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Trust, Contracting, and Adaptation in Agri-Food Hybrid Structures

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ABSTRACT

The paper considers the relationship between trust and governance structure from a Transaction Cost Economics perspective. The role of trust in the coordinating decisions is variously conceptualized according to the theoretical view adopted by the scholars. The present study adopt the three-level schema introduced by Williamson (1996) and suggest that determinants of trust may operate both at institutional and governance structure level. The analytical framework depicted maintains that trust may determine a reduction of ex post transaction cost in the adaptation of hybrid structure. As a consequence trust appears to be able to extend the range of existence of the hybrids. The empirical part of the study is dedicated to a case study which illustrates the emerging of conditional trust (Fritz et al., 2008) and the role of trust in the adaptation process.

Keywords: hybrid, conditional trust, adaptation, contractual relationship.

1 Introduction

The paper explores a specific aspect of the relationship between trust and governance structure. Trust is a very complex concept addressed under different analytical frameworks. Many definitions have been proposed, and an enormous body of literature has progressively widened the understanding of the role of trust in economic life and analysis. Theoretical perspectives differ in their treatment of the role of trust in hybrid structures (Faems et al., 2008), and controversial evidence is provided in the literature on the relation between trust and contracts (Lyons and Metha, 1997; Poppo and Zenger, 2002; Luo, 2002). The parties to a transaction are unable to anticipate at the time of the contract all future contingencies. Thus, disagreements emerge after the parties have organised their transaction. As a consequence, the transactors must cope with ex post transaction costs (Williamson, 1985). Many theoretical perspectives highlight the idea that the trust reduces transaction costs (Sako and Helper, 1998; Gulati, 1995; Faems et al., 2008; Puranam and Vanneste, 2009; Williamson, 1993; Mènard, 2004). This point crucially entails the analysis of the relation between the governance structure and trust. Contrasting views and evidence are available with respect to this relation. Williamson (1993) argues that trust may influence the choice of the governance structure, as it is part of the institutional environment. From this perspective, opportunism is recognised as a distinctive feature of individual motivation. Arrighetti et al. (1997) and Deakin et al. (1997) highlight trust-building processes in which social interaction appears to influence individual perceptions and reciprocal expectations. Bradach and Eccles (1989) define inter-organisational trust as an organisation's expectation that another firm will not act opportunistically. Trust has consequences with respect to the adaptation processes of the existing governance structures. Furthermore, scholars have addressed whether trust and formal governance are substitutes or complements (Poppo and Zenger, 2002; Luo, 2002), which is a specific issue framed in terms of the larger problem of the influence of trust on the choice of the governance structure (Punaram and Vanneste, 2009). Notably, Das and Teng (2001) distinguish between goodwill and competence trust and identify potential techniques for reducing risks in hybrid structures and thus delineate opportunities for trust influencing the attribute of the transaction.

Fritz et al. (2008) argue that information flows, activities control and risk management patterns act as determinants of trust-building within hybrid structures in agri-food chains. This study adopts a transaction cost economics (TCE) perspective and assumes that trust can operate within the adaptation processes of existing hybrid structures. Moreover, the present study focuses on a particular aspect of this complementarity, namely, the idea that trust influences adaptation processes and enhances the stability of hybrid organisations. It also considers the contracting basis of hybrid forms and the centrality of trust to the existence of hybrids (Hofstede, 2006) as basic elements of the relation between trust and the optimisation of governance structure alignment to the transaction. First, the analysis presented here considers the relationship between governance structure and trust within the institutional complexity as depicted by Williamson (1993) and distinguishes the determinants of trust into two classes: that is, those that emerge from the institutional environment and those that operate within the existing governance structure. Second, having highlighted the pattern of influence of the governance structure on trust-building, this study analyses how trust reduces the ex post transaction costs caused by emerging disturbances.

The paper is organised as follows. The role of trust in hybrid contracting is illustrated in section 2. Empirical findings are proposed in section 3; they are collected based on a case study, which indicates the existence in a hybrid structure of relations based on trust and the influence of trust on adaptation costs. In the section 4, final remarks are provided.

2 Hybrid forms and trust

2.1 The diffusion of hybrid structures in the agri-food sector

From a transaction cost economics (TCE) perspective, agents decide to organise a transaction by choosing a governance structure (that is, market, hybrid, or hierarchy) to minimise the transaction costs at stake (Williamson, 1985). Mènard and Valceschini (2005) point out the diffusion of hybrid forms in the agri-food sector, suggesting that their emergence can be considered a consequence of three main forces, namely, the evolution of the supply side, the evolution of the demand side and the redefinition of quality control to emphasise control over both processes and products (Ménard and Valceschini, 2005, pp. 426-428). They propose a complex public and private institutional framework to explain organisational choices in this field (Ménard and Valceschini, 2005, pp. 433-435) involving rules intended to support quality signals (as in the case of PDO supply and private brands (Ryanad et al., 2005)), as well as the rules set by retailers (Fulponi, 2006; Réviron and Chappuis, 2005: Mazè, 2002; Sans et al., 2005) and/or requested by food safety regulations and expectations (Martino, Perugini, 2006).

Mènard (2004) highlights three fundamental dynamics in hybrid structures, namely, the tendency towards the aggregation of resources (pooling), the contractual basis (contracting), and the tendency towards competition (competing). These dynamics explain the extent to which hybrid forms are rooted in both cooperation and competition as well as whether their functionality depends on the extent to which the various contract mechanisms are able to reconcile legal autonomy and interdependence. Namely, contracting characterises many hybrid forms because the contract signed by participants is frequently a simple framework in which ample room is more or less allowed to everyone. Thus, a typical problem involves the need to identify the best mechanisms for aligning transactions with the government structure by monitoring the organisation and searching for solutions to emerging problems (Ménard, 2004).

2.2 Trust and contracting: delineating a framework for analysing organisational choices in the agri-food sector

2.2.1 Trust and governance structures

An interdisciplinary body of literature provides many definitions of the basic elements of trust-sharing. Accordingly, trust is related to intentional behaviours, relevant in the context of economic relationships, and social norms and rules are often invoked as sources of trust. In addition, the uncertainty about future events due to human behaviour is also acknowledged. In general, trust is an expectation of the future behaviour of others and a mechanism to reduce complexity in situations involving a social decision; it emerges after positive personal experiences (Luhmann, 2000). Sako, Helper (1998) define trust as "an expectations held by the agent that his trading partners will behave in a mutually acceptable manner (including an expectations that neither party will exploit the other's vulnerabilities. This expectations narrow the set of possible actions thus reducing the uncertainty surrounding the partners' action" (Sako and Helper, 1998, p. 388). Trust appears to challenge the political economy view (Levi, 2000) . Distrust – and even the lack of trust – raises the transaction costs of cooperation, while trust can play a role in reducing these transaction costs and providing a means to move out of an equilibrium of non-cooperation (Levi, 2000). Sako (1992) introduced the distinctions among contract trust related to contractual terms, competence trust concerning the abilities of the trading partner and goodwill trust in which one party makes an open-ended commitment to take initiatives for mutual benefit while refraining from having an unfair advantage (Sako and Helper, 1998, p.388; Sako, 1992; Marchington and Vincent, 2004). McEvily et al. (2003) interpret trust as a heuristic for how actors interpret and represent information and how they select appropriate behaviours and routines for coordinating actions (McEvily et al., 2003, p. 92). Adler (2001) emphasises the nature of trust as a mechanism that contributes to an individual's comprehension of the complementarity between forms of interaction and coordination. In this context, the relationship between trust and governance structures appears to be complex, and in particular, the causal nexuses between trust and contracts together with the nature of such relationships (i.e., whether it is complementary or substitute) are questioned in light of controversial evidence (Klein Woolthuis et al., 2005).

The relationships between trust and governance structure are conceptualised in various ways in the growing literature on the subject. This debate includes analytical issues concerning whether trust and governance structure are substitutes or complements (Klein Woolthuis et al., 2005; Noteboom, 2002), as well as theoretical perspectives that emphasise the influence of the analytical role of opportunism (Gulati, 1995; Poppo and Zenger, 2002; Faems et al., 2008). Regarding theoretical approaches, Faems et al. (2008) clearly show that while sociological exchange theorists (Ring and van der Ven, 1992; Zaheer and Venkatraman, 1995; Gulati, 1995) point out the possibility that trust reduces the influence of opportunism, "structural" scholars, which include transaction costs theorists, do not admit this possibility but rather recognise that trust may modify the terms of any economic calculus (Williamson, 1993). Puranam and Vanneste (2009) offer reflections on these competing theoretical approaches and examine the role of trust in the context of the choice of governance complexity, which is also supposed to support the governance structure in coping with unforeseen contingencies. In this context, they model the relationship between trust and governance complexity and find that one satisfactory approach relies on the positive relation between ex ante trust and governance complexity.

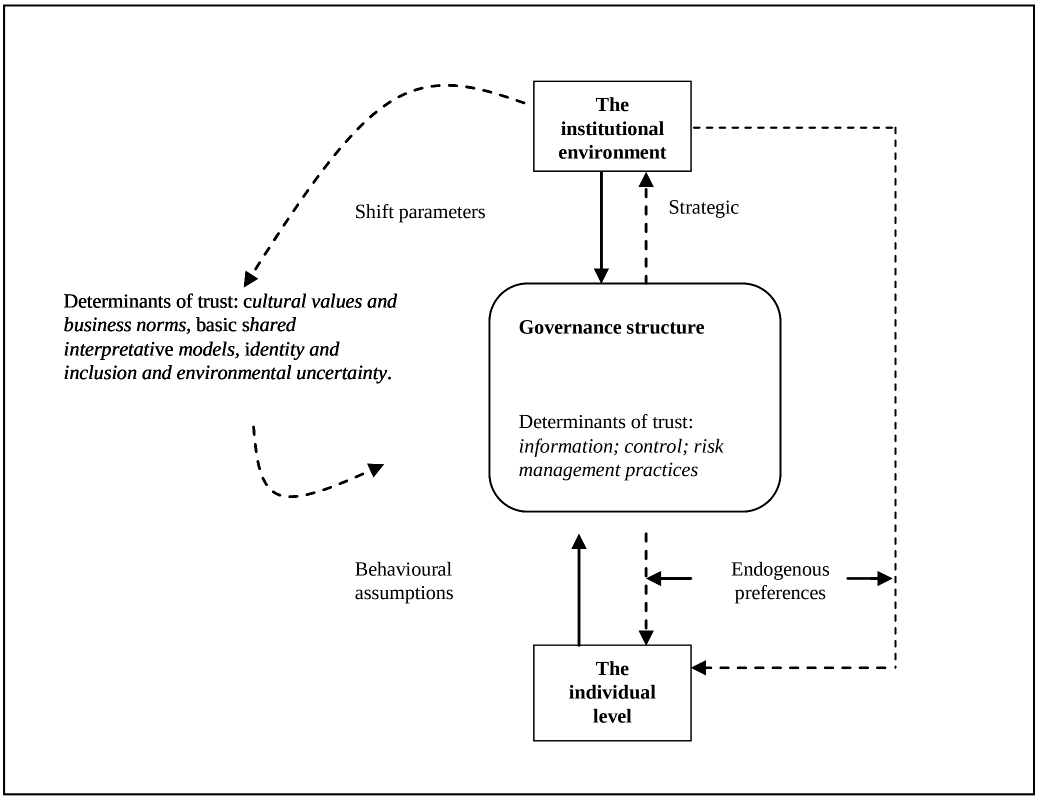

Figure 1. Determinants of trust in the three-level schema proposed by Williamson (1993b, p.113).

Analysing the relationship between trust and governance structure, Noteboom (2002) suggests that trust sustains economic agents in coping with uncertainty and bounded rationality by supplementing self-interested and coercion-based governance. Namely, trust appears to reduce the relational risks that act as complementary tools of governance strategies (Noteboom, 2002, pp. 112 ff.). Lyons and Metha (1999) and Deakin et al. (1997) recognise the influence of trust on the governance of between the social environment of economic life and the structuring and dynamics of relationships among agents. Deakin et al. (1997) examine the relation between trust and contracts and focus on trust as a factor that allows an agent to manage flexibility within existing contractual relations. These approaches recognise the capacity of institutional forces to increase information flow and reduce conflict, monitoring and risk. Increasing information flow is seen as an antecedent to trust (Deakin et al., 1997, p. 110; Fritz et al., 2008), while reducing conflict, monitoring and risk is seen as an effective way to manage contractual relationships, even though this may reduce the level of trust (Puranam, Vanneste, 2009). TCE assumes that individuals act opportunistically (Williamson, 1985). Under this view, the analytical role of trust relates to the modification of the terms of the economic calculus, as this calculus considers trust to be a factor that potentially influences certain types of transaction costs. Changes in the institutional environment can determine the role of trust, although these changes can be addressed by adjusting the transaction-specific governance structure in a cost-effective way (Williamson, 1993, p. 477). Assuming that institutional environment is characterised by some type of trust, the choices of the governance form should differ from the choices that would be made in an environment characterised by distrust or absence of trust. Williamson (1996) introduces a three-level schema that establishes a clear set of relationships among the institutional environment, the choice of governance and individual-level phenomena. In the present paper, the relationship between governance structure and trust is analysed within such institutional complexity; moreover, this paper assumes that Williamson's schema allows for a classification of the determinants of trust. Two main classes are thus identified, namely, those that stem from the institutional environment and those that operate within the existing governance structure (Figure 1).

Ménard (2000) argues that there is a lack of analytical knowledge about how rules diffuse from the institutional environment to the governance structure. Scholars have identified some determinants of trust that are thought to influence the choice of the governance structure. Among various scholars, Sako and Helper (1992) and Deakin et al. (1997) emphasise the role of cultural values and business norms in shaping decisions about the organisation of the transaction. This role implies that different cultures should differentially influence the approach to organisational choice in a specific manner. Shared interpretative models (Ancori et al., 2000) suggest that parties of the contract may also be induced to frame the search for their individual interests within common perspectives, thereby building shared expectations. Furthermore, identity and inclusion promote the development of cooperative inter-organisational relationships, as they are grounded in the motivational and cognitive predispositions of individuals to engage in sense-making and binding processes (Ring and van der Ven, 1994, p. 99). Another example of an institutional determinant of trust is linked to technological uncertainty (Sako and Helper, 1992); as this type of uncertainty decrease, the parties to a transaction may elaborate on a less heterogeneous set of expectations and rely on the fact that the counter-party has less opportunity to make inappropriate technological choices. Mechanisms for coordinating transactions, organising transactions and solving disputes gain legitimacy and support in the context of an institutional environment, and all of these mechanisms may be influenced by trust (Furubotn and Richter, 2000, Akerlof, 1970). Therefore, institutional trust influences the choice of governance structure and is a factor that potentially sustains this choice (Williamson, 1993; Luhmann, 2000).

Fritz et al. (2008) conjecture that trust may emerge as a consequence of the influences of specific factors within an existing hybrid structure, including:

a. information exchange
b. control
c. risk aversion

The hybrid establishes patterns of relationships between parties in order to foster flows of information that must be interpreted under common points of view. The systematisation of this information within an articulated cognitive framework contributes to the creation of common knowledge by also relying on common cultural values and basic interpretative modes (Ancori et al., 2000). Fritz et al. (2008) argue that communication regarding the evaluation of the outcomes of the monitoring schema contributes to reciprocal experiences among parties and, consequently, the emergence of trust. Along the same lines, Sako and Helper (1998) point out that the disclosure of information enhances trust-building in a chain relationship. Ex post governance may influence individual-level phenomena by way of the following causal sequence (Fritz et al., 2008):

Flows of high-quality information → communication → experience → trust

The emergence of trust as a consequence of communication within governance relations is related to monitoring and, moreover, can be conceived as a potential outcome of any systematic exchange of information between parties. Thus, trust in this context may operate as a tool for economising the collection of information, resulting in a reduction of monitoring costs. In this sense, communication can be thought of as a way to partially substitute control activities through trust.

Das and Teng (2001) provided a general model showing how trust and control can be conceptualized as separate tools aimed at managing the risk in hybrid structures. However, control and trust are to some extent complementary in governance relations because a basic amount of information is collected and explicitly managed by the parties involved. The potential change in risk attitudes and perceptions of reality suggests that trust can operate as a means of economising cognitive resources. Under this view, it may even influence the possibilities for substitution among control activities (Fritz et al., 2008). Finally, trust depends on risk attitudes and perceptions of reality. Two mechanisms can be identified with respect to this relation, and thus a second causal sequence can be introduced:

Authority → modification of individual risk preference → trust

This sequence connects the potential emergence of trust with changes that are determined by individual-level preferences. The possibilities to modify individual preferences are discussed by Ménard (1996) and affect the potentials for coordination within a hybrid structure. Furthermore, the relationships that arise out of the governance structure contribute to defining the decision-making process, which in turn influences risk-taking behaviours (Highhouse and Yüce, 1996).

This analysis suggests that hybrid structures can sustain trust-building processes, both by incorporating inducements from the institutional environment and by directly fostering trust through governance activities. In the next section, the consequence of trust-building are examined.

2.2.2 Trust as a driver in hybrid adaptation

What are the consequences of the trust, when trust is understood to be an effect of the determinants discussed above? Relevant consequences emerge in the context of the adaptation process. Disturbances within a governance structure may arise due to several causes (Williamson, 1985, 1991). Such misalignment requires adaptation and gives rise to ex post transaction costs (Williamson, 1985, p. 21). These costs include maladaptation costs, which are incurred as the transaction drifts out of alignment, and haggling costs, which are incurred because of bilateral efforts to correct ex post misalignment. Trust influences the type of contractual relationship (Sako, 1992), as well as three dimensions relevant to the adaptation process, all of which contribute to the reduction of haggling costs. These dimensions include contract formalisation, informal safeguard and setting of the domain of action of the parties involved. Therefore, trust can be thought of as a driver in the adaptation process, as it reduces adaptation-related transaction costs and extends the degree of hybridity, thereby enhancing the degree of uncertainty and asset specificity.

Contractual incompleteness and contract formalisation Scholars have emphasised the relationship between trust and contractual incompleteness. According to Brosseau and Glachant (2002, pp. 12-13), in transaction costs economics, contractual incompleteness is due to both uncertainty and institutional failures. Given the bounded rationality of agents and the fact that contract clauses related to unverifiable variables cannot be enforced, a contract essentially creates a "private order" allowing the parties to cooperate (Brosseau and Glachant, 2002). Nevertheless, contract formalisation has been examined by scholars in order to analyse the role of trust (Chen, 2000; Lyons and Metha, 2001). Trust appears to be relevant for the interpretation of written words in the sense that given trust, some interpretations encouraging opportunistic behaviours are a priori excluded; in other words, under trust, it would be irrational to expect these opportunistic outcomes. The distinction between a formal and informal contract often refers to the use of written words in any legally binding contract. Any "unwritten areas" are relevant to the parties involved; certain outcomes may be more likely to occur when a contact does not explicitly rule out certain actions. The distinction between a complete and incomplete contract refers to the fact that a contract cannot be completely verified by a third party in order to be enforced, even if the parties involved are able to observe all elements of the actual contract. Whether a third party is entitled to verify an unwritten term depends upon the law; for example, in some cases, contract law may allow a judge to implement an agreement. In this case, a judge may look for verifying elements in the "unwritten area." Note that it may be costly for the parties involved c to reduce this area by expanding the set of formal contractual terms. Trust may thus expand the amount of "unwritten" relative to "written" words, thereby introducing unwritten elements based on trust in order to allow the parties involved to save on the costs of negotiation. The literature on trust in business-to-business relationships, for example, suggests that a party may allocate, at least partially, her/his decision rights to a trustworthy trading partner. Whether or not the emerging "trust area" reduces the degree of incompleteness of a given contract is a different story; rather, this depends on the degree to which the contract may (or may not) involve verifiable variables. Unwritten verifiable variables do not increase the degree of incompleteness of a contract but could force the parties to a costly ex post negotiation. Unverifiable variables, written and unwritten, imply contractual incompleteness. Trusting a partner regarding unwritten, unverifiable variable does not reduce the degree of incompleteness of the contract. Rather, it facilitates the relationship among parties and makes incompleteness less effective to some degree.

Informal safeguards In approaching contracts, the hybrid structure is derived from the coordination of the partners involved. The typical mechanisms include (Mènards, 2004, pp. 361-363): a) decision regarding the number of participants to the agreement; b) duration; c) specification requirements; d) adaptation clauses; and e) complementary safeguards. Safeguards can be formal or informal, as "(…) this is where the issue of trust enters into the picture. Several authors see trust as a way to secure a transaction when the contract are incomplete (…) Trust would alleviate opportunism and would be made operational through recurrent transaction (…) In that respect, it can be argued that trust is a form of calculativeness, (…) although it has been challenged" (Ménard, 2004, p. 364). Trust can affect the nature of informal safeguards (Furubotn and Richter, 2001), alleviating the threat of opportunism and thus reducing the resources consumed in the negotiation process. Fritz et al. (2008) argue that trust can influence enforcement costs. Thus, trust helps to reduce transaction costs in terms of both specification and the utilization of safeguards.

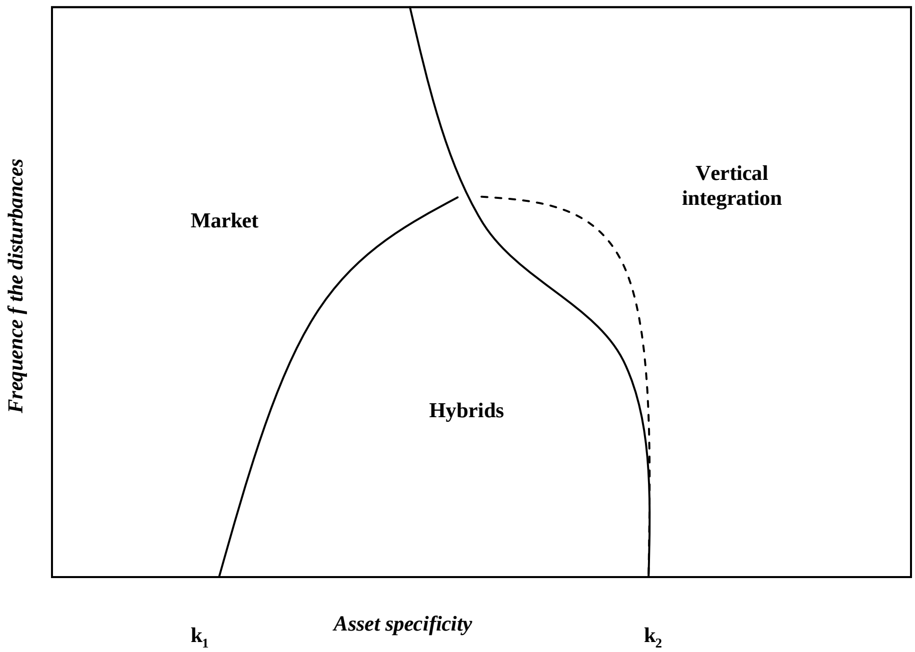

Figure 2. The relative effectiveness of governance forms, adapted from Williamson (1991)

Partners domain of action Hybrid structures require continuity, and thus, specific mechanisms must be created to coordinate activities, organise transactions and solve disputes. Among these, restrictive provisions delineate the domain of action of partners, thus limiting their autonomy and identifying areas in which collective decisions must prevail (Mènard, 2004, p. 365). To what extent individual and collective decisions are compatible may depend upon how an individual relies on her/his partners. By limiting her/his individual autonomy, a contract may connect this autonomy to the allocation of decision rights to the other party. This connection is related to the economic calculation indicated in the contract, but it also implies that parties will operate according to the understanding specified in the contract. To some extent, this approach may imply an understanding of trust as a belief that informs action (Levi, 2000, p. 139) and reflects dimensions of institutional trust already discussed above. For example, common cultural values facilitate the achievement of agreements (Sako and Helper, 1998), while the existence of basic shared interpretative practices may favour the emergence of cooperative behaviour (Ring and van der Ven, 1994).

In order to understand the consequences of trust on the adaptation process, Williamson's (1991) analysis should be considered. Critical disturbances may induce the parties involved to emphasise market mechanisms or hierarchical relationships, depending on the degree of uncertainty and the level of asset specificity (Williamson, 1991, pp. 116-117). The market is preferred up to the level of asset specificity k1, and this preference increases with uncertainty.

Above level k2, vertical integration is preferred to a hybrid structure. Nonetheless, if trustworthy relationships emerge due to the influence of the determinants discussed above, the value of asset specificity becomes closer to k2. Thus, the transaction costs caused by the disturbance are lower than in the case of an absence of trust. Therefore, the agents would still prefer the hybrid form, even in the case of a relatively high level of frequency of disturbances. As a consequence, the range of values of k2 for which a hybrid form may exist increases; this increase of the range is shown by the dotted line in the figure 2.

3 Empirical findings: the case study of Grandi Magazzini Fioroni (GMF)

Some empirical evidence is presented in order to corroborate the theoretical framework proposed here. The demand for flexibility can be studied by analysing changes due to quality signals (Raynaud et al., 2005), the relationship between agents along a supply chain (Fearne, 1998) and the evolution of relationships stimulated by consumer preferences (Fearne et al., 2001). One published case study (Martino, Perugini, 2006) uses Coop Italia, a large Italian distribution company. This study makes some interesting propositions concerning the demand for flexibility and related changes in the organisation of supply chains. The quest for enhancements in brand-product safety and quality has implied the emergence of a hybrid structure (Martino and Perugini, 2006). Some degrees of freedom for the suppliers have been introduced in order to mobilise their competences to solve problems that may emerge; in this context, trust is considered to be the factor that promotes changes in hybrid structures. Namely, in many supply chains managed by Coop, the degree of asset specificity has implied a more centralised form of governance based on buyer authority. Nonetheless, a comparable degree of asset specificity appears to be compatible with a more decentralised form, allowing suppliers to operate with more freedom. This freedom is a direct consequence of long-term relationships and the trust resulting out of these relationships. See Martino and Perugini (2006) for details on data sources.

Evidence from the GMF case study is presented here in order to examine the relationship between contracts and trust in the context of a less complex hybrid structure.

3.2 The GMF case study

From a methodological point of view, based on the usual approach taken in studies on the agri-food sector (Sterns et al., 1998), a set of research questions has been preliminarily specified. The literature on trust presents various theoretical issues and a range of interpretations of empirical findings. This literature provides the basis for the research questions considered in this paper. The present study mainly concerns: a) the main role and content of contracts adopted by agri-food companies involved in hybrid structures; b) the perceived role of trust within the contracting process; and c) the main types of contractual relationships; d) the relation between trust and adaptation of the governance structure. The generalisation method is an analytical generalisation in which a previously developed theory is used as a template to analyse empirical evidence from a case study (Yin, 1994, p.31) such that results are generalised to theory.

Theoretical propositions have been derived in order to develop predictions. Regarding this paper, the TCE framework together with the hybrid-forms economics (Mènard, 2004) comprise the basic theory from which predictions regarding nonequivalent variables (Yin, 1994) are derived. The derived theory predicts that the contracting framework provided by a hybrid structure stimulates contractual adherence that, in turn, may require some degree of flexibility. Thus, the trust-based rules of interaction among agents that are derived from the institutional environment may imply changes in the contracting framework. Therefore, the predicted patterns address: a) general characteristics of the hybrid forms chosen; b) the relationships between a given contract and flexibility; c) the role of the institutional environment, particularly the prevalence of trust-oriented contractual relationships and the influence of the determinants of trust related to governance structure; and d) the reduction of ex post transaction costs due to trust. The match between the predicted patterns and the empirically observed patterns provides a test of the theory proposed.

Given the limited knowledge regarding the diffusion of rules from the institutional environment to governance structure (Ménard, 2000), the economics of the hybrid form (Mènard, 2004) provides the analytical framework to link empirical data to theoretical propositions. Criteria for interpreting the findings are derived using the usual business study approach as well as an emphasis on the interaction between the individual level and the system level (Deakin et al., 2001).

This case study design includes a single unit of analysis and examines relations along the supply chain as they are shaped by GMF strategies. This case study has been carried out using different types of data collection. Data sources include: a) documents such as internal reports, administrative documents and newspaper articles; and b) multiple focused interviews. In order to enhance the validity of the information gathered, data triangulation using different sources has been performed.

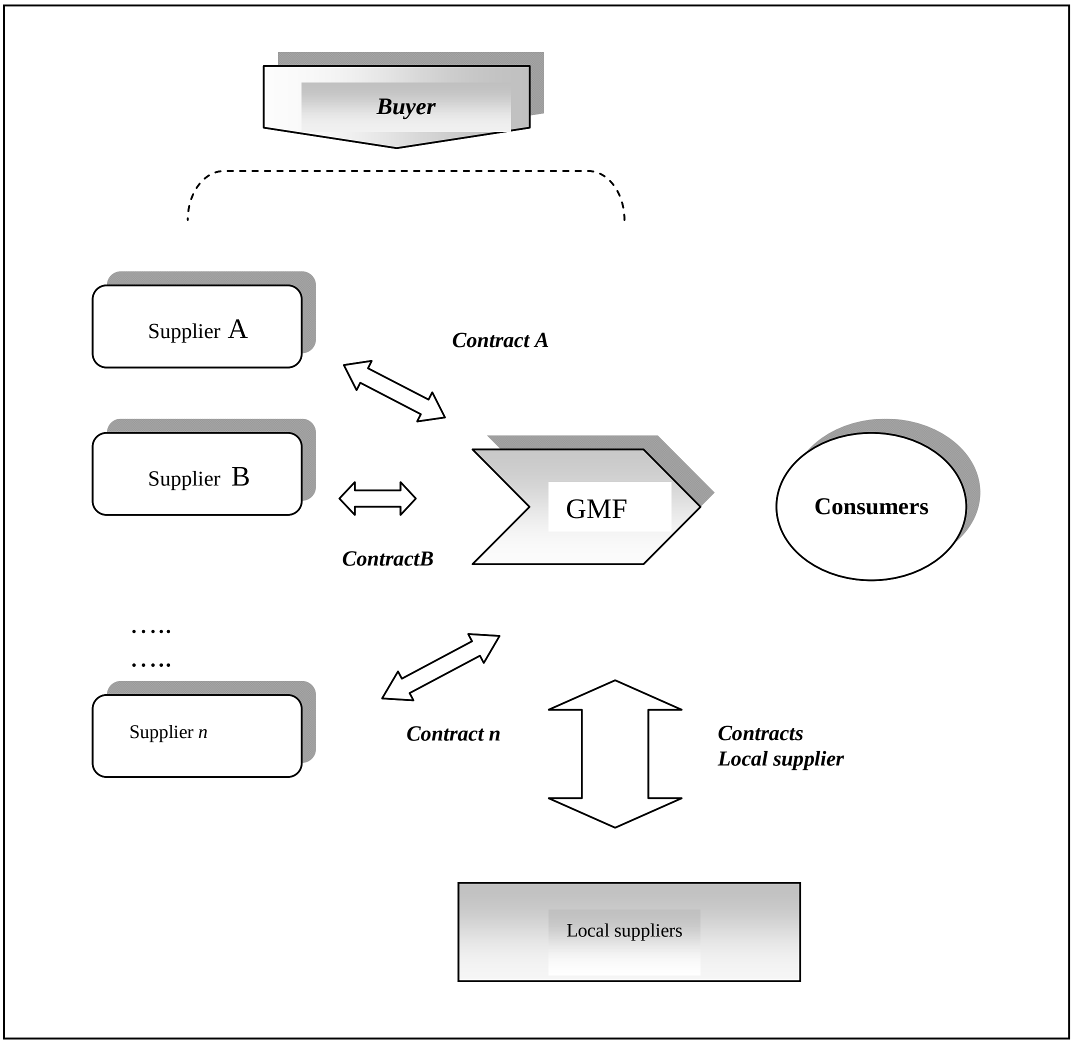

Figure 3. The contractual networks of GMF

The following sections briefly summarise interview data as well as the other collected data.GMF is a 50-year-old company involved in several distribution activities in central Italy. It employs 900 workers and clerks and manages 230 units with a total area of 100.000 m2; this includes 2 distribution centres, 8 cash-and-carry centres, 9 Ipermarkets and 29 supermarkets and several discount centres. The company is involved both in food and non-food distribution activities. The distinctive organisation of the GMF relationships is illustrated in Figure 3. GMF designs general contracts with large food companies at the national level and thus forges network relationships with these suppliers. These relationships are established by the collaboration of an intermediate agent (the Buyer) who helps GMF to find out the necessary partners and also helps the parties (GMF and its suppliers) to achieve the contractual agreement. Furthermore, GMF search for local suppliers in order to complete the range of the trading partners needed. In the case of the local suppliers, who cover a small part of the whole supply requested, GMF operates by direct contact with the agents. The centralisation of this stage of contracting allows GMS (and the other firms forming the central buyer company) to economise the contracting costs. The need for flexibility both for suppliers (i.e., specific marketing policies) and GMF (i.e., specific consumer requests) induces the trading parties to include a second level of contracting at the local level that is compatible with national-level contracting.

The role of the institutional environment is strictly determined by Italian contract law, while a structured contractual environment emerges and influences the relationships along supply chains. With respect to a single transaction between the GMF and a supplier, the framework at the national level allows flexibility that can be managed by the transactors. The governance structure can be characterised as a hybrid structure that allows agents to maintain stable relations over time and to design specific contracts on the basis of a set of basic terms concerning the quality of products and specific, periodic trade strategies. The emergence of contingencies as well as the need to enhance strategies and periodically specify short-term contracts means that GMF faces specific transaction costs. The governance structure establishes an intensive communication flow between parties regarding a) the development, implementation and enhancement of strategies at the consumer level (i.e., the autonomy of the parties involved is well recognised) and b) the basic management of current contracts. The flow of information is managed by direct contact between both the company and the supplier as well as between the company and the buyer. This communication is central to the management of the relationships among the parties involved and contributes to cooperation among them, thereby enhancing the efficiency of the coordinating mechanism (Martino, 2007). This communication must be thought of as a consequence of the governance structure chosen by involved agents. Experience plays a significant role in this framework and facilitates the management of each periodic contract as well as of the stability of the relationships with suppliers.

The main outcome of trust-building processes in this context is the trust-oriented contractual relationship established by GMF. Drawing on Sako (1992) and Marchington and Vincent (2004), the types of contractual relations identified in this case study were classified. Obligational contractual relations and arms-length contractual relations are differentiated by the degree of interdependence and the time span required to establish reciprocity (Sako, 1992). Table 1 shows the results of these classifications.

Table 1
Types of contractual relations between GMF and suppliers

Types of contractual relations	*National level*		*Local level*	
	Obligational contractual relations	*Arms-length contractual relations*	*Obligational contractual relations*	*Arms-length contractual relations*
Lowdependence on the other party, trading with a large numer of partners		X	X	
High dependence on the other party, trading with a small numer of partners	X		X	
Short-term commitment by both the parties, assumption that relations will continue		X	X	
Long-term commitment by both the parties, assumption that relations will continue	X		X	
Terms and conditions of contract written, detailed and specified		X	X	
Terms and conditions of contract may be oral rather than written, loosely specified	X		X	
Detailed performance measures laid down and monitored, reference to contract if there are problems		X		X
Extensive, multiple channels at a variety of levels in both organizations. Frequent contact and some socializing	X		X	
Little sharing risk between partners, variations in price spelt out and adhered to		X		X

The types of contractual relations differ between the local level and the national level. The nature of the obligational contractual relations reflects goodwill trust (Sako, 1992) and thus entails the possibility of relatively well-rooted, informal commitment (Sako and Helper, 1998). Thus, the local level appears to be characterised by a more pronounced degree of trust-related relationships.

The relationship between trust and contract that has emerged in the case study is illustrated in figure 4. The experience of GMF's managerial staff is central to the development of economic relationships among GMF and its suppliers. The use of distinctive knowledge and the experiences of the company represent a feature of the entrepreneurial model that was adopted. Given GMF's quality strategy, having selected a supplier, such as a local supplier, the contractual relationship is first a consequence of investments made while searching and selecting potential suppliers. Second, GMF prefers a simple written contract, and it has never needed to solve a commercial conflict by legal judgements. The low number of contractual terms (i.e., price, quantity and basic qualitative characteristics) reflects the reciprocal trust of the parties established after long-term relationships.

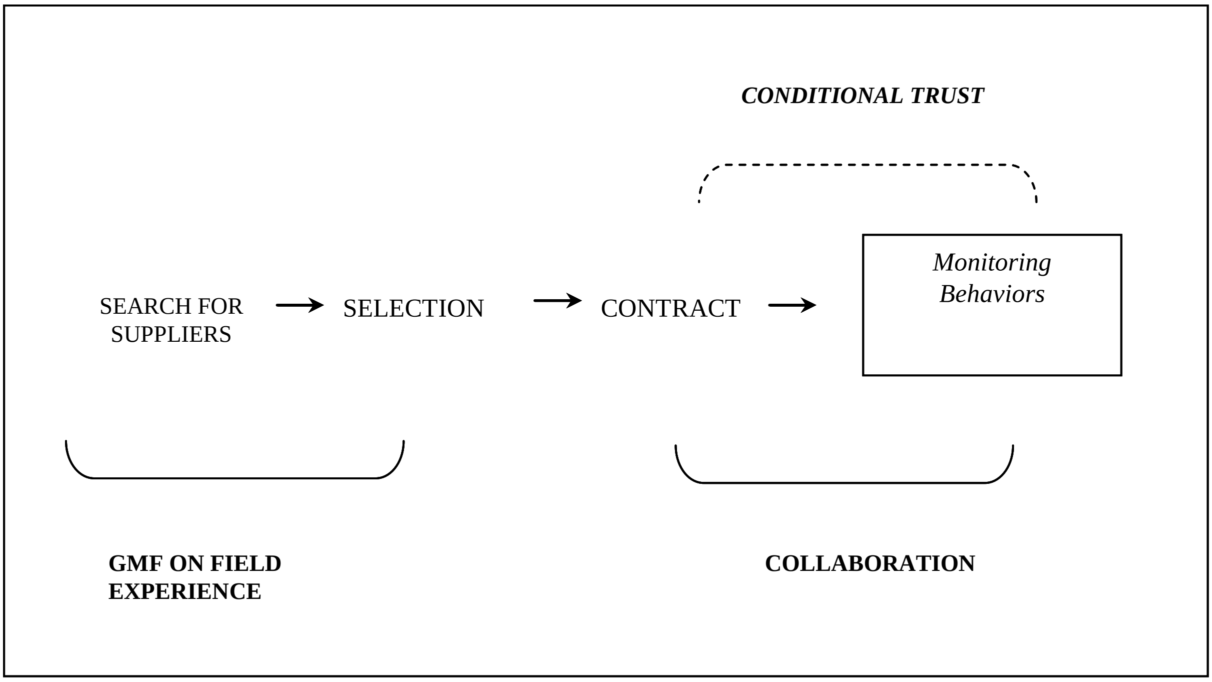

Figure 4. Experience, collaboration and trust in GMF

Mènard (2000) argues that the choice of contract safeguards is correlated to the degree of uncertainty. According to that analysis, when uncertainty is low, highly formal safeguards (e.g., tolerance zone, obligation to revealing information and so on) are chosen, while informal safeguards are adopted when uncertainty is high enough to justify the very large costs of detailed contract specifications (Mènard, 2000, pp. 241-242). Therefore, the evidence for informal safeguards in a condition of relatively high uncertainty (as is the case of the organisation under analysis here) appears either unexpected or without motivation if trust is not taken into account. GMF's contracts are based on an extended unwritten area and thus rely in many aspects on verbal agreements because GMF's costs would be larger if the company specified detailed formal safeguards. For example, this case study reveals a critical point regarding the joint management of a market crisis. During the crisis the agents face unexpected contingencies and need to adapt their arrangement. GMF bears maladaptation and haggling costs and the frequency of the disturbances may induce the firm to integrate some stage upward along the chain, the suppliers being already selected. Trustworthy relationships with the supplier, emerged after the choice of the hybrid governance structure contribute to avoid the increase of ex post transaction costs and the integration decision. Depending on the extent of this crisis, the parties may vary their behaviours. When the demand for a given product decreases, not only is GMF allowed to manage the market using its best discretion beyond the terms of the contract, but also some critical contractual terms may be jointly revised or managed differently by the parties involved. This management approach is crucial when the contract fixes a price, as this price may be revised (i.e., decreased) due to a market crisis; both GMF and the supplier prefer to share the economic losses in order to maintain the market link. A temporary loss is thus preferred to a loss in market share; this preference reflects the abilities of the parties to make reciprocal trust an element of economic utility. Trust is also the basis for the possibility to solve potential conflicts without the need for formal legal judgement. Here the importance of the ability of parties to interpret trust in the sense of economic calculativeness also becomes clear; long-term relationship allows them to look for cooperative solutions to potential conflicts, thus avoiding the costs of legal judgements. Since GMF verifies the behaviours of each supplier as well as allocates to suppliers some decision rights within the relatively small "written" area, the type of trust at stake here could be defined as "conditional trust" (Fritz et al., 2008).

This case study does not provide evidence regarding the role of setting the domain of action in reducing ex post transaction costs. In fact, even though both national and local suppliers commit to collaborate with GMF in dealing with emerging disturbances related to the quality and types of products, the advantages for GMF gained by directly managing the search for solutions via existing procurements is not comparable with the gains expected through strategies designed to enhance the network of suppliers.

4 Final remarks

Hybrid governance structures are increasingly pervasive in agri-food supply chains, and thus, their contractual basis can be investigated in different contexts. This paper has taken into consideration the relationship between trust and governance structure and proposes an interpretation of the role of trust in the adaptation process undertaken by parties in the face of emerging disturbances. This study is based on the three-level schema proposed by Williamson (1996), which provides a basis for classifying the determinants of trust. It suggests that trust can be considered a dynamic factor in the choice of governance structure. Preliminary empirical evidence provides some corroboration of the theoretical views proposed. This study contributes to the current literature by addressing a specific research question about the role of trust in the adaptation process and by highlighting the idea that trust can extend the range of contexts in which hybrid structures can exist. Elaborating on the existing literature (Fritz et al., 2008), this paper also addresses why trust reduces ex post maladaptation costs and formulates trust as a factor that contributes to stability.

Future research studies on how trust enhances contract outcomes should include a more detailed theoretical inquiry on the role of the various factors discussed in this paper as well as an expanded set of empirical data that rely on the unique research possibilities offered by case study research.

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