Evan (1962, p. 59) point out,
however, questions regarding the use of non-referent populations (i.e., students) amount to "...are the ways in which the subjects differ from the referent population correlated with the effects studied" (cf., Weick, 1967). In the current study, little theory or evidence was found to suggest that differences in the referent population (i.e., business managers) and subjects would be expected to correlate with the constructs and processes studied. Nevertheless, as described, steps were taken to ensure that participants developed adequate experience with the exchange setting, key informants were truly knowledgeable of the relationships sampled and that they possessed a working understanding of formal contracting practices as might be found for business management.

3. To obtain the final sample, a pooled methodology was employed in which data reflecting the relevant variables from the perspective of each side of the dyad (e.g., manufacturer and distributor) were concatenated. For example, relevant variables from the manufacturers perspective included manufacturer observations as to their commitment, opportunism by the distributor, and relational norms in the relationship as well as objective assessments of manufacturer decision control contained in their contracts with distributors and distributor's assessment of their own commitment. Relevant variables for the distributor's perspective were also obtained. Separate analysis of the perspective specific data yielded similar results as found for the pooled sample.

4. Some limitations attend this approach and are acknowledged. First, emphasis of the asymmetric property of commitment does not capture the implications of the overall level of commitment in the relationship. In addition, comparing commitments based on self-reports of commitment originating from differing respondents raises the potential of comparisons based on differing anchor points.

5. To ensure participants were familiar with the construction of exchange relationships via contract, each was indoctrinated as to the nature of contract practices and writing prior to play of the simulation and as part of the course.

6. The following 7-point scales were used to measure the validation variables: (1) how important is your relationship with (exchange partner) to the overall success of your firm (not very important-very important); (2) if (exchange partner) were no longer available as a channel partner, what effect would this have on your business (no effect-disastrous effect); (3) how difficult would it be to develop a relationship with another channel partner similar to the relationship you now have with (exchange partner) (not very difficult-very difficult); (4) how difficult would it be to replace (exchange partner) with another channel partner, (not very difficult-very difficult).

REFERENCES


