

To Trust or Not Trust Formal Contracts and the Building of Long-Term Relationships

Working Paper

Carolina Camén

Karlstad University
SE-651 88 Karlstad
Sweden

E-mail: carolina.camen@kau.se

Patrik Gottfridsson

Karlstad University
SE-651 88 Karlstad
Sweden

E-mail: patrik.gottfridsson@kau.se

Bo Rundh

Karlstad University
SE-651 88 Karlstad
Sweden

E-mail: bo.rundh@kau.se

Abstract

This paper takes a qualitative approach and is based on studies of formal contracts, focusing on how contracts are used to build and develop long-term relationships in a context where trust cannot be anticipated in advance. The investigation is based on 21 contractual dyads within the public transport sector in Sweden, where the service is jointly provided by contracted external fulfillers whose obligations towards the contractors are set out in formal contracts obtained via a public tendering process. Following an overview of the studied contracts, we have more closely investigated four of them.

This study contributes by providing contrasts to previous research in relation to business-to-business studies. One of the most critical decisions made by managers is formulating 'ideal' contracts since there is no room for negotiations and major adjustments. The negotiating process only provides opportunities for minor adjustments. Our analysis of contracts in the public sector reveals the importance of formal contracts in relationship building owing to (i) very detailed specification, (ii) the law having an affect on the design of the contract, (iii) the bidding process, there is no negotiation process, (iv) no scope for further discussions after signing contracts, (v) no learning processes, and (vi) contracts being used in day-to-day business. It has been acknowledged that there is a lack of empirical investigations of the nature and form of contractual arrangements and this study contributes by using formal contracts in a public context.

Keywords: Contracts, Relationships, Public service, Trust

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Introduction

In most business relationships, trust plays a significant role (Mouzas et al., 2007). Håkansson et al. (2004) argue that trust is a necessary requirement and a determinant of sound business relationships. Trust is needed in relationships, especially in long-term ones since not all aspects can be controlled, especially in a contract. The concept of trust can be conceptualized as coming into existence when one party has confidence in an exchange partner's reliability and integrity (Morgan and Hunt, 1994). Trust is something that is slowly amassed between the parties as the relationship gradually develops and matures. According to Ford et al., (1998) the development of a relationship can be described in accordance with a four-stage evolution or development process. The stages of this process are (i) the pre-relationship stage, (ii) the early or exploratory stage, (iii) the developing stage, and finally (iv) the stable stage. During the first phase, there is a large amount of uncertainty between the parties who are trying to learn about and adjust to each other. During the following phases, the parties try to reduce their distance from each other, as well as develop trust in their partner.

Since relationships are to some extent social exchange processes, personal bonds play an important role in their development. This indicates that relationships and trust can both be attributed to people as well as organizations, i.e. trust can be inter-organizational as well as inter-personal (Mouzas et al., 2007). From this perspective, the development of a relationship, in a traditional business-to-business setting, can be seen as an investment in which the parties commit resources to each other in order to receive benefits in the future (i.e. incur costs in the short-term for gains in the long-term) (Ford et al., 1996, Turnbull et al. 1996). *“If a company wishes to improve its relationship with a partner or partners to achieve future benefit, then it is likely to involve a commitment of resources, whether expressed in terms of managerial or sales force time, product or service development, process, financial or administrative adaptation. This commitment is not trivial and is not reversible without considerable loss”* (Ford et al., 1996 p. 147). Both parties need to make some level of investment in the relationship and thus relationships can be seen as some kind of investment process (Turnbull et al., 1996). Relationships will only continue to exist if the parties involved reap rewards that exceed the costs of those relationships. If not, relationships are dissolved or at least re-evaluated and/or transformed in the long-run (Dwyer et al., 1987).

In some other settings, this freedom to select a counterparty, and let the relationship develop as a result of previous interactions, does not exist. One such example of this is the setting that Laing and Lian (2005) describe as elementary relationships that result from public or competitive tendering. In a public tendering context, the factors determining whether a relationship between two parties should be developed or not should be clearly specified in advance. In order to give all the actors the same possibility to receive the contract, factors such as previous experience and relationships between parties are not allowed to affect who the relationship includes (Sweden's Public Procurement Act, SFS 2007:1091; 2007:1092).

Based on the above discussion, we could argue that we have a somewhat contradictory situation since, on the one hand, we have what could be described as an elementary relationship setting, resulting from the public tendering setting, where the relationship is characterized by bureaucratic routines and a formal atmosphere and where trust between the parties cannot be anticipated due to the tendering context (Laing and Lian, 2005). On the other hand, we have a long-term business relationship where trust and commitment play a key role in governing the relationship in an efficient way (Håkansson et al., 2004; Hunt and Morgan, 1994, Mouzas et al., 2007). In some senses there are similarities with the ‘interimistic’ relational exchanges (IRE) described by Lambe et al (2000), where companies has to work together to gain advantages or avoid threat in a short-term situation. Our setting contrasts though in the time-period the relationship exists and the possibility to select who you should work together with. While IRE only last for a short period of time, our relationships endure for a longer period of time. This provides a specific contractual context which has attracted little previous research interest. According to Mouzas and Blois (2008), there is a lack of empirically-based scholarly work as regards understanding the nature and form of contractual arrangements between organizations. In this study, we are conducting an empirical investigation of 21 contractual dyads within Sweden's public transport sector. The aim is to explore how contracts are used to build and develop long-term relationships in a context where trust cannot be anticipated in advance. Even though trust is a prerequisite for signing a contract, it may not exist at the beginning of the relationship. The need to understand the nature and form of contractual arrangements is, according to Mouzas and Blois (2008), an important issue which is key to IMP research work.

The rest of the paper will be structured as follows; in the next section, the study's theoretical point of departure will be described. The next section will continue with the research design, followed by a presentation of the empirical findings. The section after that is a discussion and the paper then concludes.

Theoretical points of departure

The role of the contract

In most business transactions, there is some form of contract between the parties which regulates each actor's contribution to the relationship (Roxenhall and Ghauri, 2004). The literature on contracts is drawn from well-known scholars like Coase (1937), Macaulay (1963), and Macneil (1978; 1981). In general, formal written contracts have a number of principal functions: (i) to bind the parties together; (ii) to specify the content of the transaction; and (iii) to provide evidence of the nature of the agreement and its enforcement (Blomqvist et al., 2005). Further, the contract helps by (iv) acting as a communication tool for the transmission of information from one party to the other; (v) by reducing uncertainty and risk by stating each party's contribution to the relationship; and/or (vi) by meeting the requirements of accepted practice in a given business setting (Malhotra and Murnighan, 2002; Roxenhall, 1999; Roxenhall and Ghauri, 2004; Williamson, 1975).

Despite the existence of a formal contract, the role that the contract actually plays in a business relationship tends to vary depending on the business context (Narula and Hagedoorn, 1999; Roxenhall and Ghauri, 2004). In many cases, contracts are seldom or never used once the contract is established; the contract just exists as a document needed for the negotiation and creation of the business while it is being initiated (Macaulay, 1963; Poppo and Zenger, 2002). If contracts are used, the purpose of using them is either as proof of what has been agreed upon, to control individuals, or as an interpreting tool to inform about the aspects of the contract which are not obvious (Roxenhall, 1999). It is possible to do business without contracts as, most of the time, there are no formal stipulation that a contract needs to be used (Grönfors, 1995). According to Mouzas and Ford (2007), contracts are seldom drawn up in new and untested relationships; instead, they are mostly drawn up in established and ongoing relationships

Different types of contracts

As a consequence of the different roles and functions of contracts, there are a variety of contractual arrangements. A contrast can be made between complete contracts (which specify all conceivable scenarios) and incomplete contracts (in which it is recognized that not all factors capable of affecting a contract are foreseeable at the time of finalizing it) (Hart and Holmström, 1987). The latter allows scope for interpretation, discussion, and maybe disagreement and although such a contract might be less secure, it is simultaneously more open and flexible (ibid).

Complete and incomplete contracts (Hart and Holmström, 1987) can be compared to what Macneil (1978) classifies as transactional and relational contracts. Transactional contracts are more like formal legal contracts which are characterised by formal rules, quantifiable contents, and a defined period of validity for the contractual arrangement (Lindvall, 2001; Sjöstrand 1985). Transactional contracts could be compared to the complete contract mentioned above (Hart and Holmström, 1987; Williamson, 1975). Typically, transactional contracts are of short duration and focus little on "personal" activities; rather, they tend to focus on issues that can easily be measured, preferably in monetary terms (Macneil, 1978). Relational contracts are more difficult to describe and specify; although they do have a specific period of validity, the exchange variables specified in them can be measurable and/or immeasurable (Macneil, 1978). In these types of contracts, there is less focus on legalities and more on reaching mutual understanding as regards the meaning of the relationship and the benefits to be gained from the contractual agreement in question. In such 'relational contracts', the structures and processes of relationships take precedence over attempts to foresee and resolve all the problems that might arise in the contractual setting (Macneil, 1978). Another type of more flexible relationally-focused contract is the type that Mouzas and Ford have discussed in various articles, labelled 'umbrella agreements' or 'framework contracts' (Mouzas and Ford, 2006, 2007; Mouzas, 2006). An "...umbrella agreement is a joint consent which explicitly sets out a framework of principles with the aim of providing flexible guidance for future contractual decisions" (Mouzas and Ford, 2006:1249).

Commitment and Trust

Two concepts that are of key importance in the discussion on relationships, and the role of contracts as governing tools, are commitment and trust. Morgan and Hunt (1994:23) define commitment "...as an exchange partner believing that an ongoing relationship with another is so important as to warrant maximum

efforts at maintaining it; that is, the committed party believes the relationship is worth working on to ensure that it endures indefinitely". Trust, on the other hand, is defined "as existing when one party has confidence in an exchange partner's reliability and integrity" (Morgan and Hunt 1994:23). One thing these two concepts have in common is that there is no clear-cut definition of either of them; there is also some ambiguity when it comes to using the trust concept in relationship settings.

According to Mouzas et al. (2007), trust is better suited for use in inter-personal relationships and the concept of reliance is better suited for use in inter-organizational relationships. Without getting stuck in this conceptual discussion, we argue that both the level of commitment and the degree of trust (as well as reliance) are important since they are a result of previous interaction, whereby longer and deeper relationships ought to lead to the commitment of bigger resources and the amassing of trust between the parties, as well as a signal to the other party regarding the perceived importance and value of the relationship. Over time, social exchange leads to the creation of trust and, further on, to the creation of social bonds. In cases where there are strong social bonds, these could replace economic and legal bonds (Easton, 1992). On the other hand, according to Macneil (1978), a low level of trust between the parties in a relationship increases the need for detailed contracts with specific written provisions. Based on this, the ability to create trust and commitment between parties is an important aspect when creating a relationship with another actor. According to Lambe et al. (2000) three variables are helpful in order to pre-judge the likelihood for that the partner is trustful; (i) prior extraexchange relationships interactions, (ii) a reputation for fair dealing, and (iii) pledges.

Bonds between Parties

Independent of the negotiated contract, the interaction process gives rise to different types of bonds between the parties in a given relationship. The use of bonds could according to Williamson (1994) function as substitute for trust. Other substitutes are according to Williamson (1994) hostages, information disclosure rules, specialized dispute settlements mechanisms and other similar things. According to Håkansson and Snehota (1995), bonds arise in a relationship between the actors as a result of those actors focusing a certain amount of attention and interest on each other. A bond, according to Easton (1992), implies a measure of tying between parties. The bonds between actors help both parties to better utilise each other's recourses and avoid conflicts. In the same way, resources are tied together as a result of the fact that they are brought together and combined with other resources (Håkansson and Snehota, 1995). Depending on the time-span, and the kinds of resources used in the relationship, the interface resulting from the resources being tied may become broad and deep. A bond, according to Easton (1992), implies a measure of tying between parties. Based on this, the kinds of bonds, as well as the strengths of the different bonds existing between the parties, could provide a measure of the structure of the networks (Easton, 1992). During the intervention created by the relationship, the parties' technical, administrative and commercial activities are linked together. The extent of the links and bonds created between the parties, and their intervention, will depend on the range of activities the relationship comprises, how much is done together, and how close the parties are to each other. However, in some cases, the actors involved in a relationship tries to more actively create bonds in order to tie the other party more closely. This strategy could be used if the party perceives itself to be unable to create enough commitment and trust to build a strong relationship, or if it feels, for other reasons, that it has to create a situation guaranteeing a certain outcome. This could be compared to the view of Blois (1998) of actively using relationship tools to draw the counterparty closer and thereby better monitor the entire relationship. In the business-to-business area, there are five bonds perceived to be important. The bonds that may exist between companies, according to the IMP school, are social, technological, knowledge, legal, and economic (Easton, 1992).

Research design

The present study is based on a documentary study (Silverman, 1998) focusing on 21 formal contractual dyads between contractors and fulfillers within the public transport sector in Sweden. The responsibility for developing and delivering public transport is legally divided between a numbers of actors (SLTF, 2002). This means that there are a number of actors that collaborate, comparatively actively, within a framework of networks in order to jointly create and provide the perceived customer offering, i.e. public transport. The government operates public transport via public transport authorities (hereafter labelled the contractor) in a specific geographical area (Swedish Code of Statutes, 1997:734); however, privately-owned fulfillers perform the actual service delivery (SLTF, 2002). The fulfillers (hereafter labelled the fulfiller) are selected by means of a public tendering process regulated in the *Public Procurement Act* (Swedish Code of Statutes, 2007:1091; 2007:1092). When it comes to public tendering, the relevant act (in Sweden, the *Public Procurement Act*, Swedish Code of Statutes 2007:1091; 2007:1092) states that the factors determining whether or not a party should be awarded a contract are to be clearly specified in advance. In order to give all the actors an equal chance of being awarded a contract, factors such as previous experience and relationships between parties are not allowed to affect the selection of fulfillers. The Act (Swedish Code of Statutes 2007:1091; 2007:1092) further stipulates that price, assuming a certain standard of service, is the dominant factor in deciding who will be awarded the contract. Contracts negotiated under the *Public Procurement Act* also have a fixed expiry date, which means that relationships end on the expiry date of the contract and a fresh round of public tendering must be held.

The analysis in this study has been conducted in two phases. During the first phase, a study of all 21 contracts was conducted in order to obtain an overview of the content and wordings of the contracts. During the second phase, we have chosen to go deeper and we have thus investigated four of the contracts more closely. Selection of these four contracts was based on the intentional sampling of information-rich cases (Patton, 1990). The four contracts were chosen subjectively in respect of (i) the formulations of the payment structure; (ii) the size of the contractor; (iii) the numbers of fulfillers (single vs. portfolios) (iv) the structure of the traffic contracted. The four contracts were analyzed using the parameters described in the table below. The creation of analysis parameters is based on the above discussion concerning important bonds between the parties.

Parameters studied	Definition
Contractual settings	How the contractual situation is organised, number of contracts the contractor has, , structure of the transport etc.
Degree of detail in the contract	The design of the contract, how detailed the contract is, the length of the contract, etc.
Financial issues	The use of financial aspects to create desirable behaviour.
Technical issues	The degree of technical specifications in the contract concerning adjustments to products and processes to meet the partner's requirements.
Social- and trust- creating issues	Wording of the contract to create trust and social bonds between the parties.
Cultural issues	The creation of a subculture of which the supplier is a provider.
Knowledge issues	How to create learning between the parties within the relationship domain.

Table 1. The parameters created for analysing the contracts.

Findings

Analysis of the 21 formal contractual dyads reveals that despite the fact that the contracts vary in content and detail (number of appendices; design; formulations; types of contract; complexity; and extent), all contracts being very comprehensive and formally written. The contracts vary in extent between 50 and approximately 300 pages. It can also be acknowledged that the contracts have a long period of validity (between 5 and 14 years). Even though the 21 contracts studied differ in part, there are still similarities between them, and the four contracts we have chosen are representative of contracts in the public transport sector.

The first contract (C1) was selected because the contractor has a strategy to have specified and detailed incentive and bonus systems in order to create a service of high quality. However, the contract stipulates formal evaluation methods specified in the contract. C1 is a single contract handling all public transport in the city the contractor has responsibility for, which makes the contract central and important to the contractor. The traffic is conducted with buses. On the other hand, the fulfiller also operates in other counties and thus has a portfolio of contracts. C1 includes a detailed specification of vehicle design (colour, carbon footprint, comfort), but also of what ticketing and information systems are to be used. The contract specifies that it is important to have uniforms and common training programmes in order to create a corporate culture,

something which represents an investment for the contractor. C1 also contains values which include both social and environmental issues (e.g. having good public transport in order to create a sustainable society). The C1 contract is very detailed and covers many different aspects of the business relationship. The period of validity of C1 is 8 years, with a possible extension of two plus two year.

The second contract (C2) was selected because the contractor has a portfolio of contracts with different fulfillers, covering various areas of the county and delivering different kinds of transport (buses, trains, and trams). The contract under study here is one of the contracts signed by the contractor. C2 is a contract that features strong incentives and fines as well as formal and detailed evaluation systems for measuring the incentives, e.g. if the fulfiller delivers transportation of high quality. The design of the vehicles is specified in detail, as well as what information and ticketing systems are to be used. Training programmes are also specified in the contracts. Furthermore, the contractor's values are defined in the contract, something the fulfiller has to comply with. The period of validity is five years, with a possible extension by five years.

The third contract (C3) was selected due to having another form of earning structure. C3 is a contract type containing prerequisites designed in such a way as to allow the fulfiller to have greater responsibility. This contract specifies both fixed and variable amounts of payment, which can provide the fulfiller with earnings up to 50 percent. On the other hand, it also means that the fulfiller takes a greater risk. In C3, there are also very detailed specifications of vehicle design (colour, carbon footprint, and comfort, as well as the ticketing and information systems to be used. There are also specifications in contract C3 concerning the training programmes and uniforms to be used. The contractor's values are described in detail in the contract in order to create mutual understanding. The contractor has several contracts within the county and operates both bus (city and regional) and rail (train) services. In this city, there is only one fulfiller providing transportation. This fulfiller is one of the top five operating on the public transport market. The period of validity of the studied contract is five years, with a possible extension of three years.

The fourth contract (C4) was selected because it features specifications regarding what happens if quality standards are not achieved. C4 contains detailed specifications concerning vehicle design as well as ticketing and information systems. C4 also specifies how drivers should behave (use proper language, be service minded etc) towards travellers. Furthermore, safety policy and how to operate services are described in detail in the contract. The contractor's values are generally specified. The contractor operates his services using buses, trains, and cars, as well as inter-regional transportation in the northern counties of Sweden with different fulfillers in those counties. The fulfiller is one of the top five operating on the public transport market. The period of validity of the studied contract is five years with a possible extension of one plus one years.

	C1	C2	C3	C4
Contractual settings	The contractor has only one major contract covering the whole area. The fulfiller is one of the largest on the market, with a portfolio of contracts	The contractor has a portfolio of contracts with different fulfillers covering different areas of the county as well as delivering different kinds of transportation. The fulfiller works in one area of the city.	The contractor has several contracts and operates different types of transportation. The fulfiller works in one of the cities in the county. The fulfiller is one of the five biggest	The contractor operates services using buses, trains, and cars, as well as inter-regional traffic in the northern counties of Sweden with different fulfillers in those counties.
Degree of detail in the contract	A detailed contract A number of formal evaluation methods.	Detailed contract Formal and detailed evaluations for incentives	The contract is designed so the fulfiller can assume more responsibility and be more involved in providing the service.	The wording of the contract is rather hard as the contractor can be awarded damages if quality standards are not met. The contract governs the behaviour of the driver.
Period of validity	8 years (2+2 optional)	5 years (+5 optional)	5 years (+3 optional)	4 years (+1 +1 optional)
Financial issues (the use of financial aspects to create desirable behaviour)	Working actively with incentives and bonus systems in order to create transportation of high quality	Detailed incentives and fine-structure	The contract specifies both fixed and variable amounts of payment, which can provide the fulfiller with earnings (up to 50 percent). The fulfiller takes a greater risk.	The contract has detailed specifications what happens if quality standards are not met.
Technical issues (the degree of technical specification in the contract re. adjustments to products and processes to meet the partner's requirements)	Highly specified description of the design of vehicles (colour, carbon footprint, comfort) Specification of the use a certain ticketing and information system	Highly specified description of the design of vehicles (colour, carbon footprint, comfort) Specification of the use a certain ticketing and information system	Highly specified description of the design of vehicles (colour, carbon footprint, comfort) Specification of the use a certain ticketing and information system	Highly specified description of the design of vehicles (colour, carbon footprint, comfort) Specification of the use of a certain ticketing and information system.
Social and trust-creating issues (wording of the contract to create trust and social bonds between the parties)	Prerequisite for social bonds Communication plan between the contractor and fulfiller (appendix to the contracts)	Not explicitly specified	Prerequisite for social bonds as the contractor allows the fulfiller to assume greater responsibility.	Not explicitly specified
Cultural issues (the creation of a subculture of which the supplier is a provider)	Training and instruction held by the contractor The use of branding The use of symbols and uniforms Fulfiller should approve of certain values (general, social, and environmental)	Training and instruction held by the contractor The use of branding The use of symbols and uniforms Fulfiller should approve of certain values (general, social, and environmental)	Training and instruction held by the contractor The use of branding The use of symbols and uniforms Fulfiller should approve of certain values (general, social, and environmental)	The use of branding Fulfiller should approve of certain values (general) Training with focus on safety, and policy The contractor's values are only specified on a general level
Knowledge issues (how to create learning between the parties within the relationship domain)	Information about customer issues Training and instruction held by the contractor The fulfiller must give all the necessary information to the contractor	No specification re. how to share information about, for example, the user of the transportation, between the contractor and the fulfiller	Not explicitly specified	Not explicitly specified

Table 2 Types of contracts studied

The analysis of the contracts reveals similarities and differences among the cases studied. All four contract types have strong legal bonds as the contracts are specified in great detail, but the design of the bonds differs. Another similarity is that all four contracts studied have technical bonds (i.e. vehicle, and ticketing and information systems) that are specified in detail in the contracts. It is apparent that all four have financial bonds that are specified in the contracts, but they differ. C1 and C2 have many formal incentives and fines. C3 is a contract type with financial bonds that are designed so as to allow the fulfiller to exert an influence on the payment structure. This also allows the fulfiller to assume greater responsibility. Other things that differ are the cultural bonds and the specification of training programs. C4 does not have the same training program as C1, C2, and C3. The social bonds are not explicitly specified in all the contracts. In some of the contracts, there is an attempt to create prerequisites for social bonds. This is the case in C1, for example, where there is a more detailed communication plan regarding how to exchange information with the fulfiller and vice versa, which is a way of building social bonds into the business relationship. Despite the differences, the similarities between the contracts are overwhelming when it comes to central issues.

Discussion

The development of a relationship can be described as evolution or as a process whereby the parties, in the interim, reduce the distance between them and develop trust in their partner (Ford et al., 1998). From this perspective, the development of a relationship can be seen as an investment whereby the parties commit resources to each other in order to receive benefits in the future (Ford et al., 1996, Turnbull et al., 1996). In this study, the relationships investigated are not based on previous interactions between the parties. In a public tendering context, the factors deciding whether or not a relationship between two parties can be developed must be clearly specified in advance. In order to give all the actors an equal possibility of being awarded the contract, factors such as previous experience and relationships between parties are not allowed to affect with the selection of fulfillers (see, for example, the Swedish Public Procurement Act, Swedish Code of Statutes 2007:1091; 2007:1092). This creates a situation whereby it is not possible to anticipate having a trustful relationship with a counterparty; this is because you do not even know who the counterparty will be. If the level of trust is low, the need will exist, according to Macneil (1978), for detailed contracts with specific written provisions. In contrast to the situation whereby contracts are seldom drawn up in new and untested relationships, instead mostly being drawn up in established and ongoing relationships (Mouzas and Ford, 2007), we have a situation here whereby the contract is what initiates the relationship; without the contract, there will be no relationship between the parties.

Another complicating factor is the legal restriction that there is no possibility of a negotiation process between the parties. This lack of a negotiation process also affects opportunities for a learning and trust-building process existing between them. According to Mouzas and Ford (2007), this is an example of an asymmetric relationship, whereby one party (the contractor) dominates the relationship. In this setting, the contract is unilaterally dictated by the contractor. In an asymmetric relationship, the contract is more important for the stronger party since he can “*shape the structure of their relationship and most of all [to] institutionalize the asymmetry*” (Mouzas and Ford, 2007:58) by using specific clauses in the contract.

This gives the formal contract, and its supplementary documents, established between the parties a key role in governing the relationships studied here. The contract (including its supplementary documents) clearly specifies the obligations and duties of the parties. In addition to this, the contract contains different types of financial sanctions in order to guarantee desirable behaviour, something that could be compared to Hunt and Morgan (1994) who claims that high relationship-termination costs, i.e. all costs associated with terminating a relationship, can be used to create commitment. In this perspective, the contract functions very much in the role that the theory gives the contract, i.e. binding parties together, specifying the content of the transaction, and providing evidence of the nature of the agreement and its enforcement (Blomqvist et al., 2005). The contract is also used on a more day-to-day basis to govern everyday interaction between the parties, since it often specifies even the mundane aspects of the relationship. This is in contrast to Macaulay (1963) and Poppo and Zenger (2002), who argue that contracts are seldom or never used during day-to-day interaction, instead just existing as a document needed during the negotiation and creation of the business while it is being initiated.

Our analysis in this study reveals similarities with the elementary relationships described by Laing and Lian (2005), which are characterised by a highly formal atmosphere containing bureaucratic routines (Laing and

Lian, 2005). In our studied context, the contract is often used to monitor the other party's performance, most often using short-term performance targets determined by the purchaser (Laing and Lian, 2005). One difference in comparison with the elementary relationship-context is the fact that the contracts between the parties studied here tend to be more long-term and that, in this scenario, formal contracts tend to have difficulties handling the higher degree of ambiguity and uncertainty which tends to exist in long-term exchange situations. In order for the long-term relationship between the involved parties to be efficient, the formal contract has to be supplemented with some sort of relationship management (Brown et al., 2005; Seshadri and Mishra, 2004). In an attempt to create the foundations for a high level of trust and commitment, the contractor words the contract in such a way that he thinks will increase trust and commitment in order to facilitate long-term interaction. Examples of such wordings are those that are supposed to create common values between the parties (training, uniforms, and brand image) as well as tools and systems for good and trustworthy communication, something which is of major importance in the creation of trust, according to Hunt and Morgan (1994). The Public transport authorities uses also a number of clauses in the contract that according to Williamson (1994) functions as substitutes for trust, for example use of bonds rules about how information should be disclosed between the parties and how disagreements should be settled.

Conclusions

The contribution of this study is to provide contrasts with previous research in relation to business-to-business studies. One of the most critical decisions for managers to make is formulating 'ideal' contracts since there is no scope for negotiations and major adjustment. The negotiating process only provides opportunities for minor adjustment. Our analysis of the contract setting in the public sector reveals the importance of formal contracts in relationship-building due to (i) very detailed specifications; (ii) the law having an effect contract design; (iii) the bidding process, there is no negotiation process; (iv) there is no scope for further discussions after signing contracts; (v) no learning processes; (vi) contracts being used in day-to-day business. It has been acknowledged that there is a lack of empirical investigations regarding the nature and form of contractual arrangements and this study's contribution lies in using formal contracts in a public context. This study highlight that formal contracts play an important role in the long-term relationship building.

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