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Opportunism and the nature of economic relationships

الانتهازية و طبيعة العلاقات الاقتصادية

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Abstract :

Using a conceptual approach, this paper aims to focus on the main origins that allow an economic party to behave in an opportunistic way by giving rise to an organizational coexistence of three contract structures linking the firm with external economic actors. The results suggest that the choice of one of the three forms of the contract depends on the level of opportunism that may be perceived; and this to surround such behavior.

Keywords: Opportunism; Uncertainty; Economic relationships; Contract; Organizational Governance.

Jel Classification Codes : D21, D23, L24.

Résumé:

En utilisant une approchant conceptuelle, ce papier vise à se concentrer sur les principaux origines qui permettent à une partie économique de se comporter de manière opportuniste en donnant naissance à une coexistence organisationnelle de trois structures du contrat liant la firme à des acteurs économiques externes. Les résultats suggèrent que le choix d’une forme parmi les trois autres formes du contrat dépend du niveau de l’opportunisme éventuellement perçu, et ce pour cerner un tel comportement.

Mots clés : Opportunisme; Incertitude; Relations Economiques; Contrat; Gouvernance Organisationnelle.

JEL classification: D21, D23, L24.

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1. Introduction.

In the economic literature, three modes of resource coordination allow different parties to meet their own needs. For a so-called client firm, the appearance of a new endogenous requirement leads to a balancing of three different solutions in terms of their form, application and longevity (Ménard, 2004; Huo et al., 2018). The first solution remains the most traditional recourse. This is the Insourcing of a transaction to serve internal needs. The firm entrusts the management of this transaction to internal departments within its internal organizational boundaries. However, the second option is the market structure. In this context, the client firm turns to anonymous parties who offer their services and/or products in the market. On the other hand, the solution introduced late in the economic sphere refers to inter-firm cooperation. This hybrid governance structure refers to a cooperative relationship that joins the client firm with legally independent external firms (Dogerlioglu, 2012).

Various factors have been cited in the literature as determinants of the most appropriate form to be chosen. Opportunism is one such factor. For several decades, behaving in an illegal manner with the other party has led to ex-ante and ex-post dysfunction in the relationship (Nemmiche et al., 2014; Huo et al., 2018). Opportunism is one of the pillars of transaction costs theory. With his famous theory, Williamson introduced the new concept of economic opportunism, building on earlier contributions that somehow introduced the notion of the economic agent as an altruistic person seeking to maximize his personal utility at the expense of the other pole (Williamson, 1993b, 2010; Doganoglu and Inceoglu, 2020).

Admittedly, opportunism is seen as a major source of transaction costs. From the perspective of seeking to reduce overall costs by reducing transaction costs, an appreciation of opportunism thus becomes essential before moving towards one governance structure or another. This paper will broaden the impact that opportunism has on determining the relational nature of the client firm's relationship with other parties.

The purpose of this paper is to answer the following question:

Is there a relationship between opportunism and the nature of the contract chosen by the client firm?

So, we will formulate our hypothesis as follows:

There is a relationship between opportunism and the form of the contract chosen by the client firm.

To do this, the conceptual approach discussed in this paper seeks to link opportunism with the nature of the contract chosen in relation to the governance structure that provides a limiting framework for such illegal behavior.

2. The Theoretical Rationale for Economic Opportunism

After having considered for a long time the economic agent as a homo-economicus possessing perfect or pure rationality in a supposedly certain environment in which information is freely transmitted without incurring costs, work such as that carried out by Knight (1921), Simon (1951), Coase (1937), Alchian and Woodward (1988) and Williamson (1991, 1993a, 1993b) has led to the emergence of new concepts historically neglected by researchers. The introduction of the notion of uncertainty and limited rationality allowed Williamson to give a behavioral interpretation based on the notion of transactions costs (Williamson, 1979).

As for Knight's contribution, the author distinguishes between two very similar and often confused concepts: risk and uncertainty has given rise to an economic applicability of what is called external and internal uncertainty. Knight (1921) considers risk to be a situation in which agents know in advance all probable outcomes. Uncertainty, however, is a situation in which agents cannot conceive in advance of all probable outcomes. Following the work of Knight (1927), uncertainty has become a widely debated topic of analysis (Williamson, 2010). The concept of uncertainty is briefly quoted in Coase (1937). The existence of the firm and the issue of internalizing certain transactions may be partly due to uncertainty in the market. This Coasian suggestion subsequently made uncertainty one of the main criteria for choosing between using the firm or the market.

In a broad sense, three sources of uncertainty have been identified. These include the lack of information relevant to decision making, information overload and difficulty in selecting information, and ambiguity of available information i. e. the difficulty of interpreting this information effectively. Subsequently, changes in the environment are seen as another major source of uncertainty, especially with the increasingly rapid and unpredictable evolution of actors'; actions in the firm's environment (Arrow, 1969). For his part, Simon (1951, 1991), contrary to neoclassical theory, considers that the human mind has a very limited capacity to formulate and solve complex problems. According to the author (1957, p. 198): "The capacity of the human mind for formulating and solving complex problems is very small compared with the size of problems whose solution is required for objectively rational behavior in the real world". The author sees that, unlike the hypothesis of substantial rationality of homo-economicus proposed by neoclassical theory, agents possess a procedural or limited rationality because they stop their search once they find a satisfactory and not an optimal solution [1] This is why we sometimes speak of satisfying and not maximizing and preferable and not optimal (Williamson, 1991). According to Simon, a so-called organizational man has partial information and is there fore characterized by a behavior of simple satisfaction (Mahoney, 2005).

In his famous article: The theory of the firm, Coase (1937) was able to criticize and put a slice for neoclassical analysis. Coase (1937) initially sought to explain the coexistence of two economic poles: the firm and the market. Hence, the author has introduced the new concept of transaction costs, which has not occurred before. For Coase (1937, p. 390): "The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price Mechanism". This Coasian contribution considerably changed the theoretical spirit of the economy deployed at that time. On the one hand, the market/hierarchy dichotomy imposed itself as an organizational dualism allowing a firm to satisfy its different needs. On the other hand, the new concept of transaction costs becomes a main analysis center for different target flows that appear later.

In the line with Coase (1937), Williamson, in the course of his work, aimed to reintroduce the problem of the shifting boundaries between firm and market. Williamson put transaction costs into his analysis centre, which allowed it to establish a new economic approach called transaction costs theory. In recent decades, this theory has remained an unrivalled theoretical basis to which researchers often refer in

[1]The concept limited does not come back to the irrational sense, but to the sense that individuals do not have all the information to make a purely rational choice by considering all possible solutions.

order to provide a framework for the organizational choices of firms. For Williamson, the nature of the economic agent (opportunism and limited rationality) and the nature of the transaction (asset specificity, uncertainty and frequency) are those that determine the level of transaction costs and therefore the choice of one of the three governance structures after the introduction of a hybrid form of economic relations called inter-firm cooperation.

The individual according to Williamson is inherently opportunistic. This behavior is defined as: “a deep condition of self-interest seeking that contemplates guile” (Williamson, 1988, p. 68). This human nature is reflected in the attempt to maximize self-interest through behaviors such as lying, deception and non-disclosure of information. Williamson (1981) considers that the highest level of self-interest is opportunism and the lowest level refers to the fact that one of the parties will not be aware of the poor performance of the contract. When an economic agent attempts to engage in opportunistic behavior, it will conceal and only partially reveal the information it possesses. This may reveal distorted or falsified information about his abilities, preferences or intentions. An informational imbalance is therefore emerging between the two contracting parties (Nemmiche et al., 2014).

Referring to Williamson, Alchian and Woodward (1988) were able to draw out two forms in which opportunistic behavior can occur. The first is possibly observed before the transaction is completed. Under the name of adverse selection, this pre-contractual or ex-ante opportunism corresponds precisely to cheating prior to the signing of the contract. For Akerlof (1970), ex-ante opportunistic behavior is reflected when one of the actors in the relationship takes advantage of the poor knowledge of the other party to sell him a product or service under degraded conditions. However, the second form of opportunism observed after the contract has been awarded is that of post-contractual opportunism, also known as moral hazard. This opportunistic behavior can be observed when the salesperson begins to manage the function entrusted by the client firm. Precisely said, this occurs when a homo-contractor behaves differently from what has been foreseen and anticipated by the other party in the contractual relationship, while assuming that verification of compliance will be costly due to the incompleteness of the contracts (Koenig, 1993; Wang et al., 2021).

3. Opportunism and the nature of the contractual relationship

In general, Williamson (1991) suggests that opportunism is made possible when the future is uncertain for agents with limited rationality. In this sense, there is a strong positive relationship between opportunism and the duration of the contract between two economic agents. This observation will allow us to deduce that the merchant contract often referred to as a classic contract is less exposed to the threat of such behavioral risk. From this angle, Brousseau (1993) sees this contractual form as the closest to contractual completeness.

To carry out this proposal, two factors are taken into account: the specificity of the product or service for which the firm uses a third party and the duration of the contract. With respect to the first factor, the market has long been the simplest solution for a client firm to offer generic products or services to meet the standard needs of anonymous parties. Therefore, the identification of the parties is negligible. There is little or no uncertainty in this case because the customer can easily choose from the existing offer what is most appropriate in terms of quality and cost, can cancel the purchase procedure, or even resort to another party. The latter is easier when competition is intense between vendors offering similar products (Espino-Rodríguez and Lai, 2014).

As for the second factor, the very short duration of the classical contract means that what a client firm needs is immediately available. Once the firm has reviewed the offer, it may forward it directly to its possession if it deems it appropriate. Furthermore, the seller may in this case neither conceal defects nor promise subsequent improvement. The immediate offer of products or services leaves no room for current or future uncertainty and therefore the scope for opportunistic behavior by the seller becomes extremely limited.

With regard to the second form of contract, which is the contract of employment or subordination, the latter leaves only marginal area for behavioral freedom that could give rise to opportunism. This is because the subordination contract, although sometimes very long, is very complex. This complexity arises mainly through the implementation of a good number of contractual clauses read and accepted by the primary manager of a firm and the new employee (Simon, 1951). This contractual form narrows the possibility of the emergence of economic opportunism. The monitoring and surveillance procedures followed by the responsible party provide an extremely narrow field of freedom, which identifies the other party's ability to become opportunistic (Frank and Henderson, 1992).

The last form of contract is the neoclassical contract; a contract associated with medium or long-term relationships between two legally independent parties. It is a hybrid form of organizational relationships that brings together a party called the client and a party called the provider when talking about services and the supplier when talking about products. It is in this type of contract that economic opportunism is well illustrated. Certainly, this particular form of economic relations reflects the place of origin of opportunism. The neoclassical contract is an important object of analysis addressed by researchers who put opportunism at the centre of their studies. In this context, the example of the contract between General Motors and Fisher Body in 1926 remains a basic reference for the authors to clearly reveal the negative impact of opportunism on the adoption of inter-firm cooperation[2]

The question that then arises is to question this strong relationship between the neoclassical contract and opportunism. The answer simply comes down to the duration of such a contract, which adds to the uncertainty, and the nature of the transaction for which the firm is using a dual cooperation. To be precise, the neoclassical contract usually runs for an almost long period of time. This contractual period is likely to be characterized by considerable endogenous as well as exogenous uncertainty (Tirole, 1999; Thu Tran et al., 2021). Indeed, this contractual incompleteness leaves more and more opportunity for behavioral opportunism. Although contracting

[2]The opportunism exercised by Fisher Body as a supplier during the execution of the subcontract led to a reorientation of the strategy followed by General Motors by reinternalizing the metal body production function ((Ménard and Shirley, 2008).

parties always seek to diversify contractual clauses and strengthen their completeness before the contract is signed, they will never be able to cover all possible scenarios. The neo-classical contract remains inherently incomplete and will never be complete[3] Change of any kind produced in the external environment of firms has a decisive impact not only on the client firm or the function entrusted to a third party, but also on the other party responsible for managing that function. The occurrence of an unforeseen change after the conclusion of the contract obliges both parties to renegotiate it to incorporate it, which leans the profit towards the provider. The latter can easily take illegal advantage of the contractual relationship either by increasing his monetary profit or through deterioration in quality that is difficult for the customer firm to appreciate (Conner and Prahalad, 1996).

As to the nature of the transaction carried out in the form of inter-firm cooperation, it is fair to say that this organizational form is associated with transactions with considerable specificity. In other words, the assets deployed to manage this function have a high specificity based on what is required by the client firm (Williamson, 1991, 1993a). However, the client firm is obliged to use the hybrid form for certain requirements when the market fails to satisfy them and when it does not have the resources to manage the function within its borders (Gulbrandsen and Sandvik, 2009). From then on, the neoclassical contract becomes the only solution through which the firm meets its own needs. The provider sees from him that the firm needs his services and that it is unable to change him, especially in a monopoly or weak competition situation. In this case, it guarantees the longevity of the contract even if the other party engages in opportunistic behavior (Anderson et al., 2000; Thu Tran et al., 2021).

4. Results and discussion

It is fair to say that the degree of potential for opportunistic behavior is increased in a co-operative relationship between firms. The long duration of the contract between the client firm and its provider gives rise to altruistic attempts to maximize personal utility at the expense

[3] The concept of the incomplete contract is emphasized by Williamson (1975, 1985) and then taken up and developed mainly by Grossman and Hart (1986) and Hart and Moore (1988).

of others. The decision-making interdependence between the two economic poles and the informational imbalance between them - generally leaning towards the provider holding the information- creates a framework of behavioral freedom to behave in an opportunistic manner. In contrast to the hybrid structure of economic relations, the very short duration of the market contract, in which the identification of the parties often remains negligible, narrows the possibility that the other party will be opportunistic. This is why the market contract is the closest to contractual completeness, which remains an imaginary situation for economists.

For its part, the hierarchical structure that surrounds a set of endogenous relationships within firm boundaries identifies illegal behavior by parties belonging to the same firm. Even if the employment contract is very long in comparison with the other two governance structures, but the complexity of the contractual clauses and the sphere of voluntary subordination and unilateral decision-making rule out any kind of illegal behavior that could take place on the part of each of the contracting parties, i. e. the superior and the subordinate.

Indeed, the hypothesis that suggests the existence of a relationship between opportunism and the preferred contractual form for a client firm is confirmed. Opportunism has a major effect on the choice of organizational form based on the form of the contract that identifies such behavior.

The following table summarizes the main results indicated in this research.

Table: **The form of the relationship between opportunism and the nature of the contract and the governance structure chosen.**

		Opportunism			
	Nature of contract	Uncertainty	Decisional nature	Information unbalance	
Market	Classic	Weak	Unilateral	Weak	Weak
Hierarchy	Subordination	Weak	Unilateral	Weak	Weak
Cooperation	Neoclassic	Strong	Unilateral	Strong	Strong

Source: according to the authors

5. Conclusion

It is necessary to say that economic opportunism can never be avoided. The contractual incompleteness that gives rise to such behavior is the immediate consequence of uncertainty. In this sense, primitive economic analyses aimed at giving a rational interpretation to the decisions taken by firms have somehow neglected uncertainty as an intractable constraint. The reality of the existence of the said uncertainty not only complicates relations with others, but also has a decisive effect on the organizational choices of firms. In this context, and given that uncertainty is a function of the duration of the contract between two homo-contractors, opportunism often becomes an embarrassment that hinders firms from using one of the forms of inter-firm cooperation.

In fact, we really see that many firms avoid the hybrid organizational solution simply because they do not consider the other contracting party to be absolutely trustworthy. Therefore, the advantages produced by a collaboration between two economic parties in the form of sub-contracting, outsourcing, mergers and acquisitions, etc., can be exploited to the full. Only partially encourage the use of such inter-firm cooperation strategies. Opportunism is therefore a behavior expected or even expected by the client firm. As a result, opportunism is unquestionably becoming one of the main reasons for a strong substitutability between the three organizational forms: the market, the firm, and inter-firm cooperation.

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