The evolution of governance mechanisms and negotiation strategies in fixed-duration interfirm relationships

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Abstract

This study focuses on how governance mechanisms and negotiation behavior develop in interorganizational relationships with a fixed endpoint. A framework for describing and analyzing interorganizational processes is developed based on contract theory and negotiation theory. The framework is applied on a case study describing cooperation between the Norwegian Road Authorities (NRA) and a private contractor. The data suggest that a cooperative climate characterized by trust and relational norms can develop even in a temporally delimited relationship. An enabling aspect is the complementary nature of different governance mechanisms, and the interdependence between governance and behavioral orientation. The key for understanding how value is both created and distributed as the relationship develops is the process itself, and how the process continually develops.

Keywords: Relationship development; Contracts; Governance; Negotiation strategies

1. Introduction

How do governance and behavioral orientations coevolve in relationships with a fixed duration? To understand this, we focus on the evolution of governance mechanisms and negotiation strategies in interorganizational relationships with an ex ante known endpoint. That is, when the contractual relationship is entered, the parties have specified the temporal duration of the relationship. We refer to such situations as fixed-duration relationships. Whether this endpoint is final or temporary is not an important distinction here, as we focus on the development towards an endpoint that is explicitly agreed upon at the outset. With fixed duration, we mean that there is no known continuance of the relationship, but without excluding possible new future interaction. While much attention has been given to the value-creating potential of relationships (Buvik and John, 2000; Jap, 1999; Dyer and Singh, 1998; Anderson, 1995; Mohr and Spekman, 1994), the existence of a fixed temporal duration shifts attention to the distribution of the created value. We justify this assumption because an initially specified endpoint imposes a time limit for the process of claiming value. The appropriation of relational rents will be an integral and important part of the process to secure each party’s performance. Our primary objective is to understand how governance mechanisms and negotiation strategies evolve from the initiation of a relationship to the known endpoint, and to study how governance mechanisms and negotiation strategies enable or restrain cooperative behavior.

When the endpoint of a relationship is known ex ante, it is likely to influence the intentions and behavior of the parties. A purposive and strategic actor attempting to create the best possible economic surplus in the long run is assumed to start out cooperatively to create value. Towards the end of the relationship, it is assumed that the actor will pursue its own goals at the expense of the partner’s goals (i.e., claim as much value as possible) to realize the best possible economic gain. As the same reasoning holds for both parties, none of the parties can rule out potential opportunistic behavior. As both parties have reason to be suspicious, this condition is likely to restrain cooperative interaction aimed at creating value in the dyad, and to promote distributive interaction to claim value. Such conditions might in the worst case result in early noncoopera-
tive behavior, and potentially lead “to an unraveling of any cooperative pattern” (Heide and Miner, 1992, p. 267). As early noncooperative behavior is likely to result in increased suspicion that future actions will also be noncooperative, the evolution of cooperative behavior may be undermined.

This paper contributes in three different ways suggested in the literature. First, we take a dynamic perspective on contracts as suggested by Heide (1994) and Zaheer and Venkatraman (1995). Second, we focus on developmental processes by conducting a longitudinal study investigating a number of events in a specific relationship as suggested by Ring and Van de Ven (1994) and Heide and Miner (1992). Third, to alleviate a shortcoming of previous research that focuses on either structure or behavior (Sydow and Windeler, 1998), we integrate the structural and behavioral dimensions of relationships. By combining contract theory and negotiation theory, we address both structure and action, as contract theory focuses on the structural dimensions of relationships, and negotiation theory pays special attention to the parties’ behavior and actions.

The current understanding of evolutionary processes in long-term relationships is rather meager, although some conceptual (e.g., Dwyer et al., 1987; Kumar and Nii, 1998; Ring and Van de Ven, 1994) and some empirical (e.g., Doz, 1996; Larson, 1992; Niederkofler, 1991; Arino and de la Torre, 1998) studies of relationship processes are reported in the literature. This study extends existing literature by specifically studying processes in terms of how governance mechanisms coevolve with negotiation behavior through the different stages of a relationship. The paper is organized as follows: we first review contract theory and negotiation theory. These perspectives are the theoretical underpinnings for how we study developmental processes. Thereafter, we discuss the research method for conducting processual studies, and describe and analyze a relationship between the Norwegian Road Authorities (NRA) and a private contractor, followed by a discussion of the findings. Finally, we discuss implications and address limitations.

2. Theoretical background

Contract theory and negotiation theory are the theoretical underpinnings for our study that develop an integrated framework that can be used for describing and analyzing developmental processes. Such processes, and in particular those focusing on both structure and behavior, are generally overlooked empirically (Anderson, 1995; Gulati, 1998; Ring and Van de Ven, 1994; Sydow and Windeler, 1998). A challenge is thus to integrate the two perspectives, and link this integration to developments over time.

2.1. Contracts and governance mechanisms

Contracts are often considered to represent the structural dimension in relationships. Contracts can be grouped into three different categories: market contracts, internal contracts, and relational contracts. Market contracts are traditionally referred to as discrete contracts, meaning that there is nothing more to the relationship than each individual transaction. The key mechanism regulating the transaction(s) is the economic structure, referred to as price or incentives (Heide, 1994; Ring and Van de Ven, 1992; Williamson, 1991). Market contracts can further be divided into classical and neoclassical. Neoclassical contracts allow for an extended time horizon, and some degree of flexibility can be built into the contract. However, economic incentives still represent the primary governance mechanism. Internal contracts reflect the firm or exchange within a hierarchical structure, as a polarization to market exchange. Firms typically exercise control and conduct allocation of resources by using hierarchical elements. This is referred to as authority, and includes rules, regulations, decision rights, formal rules and procedures, etc. Such elements may also be used to govern exchange between firms as Stinchcombe writes: “A structure with legitimate authority, with a manipulable incentive system, with a method of 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, very little like a competitive market. Yet all these features of hierarchy are routinely obtained by contracts between firms” (p. 126). Relational contracts are often associated with long-term strategic alliances and other hybrid governance modes. Here, norms of cooperation and obligation play an important role for coordinating exchange processes (Macneil, 1980; Bradach and Eccles, 1989). Actors are expected to follow certain patterns of behavior (Rousseau, 1995) represented in a set of shared norms based on trust between the partners. Norms represent “a principle of right action binding upon the members of a group and serving to guide, control, or regulate proper and acceptable behavior” (Macneil, 1980, p. 38), and important relational norms are preservation of the relation, mutuality, flexibility, role integrity, and harmonization of relational conflict. Furthermore, trust defined as “a psychological state comprising the intention to accept vulnerability based upon positive expectations of the intentions or behavior of another” (Rousseau et al., 1998, p. 395) serves as a common base for future interaction. According to Rousseau et al. (1998), three basic forms of trust exist: institutional, calculative, and relational. Over time, a relationship is expected to involve different forms of trust. Institutional trust is assumed to exist as the foundation for calculative and relational trust. In the early stages of a relationship, institutional trust is likely to be complemented by calculative trust. Calculative trust is based on rational economic reasoning, and as exchange continues over time, relational trust is likely to supplant calculative trust (Rousseau et al., 1998).

The three contract forms thus represent three different types of governance mechanisms: price/incentives, authority, and trust/norms. The three mechanisms can be used
independently, but are often combined in specific situations (Bradach and Eccles, 1989; Stinchcombe, 1985; Poppo and Zenger, 2002; Haugland and Reve, 1994). The reasons are that different issues or tasks require different mechanisms for efficient handling, and a specific governance problem can also be handled by using several governance mechanisms. Das and Teng (1998) argue that trust and control (authority) are in fact complements rather than substitutes, a view that Poppo and Zenger’s (2002) empirical findings support.

We assume in this study that relationships are formed in a market context, and the parties engage in exchange based on market incentives, reputation, and experience. Economic incentives thus provide an important condition to form relationships, and as the parties interact, rules and procedures (authority) will be added to the relationship (Larson, 1992) and complement incentives. Over time, we also expect that relational mechanisms (trust/norms) will be built into the relationship and function as complements to incentives and authority rather than substitutes (Poppo and Zenger, 2002; Larson, 1992).

Despite the fact that these three forms of governance are commonly used in interorganizational studies, the literature does not provide much insight into how they develop over time. We do not know whether the three governance forms are used interchangeably, whether they are implemented simultaneously at start-up or sequentially over time, or whether the relative importance in the use of different mechanisms changes.

2.2. Negotiation strategies

Negotiations can be defined as: “a process of potentially opportunistic interaction by which two or more parties, with some apparent conflict, seek to do better through jointly decided action than they could otherwise” (Lax and Sebenius, 1986, p. 11). Negotiation behavior is often described in terms of different strategies (Pruitt and Carnevale, 1993). Depending on each party’s goals, and whether the parties’ goals are shared or not, each party will pursue the negotiation strategy that is most beneficial for reaching the goals. Because concern for own outcomes (goals) and concern for the other party’s outcomes (goals) are viewed as independent dimensions, high concern for own outcomes will not determine the degree of concern for the other party’s outcomes (Thomas, 1976). High concern for own outcomes can be combined with either high or low concern for the other party’s outcomes. Similarly, low concern for own outcomes (e.g., issues of little or no importance) can be combined with either high or low concern for the other party’s outcomes. The degree of concern for own outcomes and the degree of concern for the negotiation partner’s outcomes determine the parties’ strategic orientations in specific negotiations.

In situations characterized by high concern for own outcomes combined with low concern for the partner’s outcomes, the preferred strategy will be contending. In the reverse case, where concern for own outcomes is low combined with high concern for the partner’s outcomes, a yielding (or accommodating) strategy will be used. These two strategies are considered to represent distributive strategies (Pruitt and Carnevale, 1993; Thomas, 1976), or a distributive dimension, where interaction primarily involves distribution of value as opposed to creation of value.

In negotiations where both parties pursue shared goals, and the concerns for both own and the partner’s outcomes are high, problem solving will be the preferred strategy. In some situations, concerns for both own and the partner’s outcomes might be low, and lead to the use of a passive strategy (inaction). However, this strategy will most likely only be used temporarily, and will be replaced by a more active strategy. Problem solving and inaction are considered to represent integrative strategies (Pruitt and Carnevale, 1993; Thomas, 1976), or the integrative dimension, where interaction involves creating value for both parties. Compromise can be found in between these strategies indicating moderate concerns for own and the partner’s outcomes. This particular conceptualization of negotiation strategies is referred to as the dual concern model (Thomas, 1976; Pruitt and Rubin, 1986; Pruitt and Carnevale, 1993).

Actors will pursue each of these five strategies by using different tactics. For example, threats, positional commitments, persuasive argumentation, and time pressure are contending tactics. Logrolling (trading issues), specific and nonspecific compensations, unbundling (splitting issues), bridging (solving underlying issues), and promises are problem-solving tactics. Reducing goals and demands, and adaptations are yielding tactics. Withdrawal, avoidance, and no response are inaction tactics. Finally, give-and-take, sharing concessions, and suggest middle-ground solutions are examples of compromise tactics.

It should be noted, however, that integrative and distributive dimensions are not necessarily bipolar. Putnam (1990) suggests that: “integrative and distributive processes are intertwined in a symbiotic bonding that pervades negotiations” (p. 5). There is thus a tension between the competitive behavior for individual gain represented by the distributive dimension, and the cooperative behavior necessary for coordinating mutual agreements represented by the integrative dimension (Gulliver, 1979; Lax and Sebenius, 1986). The challenge is to balance these two concerns. Therefore, to have a relationship that is beneficial for both, actors cannot only pay attention to their own outcomes (Corfman and Lehmann, 1993).

Empirical research also supports the view that negotiation strategies can reflect both the integrative and the distributive dimensions (e.g., Ganesan, 1993). Perdue and Summers (1991), studying how purchasing agents negotiated rebuys of component parts, found that contextual variables, such as material cost sensitivity, uniqueness of specifications, cooperative orientation, and formal planning, predicted an agent’s focus on problem solving, manipulating perceptions about competition, and tough tactics in a par-
particular set of negotiations. They found that: “bargaining behavior may be more complex, at least in an industrial purchasing context, than a bipolar integrative/distributive perspective would suggest. Both integrative (problem solving) and distributive (aggressive bargaining) strategies can be used to a greater or lesser extent within any given set of negotiations” (Perdue and Summers, 1991, p. 186).

As for the case of contract theory and governance mechanisms, the negotiation literature has not paid attention to how negotiation strategies develop over time in ongoing relationships (Sheppard and Tuchinsky, 1996; Greenhalgh, 1987, 1995). The literature cannot explain whether different strategies over time are used interchangeably, whether the different strategies replace each other, or whether the use of strategies expands in a cumulative way.

2.3. Relationship processes

The research questions raised in this study require an analytical approach. We define process as the unfolding chain of events between the parties, and an event is defined as any incident where the parties engage in joint interaction, as well as unilateral actions that affect the relationship. Above, we outlined our view on relationship governance and negotiation behavior. Relationship governance has been described in terms of three different governance mechanisms (incentives, authority, and trust/norms), and we have discussed how we expect these mechanisms to complement each other sequentially over time rather than act as substitutes. As relationships move from market-based interaction towards more dedicated modes of exchange, new governance elements will be implemented and thereby complement the existing mechanisms as structural dimensions of the relationship. We thus assume that the structural characteristics develop over time as new governance mechanisms are implemented. Furthermore, we have described negotiations along two main dimensions, distributive and integrative, with corresponding strategies and tactics.

Governance mechanisms and negotiation behavior can further be linked, as illustrated in Table 1. In a more operational term, we can define process as the chain of events that shape the pattern of development between the different cells. By integrating governance mechanisms and negotiation behavior with a processual approach, we are able to study how a relationship over time moves between the six cells.

At relationship start-up, when economic incentives represent the primary structural characteristic, we expect to observe negotiation behavior predominantly described as distributive, as distribution (claiming) of value with focus on own goals is considered to be most important, although we do not exclude integrative interaction. As authority elements are added to the relationship, competing propositions can be derived. Introduction of bureaucratic control is commonly argued to undermine the level of trust (Poppo and Zener, 2002; Das and Teng, 1998), and encourage opportunistic behavior (Poppo and Zener, 2002; Goshal and Moran, 1996). A predominantly distributive interaction is thus likely to continue, constraining value creation in the relationship. Alternatively, if introduction of bureaucratic control takes the form of securing procedural justice or restraining the use of structural power, this might enable integrative interaction. Finally, trust and relational norms with focus on both own and the partner’s goals are assumed to enable integrative behavior, in particular, the use of problem-solving tactics.

However, the two negotiation dimensions are not necessarily bipolar, and the three governance mechanisms can be combined and may interact. A relationship can thus over time move between the different cells, although specific combinations of governance mechanisms and negotiation strategies are probably more likely than others. Furthermore, we should be able to detect specific patterns in the way governance mechanisms and negotiation strategies develop. We should be able to observe whether different governance mechanisms and different negotiation strategies over time are used interchangeably, or whether they replace each other more permanently. Still, another pattern of development may be that there is a cumulative expansion, in the sense that new governance mechanism and new negotiation strategies are continually added to the existing ones, and thereby complement rather than replace existing mechanisms and strategies.

We have argued that fixed-duration relationships represent a special type of interfirm relationships, as we expect the temporal time horizon to place particular emphasis on claiming value, possibly encouraging the use of distributive behavior. Furthermore, this will restrain the evolution of trust and impede value creation. Integrative efforts are likely to have limited impact on the interaction process. Hence, we expect that fixed-duration relationships should be characterized by distributive negotiation behavior along with a governance focus on incentives combined with some use of authority. Such relationships should thus remain quite stable, and only or at least primarily move between Cells 1 and 3 for the entire contract period.

Table 1

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<th>Governance mechanisms and negotiation behavior</th>
<th>Negotiation behavior</th>
<th>Integrative</th>
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<tr>
<td>Price/incentives complemented by Authority</td>
<td>Distributive 1</td>
<td>2</td>
</tr>
<tr>
<td>Trust/relation norms complemented by Authority</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>6</td>
<td>3</td>
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Alternatively, if the parties are able to overcome the particular challenges imposed by the temporal time horizon, we could expect integrative interaction leading to increased levels of trust and positive value-creation spirals, moving the relationship towards Cells 4 and 6.

3. Research method

3.1. A longitudinal case study

As this research investigates a phenomenon with scant prior knowledge, we chose to conduct a longitudinal case study to identify a chain of events over time (Maxwell, 1996; Eisenhardt, 1989; Miles and Huberman, 1994; Yin, 1994; Pettigrew, 1990). We selected an embedded single case study (Yin, 1994) due to the fact that empirical research on relationship processes is rather limited, and we explore the usefulness of a new theoretical perspective. Furthermore, to develop a theoretical understanding of relationship processes, the importance of relationship context is secured in a case study. Basically, we traded variability and comparison for depth.

As selection of cases should primarily be based on theory (Maxwell, 1996; Miles and Huberman, 1994), we chose a case that we knew was accessible, had a predefined temporal duration, and involved a series of joint decision-making incidents characterized by mixed motives. The case was the relationship between the NRA in the county of Vest-Agder and a private contractor Nodest Vei (NV). The parties entered a fixed-duration (6 years) maintenance contract to avoid a public court ordering to settle a 2-year-old conflict.

3.2. Data collection

The relationship had existed for 4 years when we started data collection. We were thus not able to follow the entire process closely as it evolved. However, the cooperation still existed, and we were able to follow the final stages in real time and map past interactions through archival data and interviews. The data consisted of interviews, archival material (contracts, letters, memos, evaluation reports, minutes from meetings, etc.), secondary data sources (annual reports, information folders, and government documents), as well as visits to some of the sites where the maintenance work was conducted.

Interviews were conducted with eight informants from top, middle, and operational levels in the involved organizations (four from NRA, three from NV, and one third-party consultant). Each interview lasted from 90 to 150 min. Interviews were prepared based on initial meetings, phone conversations, and thorough inspection of archival material. Preparation of the interviews followed McCracken’s (1988) advice to review analytical and cultural categories, and to use probing techniques. A semi-structured interview guide was used (the initial version was adjusted to the need for data as the study evolved), and focused on how the parties had perceived the relationship, the organization of the interaction, contractual and governance issues, cooperative and noncooperative strategies, management issues, conflict issues, the role of the third party, learning aspects, the development over time, contextual issues, and whether the intended outcomes had been reached. The research staff and the parties cooperated on selecting informants. Interviews were tape recorded, and notes were taken throughout the interviews. If additional information was needed, such information was obtained in follow-up interviews or by telephone.

Archival material was studied to obtain an understanding of the relationship development over time. A third party had been appointed to secure private ordering and avoid future court ruling. The third party gave advice, arbitrated, and assisted in evaluations. As the third party’s location was a 4- to 5-h drive from the maintenance sites, the parties had agreed that the interaction should be documented in written documents. The third party could thus follow the development through written documentation, phone conversations, and occasional visits. As archival data was very rich and detailed, interviews were well prepared, but also checked for informant accuracy. Secondary data and on-site visits provided a good understanding of the relationship context.

We actively used the theoretical framework in the data collection. In this way, the study had a clear deductive component that enabled us to focus on the phenomena of interest, and avoided “death by drowning in data” (Maxwell, 1996; Miles and Huberman, 1994; Pettigrew, 1997; Yin, 1993). The study should thus meet the three criteria suggested by Van de Ven (1992): define the meaning of process, outline the theory of process, and design research to observe process.

3.3. Data analysis

Processual analysis should search for patterns in the process, reveal the underlying mechanisms that shape and drive any patterning in the observed process, and recognize that induction should go hand in hand with deduction (Pettigrew, 1997). In terms of generic strategies for the analysis of process data, we combined a narrative strategy with a temporal bracketing strategy (Langley, 1999). The data analysis involved data reduction, data display, and development of explanations.

Initial chronological event histories were worked out based on the archival material. These mapped all events according to dates and all issues were described. One extensive version identifying about 80 incidents was first developed, and subsequently, one version identifying “critical incidents” was developed. Specific chronologies were produced prior to and in between interviews. After conducting the interviews, we developed extensive (contact) summaries (Miles and Huberman, 1994) that were used in
further analyses of the data. Memos were prepared during the initial inspections of archival material and through preparation of the interviews. Displays were produced to reduce the data (role order displays, chronologies, and listing of critical events), and to serve as input to the processual analysis. Interim case summaries, case reports, and time-ordered case dynamics matrices (Miles and Huberman, 1994) were also developed. Events were coded in terms of the observed use of governance mechanisms and negotiation strategies (tactics). Operational measures were based on the theoretical perspectives used in the study (see Appendix A for coding examples).

A case archive was created to enhance reliability (Yin, 1994). Furthermore, the analyses were done by one researcher, and then inspected and checked by another researcher to secure agreement. Drafts and final reports were sent to the informants for accuracy checks to ensure descriptive and interpretive validity (Maxwell, 1992). This procedure identified no misconceptions. Theoretical validity was enhanced by the use of well-established theoretical constructs and measurement indicators. Caution should be taken in generalizing the results, primarily related to a theoretical universe rather than to a population (Miles and Huberman, 1994; Maxwell, 1992).

4. The case of road surface maintenance

4.1. Background and agreement

Roads in Norway are publicly owned. In addition to acting as owner, the road authorities undertake planning, construction, and maintenance. In 1987, the private contractor NV won a contract bid for laying asphalt cover on 15 specific road parcels. The asphalt cover was laid according to instructions from the road authorities in the county of Vest-Agder (NRA). However, it soon became evident that the asphalt cover was of inferior quality. NV repaired the damages during the summer of 1988, but still, the asphalt cover did not meet the quality standard.

NRA now claimed that NV should remove the asphalt, and lay a new asphalt cover. However, NV did not accept the claim, and in response, NRA claimed a compensation of NOK 4,125,000. Again, NV did not accept the claim, and the dispute was ready to go to court. A meeting was then called, and NV suggested that they should be responsible for the maintenance of the road parcels, and in this way, secure a sufficient asphalt quality for as long as the initial asphalt cover was expected to last. This suggestion was an unexpected solution to an escalating conflict. The road authorities at the national level decided that the regional road authorities had to accept this solution, and a 6-year maintenance contract was signed. The climate between the parties was rather hostile on both personal and organizational levels. A third party that both NRA and NV trusted on a professional basis was therefore appointed to act as mediator/arbitrator in case dyadic attempts to reach settlements failed.

4.1.1. The written contract

The agreement was formalized into a written contract. The third party, the consulting firm Via Nova (VN) assisted in writing the contract. The contract required that NV should cover NRA’s administrative costs, provide a financial guarantee, and cover all costs related to road maintenance. Furthermore, the contract provided guidelines and criteria for when and how to maintain, including extensive references to industry standards for securing the required quality. However, methods for measuring quality became a source of uncertainty, as unobtrusive measures were difficult to obtain. Furthermore, as a result of pressure from the road authorities at the national level, the contract also stated that the parties should actively use this particular situation to gain experience and build competence in handling long-term maintenance contracts. However, NRA’s regional department was rather unwilling to start this kind of cooperation.

The contract also described routines for joint inspections of the road parcels, and underlined the importance of information sharing. Most importantly, the document stated that NV had the right to, and was responsible for, making suggestions in relation to where, when, and how to conduct road maintenance. The suggestions had to be accepted by NRA, and if NRA did not accept, NV had to come up with a new suggestion until a suggestion was accepted (thus awarding NRA veto right as a decision rule). Furthermore, the contract stated that NV should receive compensation if the company produced asphalt cover that lasted longer than the contract period. In such cases, the parties should enter separate compensation contracts.

4.1.2. A yearly cycle for contract execution

The administrative procedures and routines for contract execution followed a specific yearly cycle. A major inspection of all road parcels was conducted in March. This inspection included registration of damages, measurement of asphalt conditions, and general assessment. A schedule for maintenance activities for the rest of the year was established based on this inspection. Analyses of the data from the inspection should be completed by the 1st of May each year, and suggestions for where, when, and how to carry out maintenance activities should be settled before the 15th of May. The required maintenance activities should then be performed during the summer.

A second inspection took place in late summer. This inspection included registration of new damages, evaluation of old damages, and general assessment. These data provided input to possible corrections of the yearly maintenance schedule. By the end of the year, the consulting company (VN) prepared a report that summed up all activities carried out during the year, and briefly evaluated the cooperation in...
general. In addition, both parties frequently inspected the road parcels during the year.

4.1.3. Negotiations and contract execution

Because the contract was not completely specified, uncertainty created a planning gap that resulted in situations where the parties had to agree on joint decisions. The interaction was thus open for negotiations. Although the parties had agreed on the maintenance contract, they still had conflicting interests on a number of dimensions. NRA was mostly concerned about public interests, such as road safety, road surface condition, public satisfaction, and asphalt cover after the contract period, while NV focused more on private interests, such as the costs of road surface maintenance, and compensation for increased life span. This is illustrated in Table 2.

The inspections in March and late summer usually lasted for 2 days with an overnight stay. This allowed for a more relaxed interaction during dinner and evening that over time became an important informal arena. The parties could here “flag” their views in an informal setting, and thus get a certain “gut feeling” for the negotiation zone and possible solutions to current issues.

4.2. The chain of events

During the 6-year period from when the contract was signed until early 1995, we identified about 80 interaction points in the archival data. We believe these events capture the essence of the interaction. In the following section, we describe the major developments of the relationship. Based on case chronologies, we split the relationship duration into three phases. This is illustrated in Fig. 1.

4.2.1. Phase 1

The maintenance contract was formally signed in May 1989. Only a few days later, the parties started to discuss how to organize the cooperation. By the end of May, the parties agreed upon the yearly cycle for contract execution, and NV also started the discussion of possible economic compensation for increased life span for road parcels that received more extensive maintenance than was actually required. All road parcels were inspected during the summer followed by execution of maintenance activities. However, NRA was not satisfied with the maintenance for several road parcels.

The second inspection took place in mid-August. The parties now discussed whether to postpone additional maintenance, carry out some minor maintenance, or undertake a new major maintenance. The issue of compensation for increased life span was now addressed again, and the conflict level escalated. NV wanted to establish specific compensation agreements for three road parcels, but NRA was only willing to discuss compensation agreement for one road parcel. NV expressed “their greatest disappointment,” to which NRA demanded that the guarantees should be fulfilled and their administrative costs be refunded immediately (see Coding Example 1 in Appendix A). However, both parties were also willing to emphasize their common interests. Therefore, they subsequently started a discussion of how to calculate compensation for increased life span. The conflict continued during the fall, particularly with respect to road parcels #4 and #13. By the 10th of November, the parties agreed on a separate compensation contract for road parcel #15. Potential compensation should be calculated at the end of the contract period, as the specific value would be easier to assess then.

4.2.2. Phase 2

The spring inspection in 1990 showed poor development for some road parcels, and the maintenance plan was agreed upon without major conflict. However, two parcels should receive special attention. NV wanted to try out a new work process for asphalt covering for road parcel #14. This process seemed promising and efficient, but required a very high degree of precision. NRA was very interested in this new work process, and allowed NV to try it out without further discussion. Moreover, they indicated that they were interested in learning from NV’s experiences (see Coding Example 2 in Appendix A). Road parcel #4 was more difficult to handle. The road parcel developed more poorly than other parcels. Clearly, major maintenance was needed, but NV would not carry out maintenance requiring a substantial effort unless they received compensation. In the end, minor maintenance was done.

For most parcels, low levels of conflict characterized 1991. However, the conflict regarding road parcel #4 was again discussed, and two other road parcels (#5 and #12) had similar problems. After lengthy negotiations, lasting from the 29th of May until the 12th of August, the conflict regarding road parcel #12 was resolved. The parties agreed on maintenance without compensation for possible increased life span. Regarding road parcel #5, NRA suggested that NV should carry out major maintenance and

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<td>Sources of mixed motives due to different perspectives on road maintenance</td>
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<tr>
<td>Interests of the Norwegian Road Authorities vs. Interests of Nodest Vei</td>
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<tr>
<td>Road safety</td>
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<td>Good road surface standard</td>
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<td>Public satisfaction</td>
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<td>Quality of the asphalt cover after contract period</td>
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<td>Maintenance after the contract period</td>
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<td>Homogeneous asphalt cover compared to other road parcels</td>
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receive compensation. However, NV would rather exploit the value of the existing surface, and turned down the offer. The issue was initiated on the 15th of May, and repeatedly discussed until the 22nd of August. After assistance from VN, a compensation contract was agreed upon on the 23rd of November. However, the contract was not signed before May 1992. This enabled the parties to observe surface development during the winter. No agreement was reached for road parcel #4. However, minor maintenance was carried out.

The parties had come to learn the game by 1992, and the interaction in general proceeded smoothly. However, road parcel #4 was still an issue. After several discussions, the parties agreed that they were not able to resolve the conflict, and forwarded the issue to VN for arbitration. They also agreed that both parties should accept the solution suggested by VN. An agreement for compensation was finally reached on the 18th of June. Then, however, the parties disagreed on necessary maintenance for road parcel #1 in May. During the following month, this road parcel was discussed on several occasions. In June, NRA accepted to take over responsibility for the road parcel by the end of the year without further maintenance.

4.2.3. Phase 3

Maintenance responsibility for road parcels #4, #5, and #15 was transferred back to NRA in 1993. The question of estimated life span resulted in a conflict about how additional value should be shared between the two parties. Both parties used contending tactics this time, and the parties held firm positions and made no concessions. After discussing the issue at several meetings during May and early June, the parties sent the conflict to VN for arbitration, and the parties accepted the suggested compromise solution. The interaction process now became predictable, and no new major conflicts occurred. The responsibility for the majority of road parcels was transferred back to NRA in 1993. NV claimed that many of the road parcels were in better condition than required by the contract, but did not demand economic compensation (see Coding Example 3 in Appendix A).

The last yearly inspections and maintenance schedules were handled in 1994. The parties agreed without much discussion on the maintenance schedules. Near the end of the relationship, no further problems arose and responsibility for the remaining road parcels was transferred back to NRA in 1995.

4.3. Relationship outcomes

In addition to settling a difficult conflict, the parties managed to gain experience in managing long-term relationships. In an industry characterized by short-term market contracts and immediate economic compensations in case of failure to fulfill the contracts, this was regarded as important. If NV had accepted the claim at the outset, the company would have to acquire additional revenues of about NOK 40,000,000 with 10% profit margins to yield a normal profit (margins in the industry were substantially lower). NV had, during the contract period, maintenance and administrative costs of about NOK 4,940,000. However, by deducting the compensation for extended life span, total costs for NV were approximately NOK 3,890,000. Spread over 6 years.

5. Findings

Based on the theoretical discussion and the case description, we created a case dynamics matrix (Miles and Huberman, 1994) as shown in Table 3. The data reflect the theoretical framework and focus on contractual elements, negotiation strategies, issues that were handled during the process, key decisions, and outcomes. Table 3 organizes the data into the three relationship phases.

All formal contractual issues were settled during Phase 1. Two additional compensation contracts were signed during Phase 2. However, they were more or less carbon copies of the first compensation contract signed in Phase 1. Furthermore, administrative procedures and organization of the interaction were also agreed upon during Phase 1, and remained unchanged during Phases 2 and 3. With regard to the use of governance mechanisms, most of these issues were settled during Phase 1 and to some extent, during Phase 2. However, trust and relational norms developed from late Phase 1
Throughout Phases 2 and 3, moreover, some major conflicts were addressed in Phase 1 resulting in mostly integrative outcomes. The end of Phase 1 thus represented a breakthrough, as it now became easier to follow the initial intentions of the agreement. This was rather difficult in the beginning of Phase 1. NRA more and more trusted that NV carried out road maintenance in both parties’ interests, while NV trusted that NRA would accept to pay compensation for maintenance beyond what was required by the contract. This enabled the parties to give the relationship a “new start” as it entered Phase 2.

During Phase 2, preservation of the relation and harmonization of conflict became more important. The parties recognized by now that they performed different roles in the relationship. This enabled the parties to settle conflicts, as conflicts were often a result of different roles and different risk profiles. While NRA, as the owner, generally wanted to avoid any kind of risk, NV, as the maintainer, accepted more risk as the company was responsible for maintenance costs.
However, as personal relations gradually became better, and the parties learned each other’s intentions and interests, it was also easier to agree on maintenance plans. Trust and relational norms became increasingly more important in the management of the relationship. This was partly due to the involvement of the third party.

The administrative procedures, in particular the joint inspection routines and the split decision process, represented a guarantee for procedural justice. This was very important in Phase 1, as relational norms and trust were at low levels. These hierarchical mechanisms were also important during Phases 2 and 3. In addition, a substantially more collaborative climate developed. This made it easier for the parties to be involved in integrative-oriented decision processes with a focus on problem solving. While the interaction in Phase 1 generally had been contentious due to competing interests, the interaction was smoother in Phases 2 and 3. Despite regular conflicts, they were much easier to handle. In some cases, conflicts ended in locked positions, but the use of the third party reinforced arbitration as an option. Furthermore, both parties adopted yielding strategies in Phase 3, indicating that the parties also had concern for the partner’s interests. Thus, substantially more relational aspects characterized the interaction in Phases 2 and 3.

Negotiation strategies differed during the three phases. While interaction in Phase 1 mostly involved distributive tactics, Phase 2 was characterized by a more mixed use of negotiation strategies. The use of contending tactics in Phase 3 was related to calculation of compensation for increased life span. Here, both parties contended firmly, and the issue was finally solved by arbitration. Yielding tactics were also used in relation to calculation of the compensation. Both contending and yielding represent the distributive dimension. However, the interaction process was overall characterized by an integrative orientation.

During the three phases, the parties also evaluated outcomes more positively. While the evaluation after Phase 1 was somewhat mixed, except for the positive economic outcomes for NV, evaluations in later phases were increasingly more positive despite the fact that the parties had to solve difficult conflicts.

By returning to Table 1, we can relate the relationship processes to the matrix as shown in Table 4.

The background for the maintenance contract can be placed in the price/distributive cell. The decision to enter a maintenance contract represented in itself an integration of interests. Because the maintenance contract should cover a 6-year period, uncertainty was brought into the relationship, and a predominantly incentive-based contract was not appropriate. The parties solved this problem by building administrative procedures into the contract (i.e., adding “authority”). The background for the contract can thus be placed in Cell 1, and the beginning of Phase 1 represented a move to Cell 2, and further to Cell 3. The last part of Phase 1 was important, as the relationship moved towards an integrative behavioral mode, indicated by a move to Cell 4.

In Phase 2, governance mechanisms represented by relational norms and trust emerged and became increasingly important throughout the phase, although interaction to some extent also involved the use of distributive tactics. This enabled the development of a collaborative climate, and integrative solutions were reached by using problemsolving negotiation tactics. However, the administrative procedures (authority) were also important in Phase 2.
Trust and relational norms did not substitute, but rather complemented authority. Thus, in Phase 2, the relationship was characterized by movements between Cells 3, 4, 5, and 6.

By the time the relationship entered Phase 3, trust and relational norms played an important role. However, the interaction now became contentious (distributive) as the parties started to negotiate the actual size of the separate compensation agreements. However, the final events remained within a cooperative climate. The relationship thus moved between Cells 5 and 6.

As the relationship evolved throughout the contract period, different governance mechanisms and different negotiation strategies were dominating in the different phases. Both structural conditions and observed behavior changed during late Phase 1 and Phase 2 towards more reliance on trust and norms, and search for integrative solutions. Finally, distributive tactics were used in Phase 3, particularly in relation to “money issues” (claiming value). However, the key structural dimensions remained primarily relational in this phase. By looking at the entire process, the start of the relationship was dominated by distributive negotiations with governance by price. As the relationship developed, integrative negotiation behavior along with governance by authority, and later, also trust and norms emerged. It is, however, important to note that this developed in a rather cumulative way (Van de Ven, 1992), where new negotiation strategies and governance mechanisms were added to the relationship at different stages. The new negotiation strategies and governance mechanisms did not replace, but rather complemented, the ones used at earlier stages. The actors were in this way able to use a wider range of negotiation strategies and governance mechanisms as the relationship developed. The different negotiation strategies and governance mechanisms coexisted, and were used in different situations depending on the specific issues to be addressed.

6. Discussion

6.1. Discussion of the results

We have described and analyzed factors that we conceive to be important for the evolution of the relationship. Despite difficult initial conditions, trust evolved over time changing the structure of the relationship and the interaction process. We also believe that the temporal order of these factors was important for a positive development of the process. The most important factors were, in chronological order:

1. Explicitly including an intention to learn how to manage long-term cooperation in the contract.
2. Appointing a mutually trusted third party.
3. Establishing a system for joint inspection and a split of the decision process, in which NV had the duty and the right to suggest maintenance efforts, while NRA had the right to veto. This secured procedural justice and made unacceptable decisions impossible.
4. Entering separate compensation contracts reduced uncertainty, as maintenance efforts with a life span exceeding the original contract should be compensated. Better long-term maintenance solutions were in this way implemented.
5. Moving between distributive and integrative subprocesses enabled the parties to understand and respect the range and limit of the negotiation zone.
6. Information sharing, which made it easier to understand each partner’s interests, increased the willingness to share experiences.
7. A willingness to learn how to manage long-term contracts.
8. Over time, unresolved conflicts were not accepted. Positive experiences were thus reinforced, which in turn led to positive developmental processes and restrained opportunistic behavior.

After the initial conflict had been settled, the parties realized that they were able to learn how to manage such contracts. As trust between the parties was low, the contractual framework relied on economic incentives and hierarchical elements to secure formal routines and procedures for the subsequent interaction and decision processes. In addition, the parties realized the large conflict potential and assigned a third party. The contract also stated that any compensation not regulated in the original contract required additional contracting. As the frequency of interaction was high in the early stages, the parties were forced to share information to manage the contract. Although the process itself was to a large extent distributive in nature, the parties realized that the contract also had integrative potential.

The initial information-sharing and problem-solving behavior, followed by successful implementation, gave the parties positive experiences. Thus, as interaction moved between distributive and integrative processes, the structural conditions changed as relational norms and trust emerged. We believe that the organization of the interaction, especially the joint inspections and standard measurement procedures, enabled the development of trust as it reduced the potential for opportunistic behavior. These initial positive experiences from exploiting the integrative potential led to a reinforcement of trust as a governance mechanism and problem solving as a negotiation strategy. As interaction still involved both distributive and integrative subprocesses, the parties increased their knowledge of the partner’s positions and reservation points. Such explicit and implicit information sharing made it possible to understand the partner’s concerns and interests, and the parties learned to identify the integrative potential in different situations. Trust and relational norms were reinforced over time, and became important structural conditions that fostered a more cooperative climate where both parties yielded on issues to the
other’s advantage. It also restrained the use of contending tactics.

The complementary nature of governance mechanisms and the coexistence of distributive and integrative orientations suggest that governance mechanisms and negotiation strategies complement each other as relationships develop. We have noted that the developmental pattern observed over time reflects cumulative events. That is, “elements found in earlier events or stages are added to and built upon in subsequent events or stages” (Van de Ven, 1992, p. 173). Furthermore, the data suggests that the progression in the cumulative model is conjunctive, as the events seem to be causally related, “meaning that events in one pathway may influence events in other pathways of a multiple progression” (Van de Ven, 1992, p. 174). This suggests that even a small cluster of integrative events can serve as a foundation for positive developmental spirals, acting as complementary pathways that result in positive relational outcomes. Ultimately, the process led to economic success, and the parties learned how to manage long-term cooperation.

6.2. Theoretical implications

The study broadens our knowledge about interorganizational processes in several ways. Das and Teng (1998) argue that confidence is an important but overlooked aspect of interorganizational relationships. They suggest that the level of confidence in a relationship is determined by two components: trust and control. Furthermore, they argue that trust and control should not be viewed as substitutes, but rather as complements: “That is, the trust level and the control level jointly and independently contribute to the level of confidence in partner cooperation” (Das and Teng, 1998, p. 496). In this study, confidence in partner cooperation was, in the early stages, primarily rooted in the level of control or hierarchical mechanisms. Subsequently, trust and norms were added. The finding supports Das and Teng’s argument of a complementary relationship between governance mechanisms, but does not support their proposition that formal control mechanisms (as opposed to social control mechanisms) will undermine the level of trust, as the deployment of formal control actually enhanced the emergence of trust. However, the case clearly supports their argument that confidence is an important concept, and that trust and control can coexist and jointly contribute to partner confidence. The concept of confidence might be particularly important for understanding structural and behavioral aspects in fixed-duration relationships. Although levels of trust can be very low, partners can still have sufficient confidence in the cooperation due to the existence of hierarchical control mechanisms. However, to exploit the integrative potential, we believe that an increased level of trust, and not an increased level of control, will enhance information sharing, which is considered to be important for developing problem-solving negotiations.

Although the studied relationship had a fixed duration in the sense that no known continuance existed, we may draw implications for other kinds of relationships as well. Sometimes, relationships involve planned “milestones,” predefined sequences in terms of calendar time or processual breakthroughs, or predefined evaluation points. Such circumstances might in some cases function as “potential endpoints” where performance criteria must be met or where performance measurement will determine the future direction of the relationship.

Our results suggest that the coexistence and interaction of governance mechanisms are complex and develop gradually over time. By giving careful attention to how different governance mechanisms can be used as complements, enable integrative efforts, and restrain distributive moves, long-term relationships can contribute to joint value creation. Consequently, interorganizational governance can be an important source of relational advantage (Dyer and Singh, 1998).

6.3. Limitations

An important question is whether relational norms and trust actually did emerge in this study, or did the relationship over time just become predictable and controllable? We argue that the level of trust increased over time, and although the parties knew the endpoint, many issues were uncertain and unresolved at the beginning. This was the case for issues, such as the long-term development of road surface quality, the effects of different maintenance efforts, compensation for increased life span, and measurement difficulties. The parties were not able to fully control these factors, and trust became, over time, an important governance mechanism for solving these issues. Furthermore, the empirical findings show that the parties gradually developed an understanding of their relational roles and attempted to harmonize conflicts.

Another limitation is related to the endpoint. Did the actors expect to interact in the future? To some extent, they did. However, future interaction was dependent on the ability of NV to compete for new contracts, and the volume of maintenance activities that NRA would assign to private companies. We also note that neither party attempted to preserve the relationship beyond the contract period.

7. Conclusion

This study provides evidence that trust and cooperative behavior can emerge in relationships with a known endpoint. The relationship developed from relying predominantly on incentives to relying on complementary mechanisms where authority and trust/relational norms were key elements. This change was interdependent on the behavioral interaction process between the parties,
including the role of the third party. An interesting finding was that the relationship development involved complementary subprocesses that affected each other over time. Although the relationship moved away from an incentive-based, distributive mode of interaction to an integrative mode based on additional use of hierarchical and relational governance, the joint value created in the relationship “was up for grabs” as both parties claimed their share of the specific value for increased life span, and the process was again dominated by distributive orientations. However, trust and relational norms served to constrain the use of contending tactics and opportunistic behavior. This suggests that the key for understanding the evolution of structural conditions and behavioral orientations is the process itself, and only by understanding the dynamics involved in the process can we explain how relationships develop.

Appendix A. Coding examples

A.1. Coding Example 1

NRA has previously not accepted NV’s maintenance suggestions, arguing that some suggestions represent low costs for NV. Furthermore, they have refused a suggestion for compensation if the maintenance resulted in increased life span beyond the contract period. NV writes to NRA: “In our view this should be satisfactory to eliminate costs for NRA and not implicate drawbacks for the public, which is NRA’s arguments for not accepting less costly (underlining in original) efforts…. We think the maintenance costs should not be the decisive parameter…. Again, we underline that potential additional value should be decided at the end of the contract period, and that NRA bear no risk or accept more responsibility. Thus, we must express our deepest disappointment. . . .”

The above caused NRA the next day to demand immediate fulfillment of paragraphs 4.8 and 4.9 in the contract, requesting a guarantee for the maintenance work (NOK 3,500,000) and NOK 120,000 for covering administrative costs.

NV commented subsequently in writing to the third party: “This attitude is at least no incentive for us to suggest more extensive maintenance efforts than utterly necessary, even though these in the long-term do not represent the most economic efficient solutions for any party.”

The above situation is coded as involving contending tactics (holding firm initial tough demands) representing distributive interaction, primarily based on the incentive structure in the relationship (i.e., Cell 1 in Tables 1 and 4). Although NV attempted to solve underlying concerns and introduce unspecified compensation (problem solving, integrative), they were forced to yield (distributive). The example is from mid-Phase 1.

A.2. Coding Example 2

Inspections of road parcels have been conducted, and NV suggested in writing maintenance efforts. They suggested for one particular parcel to try new, but risky procedures due to very high levels of accuracy in the work process.

In early August we will decide on whether to suggest sealing. We are interested in trying microseal with modified bitumen on roads with medium traffic-load. Due to limited depth in tracks and some open parts, this might be a well-suited place. We would like to discuss this suggestion in more detail. . . .

NRA replied in writing: “Your suggestion is accepted…. During discussions regarding sealing in relation to the maintenance agreement, the use of modified binder has been mentioned. We are interested in this, also for sealing in other situations, and we would like to be informed if/when this will be used.”

The above situation is coded as integrative (value creation in terms of learning, efficiency, and information sharing) and occurred in Phase 2. The decision deviates from “pure” maintenance, and explores potential relationship benefits enhanced by stable and shared procedures and control systems (authority mechanisms; i.e., referring to Cell 4 in Tables 1 and 4). The incident contributed positively to the emerging and subsequent evolution of trust and relational norms.

A.3. Coding Example 3

During transfer of responsibility for road parcels (Phase 3), compensation for additional value for three parcels was discussed. Estimates for increased life span were brought forward by both parties. Both parties held firm positions, resulting in third-party arbitration (a compromise, middle-ground settlement was accepted). NRA responded in writing to NV regarding other parcels that they expected “some minor maintenance efforts” that NV would not undertake. NRA wrote: “We did not expect such a negative attitude; however, we do not find it expedient to raise this issue again.” NV had immediately before agreed not to ask for compensation for additional parcels, despite the fact that they stated, “In general, many of the parcels have a better standard than required in the contract.”

These incidents are considered distributive. The compensation settlement was a compromise based on two contending parties’ positions to claim value. The other two episodes are considered distributive because both involve one contending (holding firm position) and one fully accommodating party (reduce initial demands), although the roles were reversed in the two episodes. The behavior is understood as attempts to harmonize relational conflict (relational norm; that is, these incidents refer to Cell 5 in Tables 1 and 4).
References


