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**CONTRACTS IN ASYMMETRIC RELATIONSHIPS**

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## **CONTRACTS IN ASYMMETRIC RELATIONSHIPS**

### **Abstract**

Manufacturer-retailer relationships demonstrate the existence of asymmetric relationships among companies. A large number of consumer goods manufacturers negotiate and conclude contracts with a small number of strong grocery retailers. Consumer goods manufacturers have expertise in the areas of sourcing, producing and marketing eponymous brands which are demanded by consumers. However, these manufacturers need to obtain listing for their brands within few grocery retailers which represent a significant share of their business. Companies choose to become dependent on other strong companies because of the benefits that derive from their relationships, even if they are asymmetric. The benefits may include securing substantial business size, cost advantages or rationalisation of production and supply, simplification of business process and business reliance. Rapid technological changes, shifting economic conditions, mergers & acquisitions as well as global sourcing create conditions for growing asymmetric interdependencies among companies. The present paper deals with an increasingly important aspect of business networks, which is the role of contracts in asymmetric relationships. Contracts are manifestations consent that give legal effect to business relationships. Based on empirical research in manufacturer-retailer networks that covered the period between 2002 and 2005, the

study examines how companies use contracts to manifest their joint choices over time. The research demonstrates three counterintuitive findings: a) contracts are made in established and continuing relationships and not in new untested relationships b) contracts are more important for the stronger party in asymmetric relationships and c) contracts do not mirror contractual decisions but provide a framework in which contractual decisions are made. The study discusses these counterintuitive findings and draws conclusions on the role of contracts and more widely on the nature of interdependence itself.

Keywords: Contract, relationship, interdependence, network

## **INTRODUCTION: JUST TWO OF A MANAGER'S CHALLENGES**

This paper is concerned with two interrelated challenges commonly faced by managers. The first challenge is as follows:

How can a manager cope with his or her own company's dependence on other companies? In particular, we are concerned with how a manager may cope with those particular situations when there is an *asymmetry* in the respective dependence of each other of the companies in a business relationship.

Interdependencies between companies both provide a structure for business networks and are themselves the outcomes of the interaction that occurs within each business relationship. Interdependency is an inevitable consequence of the interaction through

which companies gain access to the resources and abilities of others. By becoming dependent on the resources and abilities of others, a business company frees up its own resources and abilities for use in more productive directions either within that relationship or in other relationships. *Asymmetric relationships* are those relationships where an imbalance in the resources of one of the companies or in the way that those resources are used *enables one of the companies to be more able to influence the other, to initiate change in the relationship or to dominate the relationship* (Holmlund and Kock, 1996; Johnsen and Ford, 2001). In an asymmetric relationship the stronger party is likely to be able to dominate and influence the conclusion of contracts and, thereby, determine the processes and outcomes of the relationship (Buchanan, 1992; Grundlach, Achrol and Mentzer, 1995).

Rapid and costly technological changes, the growth of outsourcing, mergers & acquisitions as well as global sourcing create conditions for growing asymmetry in the interdependencies among companies. Common examples of these asymmetric interdependencies occur among companies in the automobile industry. Although car manufacturers depend on a large number of suppliers to source the parts that will go into an assembled car, the ability of the suppliers of parts to determine what happens in their relationship with a car manufacturer remains limited (Macaulay, 1974; Womack, Jones and Roos, 1990; Lamming, 1993). Similarly, car dealers operate under a franchise system that requires them to perform their activities according to the requirements of the manufacturers. Hence, car manufacturers create “contracts of adhesion” that serve their own ends and transfer risks and liabilities to suppliers and to dealers (Macaulay, 1974, p. 18).

This leads us to the second challenge with which we are concerned:

How can a manager determine whether and in what form he should sign up to a contract with companies on which he depends more than they depend on him?

A contract is clearly a manifestation of consent between companies (Fuller and Perdue, 1936, 1937; Treitel, 1988; Steyn, 1997; McKendrick, 2003; Burrows, 2000). Contracts are about agreed exchanges; they “circumscribe the valuation of conduct” (Collins, 1999:21) and give legal effect to business relationships (Cohen and McKendrick, 2005). Thus contracting is a highly dynamic process of interaction, through which interdependent companies with different capabilities as well as different business interests and appreciations, seek to do better through jointly agreed action (Mouzas and Ford, 2006). But of course a contract also simultaneously limits the abilities of the participants to change the pattern of interaction with their counterpart and restricts their freedom to interact with others.

### **AVOID OR ACCEPT?**

Asymmetrical relationships and the contracts within them limit the freedom of a company's actions and may impose negative conditions on them. This may lead to the judgement that companies should seek to avoid them. But companies *choose* to become dependent on other strong companies because of the gains that derive from their relationships, even if these relationships are asymmetric. The gains may include

securing substantial business size, cost advantages or rationalisation of production and supply, simplification of business process, process innovation and business reliance. There is also no doubt that these asymmetric interdependencies create rationalized economies of scale that produce opportunities for profit for many companies, wealth for their shareholders and price advantages for end-customers.

The question for companies is not how to create symmetry between unequal partners. Instead, the question is more about how companies can best operate their asymmetric relationships. In this respect the companies' challenge is concerned with the issue of arranging a 'joint' consent.

Further, companies in asymmetrical relationships also make contracts with each other as manifestations of consent. These contracts offer companies the opportunity to articulate and map out their approaches and policies. But clearly, any such contracts may provide more benefits and fewer restrictions on one of the parties within a relationship when compared to the other.

The issues of asymmetry and contractual arrangements clearly require an understanding of the nature of asymmetry, of the problems to which it leads and to the range of available contractual and other options for the companies. We will now attempt to develop an initial understanding of these issues starting from the basic problems that arise for companies from their asymmetric relationships.

## **PROBLEMS IN DEALING WITH ASYMMETRIES**

Companies are confronted with five discrete problems in attempting to deal with asymmetric interdependencies: Firstly, companies need to balance business opportunities against their inherent risks. Contracts in asymmetric relationships may offer some certainty and calculability of exchanges, but they may also increase corporate vulnerability because of over-reliance on a single customer or supplier and they may impose constraints to the development and growth of the weaker company. Secondly, companies constantly need to assess their “best alternative to the negotiated agreement (Raiffa 1982; Sebenius, 1992). The availability of alternative options can also be crucial in asymmetric relationships. Companies usually give their consent to an exchange only if this exchange is not worse than their perceived alternatives (Sebenius, 1992). Thirdly, companies are confronted with the problem of developing skills and capabilities that are valued by others in the network. Contracts in asymmetric relationships may limit or distort the development of capabilities that are valued in other relationships. An asymmetric relationship may restrict innovation or narrow the range of the weaker company’s abilities or resources, either because of convenience or the pressures from a counterpart. This may be to the detriment of both the stronger and the weaker party. In contrast, strong companies may contribute to a relationship that fosters continuous improvement and innovation. This is evidenced in many contractual arrangements where suppliers are encouraged to merge or form alliances to supply whole modules to manufacturers (Lamming, 1993; Sabel and Zeitlin, 1997). Fourthly, companies are confronted with the task of making themselves difficult-to-replace suppliers. The inherent vulnerability of an asymmetric relationship creates the need for the supplier to become ‘sticky’. In this way sticky suppliers successfully leverage switching costs by creating added value over and

above that demanded by the exchange counterpart. These switching costs are likely to intensify the interdependencies in asymmetric relationships. Fifthly, companies are confronted with the problem of building relationships that raise the market value of their companies above the cost of capital needed to finance their endeavours. This problem is best illustrated by the principle that companies need to embrace opportunities inherent in business relationships that consistently generate a return on assets that exceed their financing cost (Modigliani and Miller, 1958; Hart, 1995).

Extant research into asymmetric relationships has examined a number of the dimensions of asymmetry and provided various typologies of business relationships, but there is little evidence of work to uncover the ways that companies manage their contracting process in asymmetric relationships (Johnsen and Ford, 2001; Johnsen, 2005). Extant research into business contracts provides valuable insights on how companies manifest their agreements and reveals some significant aspects of the complexity of exchange relationships. Contract research has also attempted to address the changing nature of contracts in order to explain their regulation as well as some of their implicit dimensions (Collins, 1999; Campbell, Collins and Wightman, 2003). But this research has not provided a coherent theory that differentiates between contractual decisions and the framework of the terms under which contractual decisions are made. The problem that companies face is that that it is impossible for them to pre-determine all future contractual situations and the appropriate decisions in relation to them. Therefore as business complexity increases, companies increasingly choose to retreat from immediate contracts and arrange *framework contracts* (often called umbrella agreements) to balance the need for certainty and calculability of their exchanges with the need to remain sufficiently flexible (Mouzas and Ford, 2006). A

framework contract between two companies is not concerned with immediate contractual decisions. Instead it is a joint consent which articulates a framework of principles that guides future contractual decisions (Crone, 1993; Krüger, 2003; Mouzas and Ford, 2006).

Of interest, therefore is an exposé of framework contracts in asymmetric relationships and, thereby, a better understanding of how and why such contractual arrangements occur.

## **PREVIOUS RESEARCH**

Our research into contracts in asymmetric relationships builds on previous research in two areas: The changing nature of contracts and the existence of asymmetric interdependencies. We can outline some of the output from this research as follows:

### **The Changing Nature of Contracts**

Contracts are manifestations of enforceable agreements within relationships (McKendrick, 2003; Burrows, 2000). They are, in general, concerned with the enforcement of relationship arrangements to protect the reasonable expectations of the related parties as expressed or implied in an objective manifestation of an agreement (Steyn, 1997). The theoretical underpinnings of contracts can be traced back to the *will theory* developed by Friedrich von Savigny (see Simpson, 1975; Ibbetson, 1999). It is a theory of rules that recognizes, encourages and facilitates free and voluntary exchanges. In this sense, contracts give legal effect to business relationships. Contracts could, nevertheless, limit a company's ability to change its business policy.

For example, prior contractual decisions made by a company may limit its ability to embrace new market opportunities or change its arrangements in the future (Argyres and Liebeskind, 1999). This might explain why in many business relationships, companies prefer not to use contracts at all (Macaulay, 1963, 2003; Smitka, 1994; Roxenhall and Ghauri, 2004). Companies may build relationships without concluding any formal contract; reliance on other party's promises without any manifestation of agreement, however, may become a problem (Harrison, 2004; Blois, 2003; Mellahi, et al., 2002). For this reason, companies attempt to balance the certainty and calculability of exchange relationships with the need to remain sufficiently flexible to embrace new or emerging business opportunities (Mouzas and Ford, 2006). Historically, the companies' problem of balancing certainty and flexibility was addressed in the work of Otto von Gierke (1914), who made the claim for the existence of 'continuous obligations' in each relationship. Much later, it has been argued that companies may develop relational contracts; a term developed by Macneil (1985, 1987, 2001) to describe a relational theory of contract which challenges the premise that all contracts are mere transactions. It has been argued that this inherent incapability is evidenced in long-term relationships (Campbell and Harris, 1993; Campbell, 1996). Hence, relational contract theory results in two conceptual axioms. The first axiom is the juxtaposition between *relational* and *discrete* contracts and the second is the differentiation between *short-term* and *long-term* relationships. These conceptual axioms have been adopted in marketing theory and have been used widely in many studies without a necessary scrutiny at theoretical or empirical level (Dwyer et al., 1987; Grönroos, 1990, 1991; Gundlack and Murphy, 1993; Li and Nicholls, 2000; Coviello et al., 2002; Selnes and Sallies, 2003; Jayachandran et al., 2005). Despite the valuable contribution of these studies in challenging the premise that all

relationships are merely transactions, it can be posited that all relationships have *discrete* and *relational* components and “that even the most apparently ‘simple’ act of market exchange hides a relationship behind it” (Saren and Tzokas 1998: p. 189). Furthermore, there is no compelling evidence that long-term relationships between buyers and sellers are more beneficial for both parties (Pressey and Tzokas, 2004). It can also be posited that the “length of time during which performance is likely to occur should not be regarded as significant for the purpose of the analysis of contractual relationships” (Collins, 1999: p. 142). Escaping the analytical trap of the axioms *relational versus discrete* and *short-term versus long-term* relationships, contemporary studies of contractual relationships indicate the existence of formidable barriers to making contractual decisions and the need for flexible contractual arrangements (Schwartz, 1992; Gergen, 1992; Scott, 2003; Schwartz and Scott, 2003). A flexible way of dealing with the existence of barriers to contractual decisions is to arrange framework contracts. The function of a framework contract differs from the function of pre-contractual agreements which define most of the terms of a relationship. A framework contract between related parties is not concerned with immediate contractual decisions for all future eventualities. Instead it is a joint consent which explicitly spells out a framework of principles that flexibly guides future contractual decisions (Crone, 1993; Krüger, 2003). A framework contract can be used to regulate all crucial aspects of an on-going relationship. For example, it defines and regulates interaction processes, information systems and enabling technologies, terms of payment as well as performance measurement. The parties to such a framework contract are usually not required to specify new terms in their future exchanges nor are they required to refer to the pre-existence of a framework contract. This is particularly useful if products or services are ordered regularly from a

key supplier; or conversely if particular products or services are sold regularly to a key customer (Crone, 1993; Mouzas and Ford, 2006). Framework contracts, therefore, codify the parties' knowledge about efficient ways to interact and, thus, become "knowledge repositories" (Mayer and Argyres, 2004: p. 405).

### **Asymmetric interdependences**

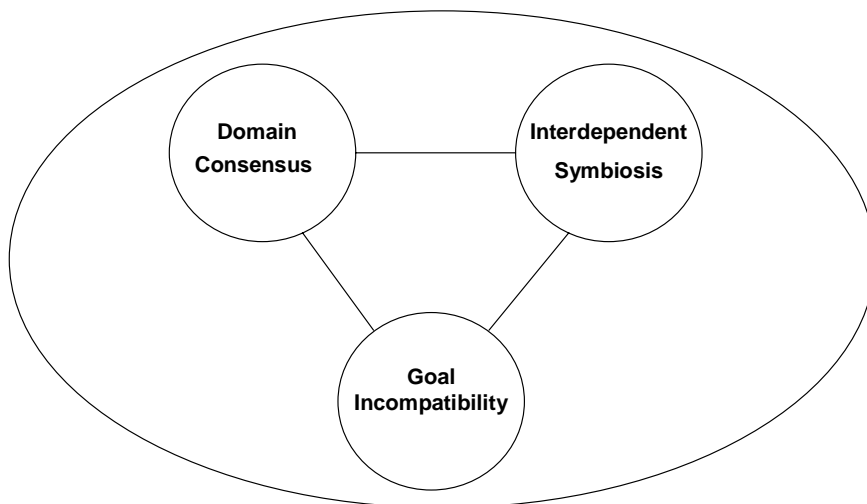
The existence of interdependencies among companies does not mean that companies are equally affected by these interdependencies. Often the inherent interdependencies among companies are asymmetric because one party is able to dominate and influence what happens in the relationship (Grundlach, Achrol and Mentzer, 1995; Araujo and Mouzas, 1998; Söllner, 1998; Johnsen and Ford, 2001). This is likely to be the case if a contracting party provides critical resources for which there are few alternative sources of supply or demand (Pfeffer and Salancik, 1978; Buchanan, 1992). Hence, asymmetric interdependencies can bring about the existence of an imbalance in a number of relevant relationship characteristics, such as commitment, power, information but also initiation of change (Holmlund and Kock, 1996). Johnsen's (2005) research in asymmetric business relationships represents an attempt to map a number of relationship characteristics, such as mutuality, particularity, inconsistency, intensity, dependence and power and, thereby, sharpen the definition of symmetric and asymmetric relationships. Linking these relevant relationship characteristics and companies' capabilities, Johnsen and Ford (2001) develop a typology of symmetric and asymmetric relationships and address the problem of identifying the sets of capabilities that may support the development of symmetrical relationships. Business interaction between parties will determine how valuable these capabilities are; how

they will be utilized and whether they will stay passive or develop over time (Ford, Johanson, Håkansson, 1986; Håkansson and Snehota, 1995; Ritter, 2000). This implies that companies' capabilities are dynamic assets; they may include evolving technical systems but also intangible assets such as specified procedures or rules developed and institutionalized through repeated interaction in continuing relationships (Teece, Pisano, and Scheun, 1997). In asymmetric relationships the weaker party may use its knowledge and skills reactively according to the rules and procedures prescribed by the stronger party. The existence of such an asymmetry, however, should not divert our attention from the fact that companies choose to become dependent on other strong companies because of the benefits that derive from their relationships, even if they are asymmetric. The benefits may include exploiting the use of a core capability and thus securing substantial business size, cost advantages or rationalisation of production and supply, simplification of business process and increasing business reliance. For this reason, joint consent is a key term in understanding asymmetric relationships. Joint consent implies that exchanges among companies, even within asymmetric relationships, are voluntary (Mouzas and Ford, 2006). Companies may accept dependencies today in return for promised or potential future benefits. The preponderance of research evidence suggests that companies tend to give their consent to an exchange only if the exchange is not worse than their perceived alternatives and exchanges which are not based on genuine consent are not sustainable (Raiffa, 1982, Sebenius, 1992; Mouzas and Ford, 2003).

## **CONTRACTING IN ASYMMETRIC RELATIONSHIPS: TOWARDS A THEORETICAL FRAMEWORK**

We propose a theoretical framework for the study of contracts in asymmetric relationships consisting of three conceptual dimensions drawn from previous work within the IMP tradition (For an analysis of these see Araujo and Mouzas, 1994). This considers contracting in asymmetric relationships as a dynamic process that is determined by three elementary forces: a) domain consensus, b) interdependent symbiosis and c) goal incompatibility (see figure 1).

**Figure 1: Contracting in Asymmetric Relationships**



### **Domain consensus**

Domain consensus refers to the parties' agreement over functions and roles in a business relationship. Domains reflect the parties' right to operate and perform within specific areas; for instance in the production or advertisement of consumer goods, or in selling directly to consumers. Domain consensus is, therefore, related to the

definition of boundaries, role sets, companies' capabilities and expectations. Parties may lack resources, technological or organizational capabilities to fulfil certain functions or they may specialize in a limited range of product or services. Alternatively, companies' capabilities may develop or change and thus, domains may be disputed and redefined over time. This is demonstrated vividly in the engagement of retailers in boosting retailer brands (Dunne and Narasimhan, 1999). This tendency can be regarded as an attempt by the retailers to invade domains that are traditionally the preserve of manufacturers, to redefine role-sets and to redraw the boundaries of domains in which both retailers and manufacturers are embedded. Domain consensus is not a mere collection of isolated, non-related functions or roles. Instead, consensus takes place within continuing relationships where the current agreement is affected by the perceptions of the participants of their previous agreements and by their expectations of the future. But even in this case, 'consensus time' does not appear as a linear process but as recursive practice. Habits and institutionalized forms of inter-firm negotiations are manifestations of recursive time. Examples include periodic business or task reviews or annual negotiations between customers and suppliers. Another aspect of domain consensus is that the time perspectives of different companies are often not aligned. Each may have a quite different view of the actual or desirable evolution or progress of their relationship, despite extensive information exchange between them (Mannix, Tinsley and Bazerman, 1995).

### **Interdependent symbiosis**

Interdependent symbiosis reflects the need for mutuality and co-operation. Contractual links presuppose the existence of complementarity in information, resources and activities. Complementarity may lead to exchanges, but this has a price

in the development of interdependence. Cunningham (1993) has explained that the dependence of a manufacturer M upon company retailer R is directly proportional to manufacturer M's motivational investment in goals mediated by retailer R and is inversely proportional to the availability of those goals to manufacturer M outside the M-R relationship. The customer's goals mediated by the supplier might include low cost, flexible credits, technical advice etc. Again dependence brings with it the problem of power. If firms are mutually dependent, then close co-operation will affect and develop their information exchange. Even if complementarity exists, there is always a different degree of interdependence. The availability of options can be crucial. For example, if customers can choose among a large number of suppliers, then they may view their suppliers as undifferentiated, interchangeable and replaceable (Johnsen and Ford, 2001).

Interdependent symbiosis means that companies are likely to co-exist connected to each other at several levels and between several functional areas. This connectivity may exist between customers and suppliers, between suppliers, subcontractors, customers and even among competitors (Gnyawali and Madhavan, 2001, Uzzi and Lancaster, 2003). A major task for marketing and purchasing staff is to manage or coordinate these elements of connectivity. Inconsistency between connections over time is likely to be an important management challenge for both parties and a source of conflict and debate (Ford, Hakansson and Johanson, 1988).

### **Goal incompatibility**

Goal incompatibility refers to the extent of incongruities in the parties' underlying interests as well as in their business assumptions. We argue that goal incompatibility

is deeply rooted in the companies' fight to capture a share of the value created through exchanges. Furthermore, the quest for control over existing shares of value, and the attempt to exert influence and power over relationships are important factors accounting for evolution in business relationships. The distribution of power in a business relationship is unevenly scattered and may change over time. At any time, this distribution may be regarded as the momentary outcome of a struggle in which actors try to increase their power, i.e. their control over information, activities and resources. We can posit that the driving forces behind this struggle are human attributes such as greed, in combination with the fact that many resources are scarce. The struggle for control over information, activities and resources includes both cooperative and competitive elements in business relationships. This process generates two opposite and co-existent tendencies: one towards increasing order and consolidation of relationship constellations and the other towards increasing disorder and disruption of existing constellations. Both tendencies are affecting the evolution of consensus. By developing contractual platforms of continuous negotiation and deal-making, organisations not only gain access to resources of a single company, but they implicitly seek control over other companies and, through those they seek, control over their surrounding business network.

## **EMPIRICAL STUDY**

This study of contracts in asymmetric relationships is part of a wider research project into the ways in which companies negotiate and make deals in complex business networks. One of the most intriguing empirical findings of the initial research was the existence of asymmetric interdependencies between a large number of fast-moving consumer goods companies and few, strong grocery retailers (Villas-Boas and Zhao,

2005; Hingely, 2005). Consumer goods manufacturers have expertise in the areas of sourcing, producing and marketing eponymous brands which are demanded by consumers. They need, however, to obtain listing for their brands within few grocery retailers which represent a significant share of their total business. We found that framework contracts are seen by manufacturers and retailers as a coping strategy to deal with the complexity of asymmetric relationships between unequal companies. This encouraged us to examine manufacturer-retailer networks more closely to determine how these companies manifest their agreements in asymmetric relationships and how these agreements facilitate continuing negotiation and deal-making. By using case study research (Eisenhardt, 1989; Tsoukas, 1989; Orlikowski, 1992; Ragin, 1992; Easton, 1995; Halinen and Törnroos, 2005), the present research looks at how framework contracts are used as a way of dealing with the existence of asymmetric interdependences. 68 in-depth interviews and 12 company workshops with 84 senior managers were conducted between 2002 and 2005. The method of data collection placed an emphasis on obtaining contemporary manifestations of inter-firm agreements as well as ensuring participant observation and personal interviews. We identified an initial pool of interviewees from trade and manufacturing congresses. We enriched and expanded this pool by continually asking "who works where and who knows whom". The interviewees included decision-makers such as Marketing Directors, Trade Marketing Managers, Sales Directors, Purchasing and Supply Directors, Key Account Managers and Corporate Lawyers. These represented some of the best known blue chip companies in manufacturer-retailer networks.

We analysed the empirical data by critical examination, evaluation, categorization and recombination. This method addressed the complexity of companies' interaction with

each other. This analysis encountered four major challenges: a) the problem of network boundaries, b) the problem of complexity, c) the problem of time and d) the problem of comparison (Easton, 1995; Halinen and Törnroos, 2005). Network boundaries are arbitrary and thus we were not able to study the 'entire' manufacturer-retailer network because business relationships are interconnected throughout the network. Hence we focussed on the complexity of asymmetric interdependence between companies and analysed the anatomy of their contractual agreements. Over the period 2002-2005, we concentrated our attention on contracting episodes which contributed to changes in the relationships. We addressed the relationship between asymmetric interdependencies and the evolving patterns of contracting in the manufacturer-retailer networks. These patterns of contracting between manufacturers and retailers included institutionalised forms of annual contract negotiations, business reviews as well as the process of renegotiation. Our aim was to evaluate, test and determine the extent to which our knowledge claims do, or do not, truly represent or correspond to the world (Hunt, 1976, 1983). We identified the conceptual dimensions of contracting in asymmetric relationships from the literature and from our initial empirical observation of reproduced patterns of manufacturer-retailer contracting. Our primary goal in data analysis was to link the theoretical knowledge with the empirical observations. We established this link through several cycles, moving between theoretical ideas and data on interaction practices. We conducted an iterative examination of the manifestations of consent. These manifestations included interview statements, comments and the observed repetition of annual negotiations. This process encouraged conceptual dimensions to emerge from the data rather than being imposed on them.

We will now examine the variations in the content of these contracts, and analyse the motivations of the parties involved and their experiences within asymmetric relationships. This will demonstrate that in many cases, contracts in asymmetric relationships nowadays spell out the framework for dealing with the complexity of asymmetry between companies. We will explore the advantages of contracts in asymmetric relationships and highlight the situations in which companies find them particularly useful, such as those involving regular transactions. We will also show that the reasonable expectations and joint appreciations enshrined in contracts mean that managers can time and again use them as a way-station to test their understanding of what they have jointly agreed. If circumstances for either business partner change, then they are able to re-negotiate contracts. Thus companies consider contracts as a strategic tool that sets the ground for an on-going interaction among business partners.

### **What do contracts include?**

We now present four framework contracts in asymmetric relationships between manufacturers and retailers companies in order to examine the variations in the content of their agreements, (see Table 1). The first framework contract is between Alpha, a manufacturer of laundry and cleaning products and Engel, a grocery retailer that specializes in large hypermarkets. The second framework contract is about the co-operation between manufacturer Beta, also producer of laundry and cleaning products, and Retailer Sunways. The third framework contract is between a manufacturer Unis, a producer of food and drink products and retailer retailer Econ who specializes in discount grocery shops. The fourth framework contract is between CosmedCo, a manufacturer of cosmetic products and Metros, a retailer active in large

department stores. We have disguised the names of the companies to ensure the confidentiality of contractual arrangements. The iterative examination of these contracts enabled us to identify important clauses. These clauses start by describing the domain of business by specifying types of products or range of services and then move on to express the basic rules and principles that regulate their interdependence and facilitate the achievement of manufacturers' and retailers' goals. These rules and principles set out a framework according to which voluntary and informed exchange may take place. Therefore, the clauses presented in Table 1 deal with sensitive issues of exclusivity of business, information flow, confidentiality of agreements, the possibility of subcontracting, the provision of warranties, property rights as well as termination rights. They also emphasize the importance of continuous negotiation and the inclusion of extreme eventualities or contingencies in the form of force majeure, such as political unrest, strikes, lock-outs and governmental interventions or natural catastrophes (see table 1).

**Table 1: Contracts in Asymmetric Relationships**

<b>Clauses</b>	<b>Framework Contract 1 Manufacturer Alpha &amp; Retailer Engel</b>	<b>Framework Contract 2 Manufacturer Beta &amp; Retailer Sunways</b>	<b>Framework Contract 3 Manufacturer Unis &amp; Retailer Econ</b>	<b>Framework contract 4 Manufacturer CosmedCo &amp; Retailer Metros</b>
<b>Product range/ Services</b>	Manufacturer Brands/ Laundry and Cleaning Products.	Manufacturer Brands/ Laundry and cleaning products.	Retailer Brands/ Food and Drink Products.	Reyailer Brands/ Cosmetic products.
<b>Exclusivity</b>	No exclusivity.  Retailer Engel has the right obtain competitive offers at any time.	No exclusivity.  Retailer Sunways has the right to obtain competitive offers at any time.	Retailer brands are produced by manufacturer Unis exclusively for retailer Econ.  Unless otherwise agreed,	Retailer brands are produced by manufacturer CosmedCo exclusively for retailer Metros.  Unless otherwise agreed,

			terms and conditions are valid for all future contracts within the domain of retailer brands.	terms and conditions apply for all future transactions within the domain of retailer brands.
<b>Information/ Notification</b>	Manufacturer Alpha will inform retailer Engel quarterly about marketing and sales activities as well as new product development.	Key dates for business reviews are arranged quarterly throughout the year.  The manufacturer is obliged to inform the retailer immediately if he is aware of any circumstances that will affect delivery times.	Business reviews every six months to discuss performance and take joint action  Notification regarding product damages need to be made within 2 weeks.	Business reviews quarterly to discuss performance and take joint action.

		agreed cannot be		
<b>Subcontracting</b>	Possible only upon consent.	Possible upon consent.	Not possible.	Not possible.
<b>Assignment</b>	All requests in writing. Verbal requests will be confirmed in writing. Vendor managed inventory (Manufacturer Alpha manages the retailers' orders according to consumer-off-takes provided electronically by	All requests in writing. Verbal requests will be confirmed in writing. Continuous stock replenishment (based on an electronic data interchange).	All requests in writing. Orders regarding retailer brands cannot be revoked after manufacturers' production start.	All requests in writing . Verbal requests will be confirmed in writing. Continuous stock replenishment (based on an electronic data interchange). Orders regarding retailer brands cannot be revoked

	retailer Engel).			after manufacturers' production start.
<b>Volume/ Price/ Discounts</b>	To be agreed.	To be agreed.	To be agreed.	To be agreed.  Volume is to be agreed and manifested in a rolling forecast
<b>Invoicing</b>	Unless otherwise agreed, on a monthly basis. Delivery cost is paid by the manufacturer Alpha (Delivered Duty Paid).	Payment in 30 days. Delivery cost is paid by the manufacturer Beta (Delivered Duty Paid). Electronic data invoicing	Payment in 60 days. Invoices shall not be part of the delivery of products.	Payment in 60 days. If there is no objection in writing within 6 months, invoices will be considered approved.

	Electronic invoicing			
<b>Re-negotiation</b>	Annual re-negotiation will take place during the period between September and December.	Annual re-negotiation will take place during the period between September and December.	Re-negotiation possible after six months.	Annual re-negotiation.
<b>Force Majeure</b>	Manufacturer Alpha will contact retailer Engel immediately in case of obstacles and will negotiate the steps to be taken.	Manufacturer Beta has the obligation to contact retailer Sunways immediately in case of obstacles and will negotiate the steps to be	Retailer Econ bears no liability for damages occurred as a result of war, political unrest, strikes, lock-outs and governmental	Manufacturer CosmedCo will retailer Metros immediately in case of obstacles and will agree the steps to be taken.

		taken.	interventions.	
<b>Guarantee/ Liability</b>	Manufacturer Alpha gives the guaranty to deliver the highest quality of products and has the obligation to remedy deficiencies in products or other services to Engel. This applies also to services obtained from subcontractors.	Manufacturer Beta guarantees that all delivered products fulfil the necessary legal /health and environmental requirements. Manufacturer has the obligation to remedy any product or service deficiencies.	The retailer has the right to test the quality of products delivered.  Manufacturer has the obligation to remedy any product or service deficiencies.	Retailer Metros reserves the right to return all unsold items.  Manufacturer CosmedCo guarantees the delivery of point of sales material according to the requirements specified by retailer Metros.
<b>Secrecy</b>	All information is confidential and not to be available to third parties	All business planning, volume and price information is confidential	All information is confidential and not to be available to third parties	All information is confidential and not to be available to third parties.

	without written consent of the other party. This obligation continues after expire of the agreement.	and not to be available to third parties without written consent of the other party.	without written consent of the other party.	This obligation continues after expire of the agreement.
<b>Property rights</b>	All brand names, logos, iconographic elements and promotion material will remain property of manufacturer Alpha. Transfer of property rights on goods delivered is concluded with the payment. Supplier ensures that no third person has	All brand names, logos, marketing material will remain property of manufacturer Beta. Transfer of property rights on goods delivered is concluded with the payment. Manufacturer ensures that no third person has obtained	All retailer brands are property of retailer Econ. Transfer of property rights on goods delivered is concluded with the payment. Manufacturer ensures that no third person has obtained property rights.	All retailer brands and promotion material will become property of retailer Metros 5 years after the commencing of agreement. Transfer of property rights on goods delivered is concluded with the payment. Manufacturer ensures that

	obtained property rights.	property rights.		no third person has obtained property rights.
<b>Saving Clause</b>	Unless it is of major importance, invalidity of one or more clauses will not have any effect on the agreement as a whole.	In case that single clauses are invalid both parties will replace them accordingly.	Unless otherwise agreed, terms and conditions apply.	In case that single clauses are invalid both parties will replace them accordingly.
<b>Legal venue</b>	Germany.	Germany.	Germany.	Germany.
<b>Amendments/ Addition/</b>	In writing.	In writing. Restrictions apply to the amendment of rolling forecast.	In writing.	In writing.
<b>Duration/</b>	Unless otherwise agreed	Indefinite agreement	Indefinite contract	Indefinite agreement

<p><b>Termination</b></p>	<p>this contract terminates at the end of a calendar year.</p> <p>Retailer Engel reserves the right to revoke in writing any orders (of the Vendor Managed Inventory) which she wishes not to accept.</p>	<p>renewed annually and fine-tuned quarterly.</p> <p>Each party has the right to terminate the agreement immediately with regard to a particular type of services if the other party contravenes important provisions</p>	<p>renewed and adapted every six months.</p> <p>The supplier has the obligation to revoke any orders in writing which she wishes not to accept.</p> <p>Otherwise, the contract is concluded with the retailer's order.</p>	<p>renewed annually.</p>
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## **DISCUSSION OF RESULTS**

The framework contracts between manufacturers and retailers presented in table 1 demonstrate the existence of an asymmetric interdependence, where retailers are able to insert clauses which allow them to exercise significant influence over the conclusion of exchanges. The purpose of these framework contracts is to arrive at a manifestation of consent regarding all crucial aspects of dealing with asymmetric interdependences. Hence, framework contracts provide a set of jointly decided focal points (Schelling, 1960) that guide all future exchanges (Crone, 1993; Krüger, 2003). Framework contracts indicate the companies' consent that exchanges can be agreed according to a pre-existing framework and that "it is the intention of the companies to do so" (McLauchan, 1998, p. 97). The fact that important terms of exchange, such as prices, volumes and discounts, have not been agreed but deferred for future agreement may be a significant rationale indicating that retailers and manufacturers nowadays prefer to remain flexible and do not intend to be contractually-bound. This empirical observation does not quite fit with the traditional approach of contract scholarship that "unless all material terms of a contract are agreed there is no binding obligation" (Beatson, 2002, p. 60). The reason for this traditionally rigorous approach is straightforward. Parties to a contract need to specify all terms of their agreements because it is the onus of the parties to make their own contract. The court will not construct a contract for them; a judge will simply ascertain the meaning of their agreement (Lewison, 2004). Hence a contract that defers important terms to a future agreement may be regarded void because of the lack of certainty (Beatson and Friedmann, 2002). Our study of contracts in manufacturer-retailer networks indicates that it is practically impossible and certainly not desirable for retailers and manufacturers to pre-determine all future volumes, prices and discounts as it is

difficult to overcome tremendous barriers (Hart and Moore, 1988; Schwartz, 1992). Barriers to final and predefined contracts between companies usually include massive information asymmetries and significant transaction costs, which involve a) unforeseen contingencies, b) drafting costs, c) enforcement costs and d) renegotiation requirements (Tirole, 1986). In manufacturer-retailer networks, an additional barrier to final and predefined contracts includes the existence of asymmetric relationships. Framework contracts reflect the conceptual dimensions of asymmetric relationships better than other forms of business agreements e.g. final and complete contracts or informal agreements. Table 2 illustrates this. First, framework contracts articulate a *domain consensus* by specifying the scope of business or the specific products and services to be delivered. Second, they attempt to express the basic rules and principles that govern the *interdependent symbiosis* between parties. The rules and principles included in a framework contract regulate the connectivity or ‘relatedness’ between companies and facilitate a process of on-going negotiation. Third, they express the inherent *goal incompatibility* between parties by mapping the parties’ relevant interests as well as their business assumptions. Differences in the parties’ interests will form the raw material for possible exchanges between companies (Raiffa, 1982; Sebenius, 1992).

**Table 2: Framework Contracts in Asymmetric Relationships**

<p style="text-align: center;"><b>CONCEPTUAL DIMENSIONS OF CONTRACTING IN ASYMMETRIC RELATIONSHIPS</b></p>	<p style="text-align: center;"><b>FRAMEWORK CONTRACTS</b></p>
<p style="text-align: center;">Domain Consensus</p>	<p>Scope of Business Manufacturer brands Retailer brands Products/Items Services Property Rights</p>
<p style="text-align: center;">Interdependent Symbiosis</p>	<p>Exclusivity Information Notification Subcontracting Assignment Invoicing Secrecy Saving clauses</p>
<p style="text-align: center;">Goal Incompatibility</p>	<p>Business Interests Guarantee/ Liability Force Majeure Re-negotiation Volume/Prices/Discounts Duration/ Termination Legal Venue</p>

We can identify a number of differences between the framework contracts we have presented. The main differences relate to the existence of various *domain consensus* and different *interdependent symbiosis*. In our empirical cases (See table 1), manufacturers and retailers demonstrate different business interests, sensitivities and priorities. Some of the retailers were concerned with the retailer brands, transfer of property rights and exclusivity while others were more concerned with risk minimisation, warranties or force majeure. Manufacturer Alpha and retailer Engel, for

example, agreed all brand names, logos, iconographic elements and promotion material will remain property of manufacturer Alpha, while manufacturer CosmedCo and retailer Metros agreed that all retailer brands will become property of retailer Metros 5 years after the commencing of the agreement. Framework contracts show a variety of accepted rules and principles regarding re-negotiation or termination requirements. Manufacturers Alpha, Beta and Unis and retailers Engel, Sunways and Metros agreed to re-negotiate their framework contracts annually and fine-tuned by business reviews quarterly while manufacturer CosmedCo and retailer Econ decided to do so on a six months basis. This demonstrates that negotiation between companies is an interaction that does not occur in a vacuum but is embedded in a set of rules and principles. The rules presented in table 1 refer to “implicit or explicit rules of expected behaviour that embody the preferences” of retailers and manufacturers of a business network (Nee, 1998: p. 87). Continuous negotiation leads to the development of principles which operate as ‘optimization commands’ (Dworkin, 1967) and the characteristic norms of conduct within each business relationship will owe something to the predilections of both companies. The companies’ idiosyncratic rules and principles may, therefore, limit the types of relationships in which the companies are able to participate (Hakansson and Ford, 2002). They increase the “predictability” of group members’ behaviour and give expression to a group’s “central values” (Feldman, 1984: 47). The ‘invoicing’ clauses presented in table 1 illustrate this. Within the domain of *manufacturer brands*, manufacturers Alpha and Beta agreed with retailers Engel and Sunways a 30-days delay of payment, within the domain of retailer brands manufacturers Unis and CosmedCo agreed with retailers Econ and Metros a 60-day delay of payment. These agreed ‘rules’ are valid for a certain period, usually for a year or six months. Annual renegotiations of these ‘rules’ confirm and

renew these agreements and establish the ‘principle’ that retailers are entitled a substantial delay of payment. This principle has significant financial implications. Retailers draw on manufacturers as trade creditors to provide working capital for their retail stores. Working capital is the difference between operating assets (trade receivables, inventories and prepaid expenses) and operating liabilities (trade payables and accrued expenses), in other words, working capital is the company’s net investment in its operating cycle (Hawawini and Viallet, 1999). In manufacturer-retailer networks, however, stock is turned into cash at retailers’ check-out counters long before manufacturers have to be paid (see table 1). This asymmetry between manufacturers and retailers results in negative working capital requirements for retailers. Manufacturers, thereby, provide interest-free finance for retailers’ continuous investments in fixed assets, such as the acquisition of smaller retailers.

## **CONCLUSIONS**

Some conclusions from this research project can be discussed under the following questions:

What happens in asymmetrical relationships?

Asymmetry is not a dichotomous variable. It has its roots in the resources and abilities of the companies in a relationship and their consequent dependencies on each other. Both companies are likely to be dependent on each other to a greater or lesser extent and that dependency may be involuntary, accepted or chosen. We have used the term asymmetry to refer to the outcomes of these interdependencies. In particular we

have used the term to refer to the ability of one party to influence the other or to initiate or determine action or changes in the relationship between them, based on their resources and abilities. This study has highlighted the existence of asymmetry in manufacturer retailer relationships. But, the study has also demonstrated that asymmetry does not confer a monopoly to the retailers' in the ability to exercise influence. Retailers are unable to completely dictate the terms of their relationships. Instead, they have to constantly negotiate with manufacturers and obtain their consent or at least their acceptance of their proposals.

What is the role of contracts in these relationships?

Contracts provide the manifestation of consent. In our study, contracts spell out the agreement between manufacturers and retailers. Our research showed that these contracts are more likely to be concluded between companies that already have continuing and established relationships. These contracts are neither complete nor deterministic. They spell out a framework under which future exchanges may or may not happen. These framework contracts are particularly valuable for the stronger party, the retailer. This value is because retailers can insert clauses into their contracts which allow them to shape the *structure* of their relationships and most of all to *institutionalise* the asymmetry between them and the manufacturers. In this way, their interactions are not pre-specified, not a series of discrete episodes, but are subject to recurrent patterns over recursive time.

What can we learn about the nature of interdependence itself?

The research reinforces our ideas that relationships are built on complementarities between the parties. It emphasises the uneven distribution of abilities and resources throughout the network, the ubiquity of interdependence and the need of companies to rely on the resources and abilities of others. The research further shows that interdependence is also an outcome of the interaction that takes place in relationships. Interdependence is neither static nor is it a zero-sum game. Interdependence is continually reshaped and reconfigured. Finally the research shows that the interactions of companies in a business relationship take place within the context of their interdependencies. But they also take place as part of a process through which they are reordering or reconfirming them. It is in this latter process that the role of contracts is critical.

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