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DESIGNING EFFECTIVE CONTRACTS: EXPLORING THE INFLUENCE OF FRAMING AND EXPECTATIONS

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How a contract influences the exchange and ongoing relationship between parties is an unresolved issue. While some suggest contracts negatively or positively influence the exchange and relationship, we argue that the contract frame determines its impact. Using regulatory focus and expectancy violation theories, we argue that promotion- and prevention-framed contracts induce different emotions, behaviors, and expectations, leading to different exchange outcomes and relationships, depending on the context. By considering contract framing, we provide new research opportunities in areas that use contracts to achieve desired outcomes.

While the use of contracts is ubiquitous in interfirm transactions, the effect of using formal contracts has been debated in various research streams. In transaction cost economics (TCE), Williamson (1975, 1985, 1996) has argued that contracts are merely necessary safeguards that protect each firm against the potential for opportunistic behavior, thus enabling exchanges to occur. Scholars in other research domains have argued that in attempting to mitigate threats from opportunistic behavior, formal contracts actually serve to foster distrust and bring about the very actions they are designed to prevent (e.g., Dyer & Singh, 1998; Ghoshal & Moran, 1996; Malhotra & Murnighan, 2002; Ring & Van de Ven, 1992, 1994).

More recent research, however, suggests that the actual impact of contracts may be more nuanced. Work dissecting contracts indicates that some clauses play a coordination role, which does not provoke distrust between the parties, while other clauses mitigate opportunism and may well pose barriers to trust development (e.g., Vanneste & Puranam, 2010). Additionally, other research has shown that some firms add more task description and process detail to their contracts without negatively impacting their relationship, as the two parties learn to write more effective contracts with one another (Mayer & Argyres, 2004). These studies examine how different parts of a contract impact the relationship in opposite ways (technical versus legal detail in Vanneste and Puranam [2010] and enforcement versus expectation alignment clauses in Mayer and Argyres [2004]), providing a more nuanced understanding of the impact of formal contracts on relationships than what was previously offered. In contrast, we argue that contractual safeguards (enforcement clauses, legal detail, etc.) are not necessarily detrimental to buyer-supplier relationship development and that expectation alignment clauses or technical detail is not necessarily benign. Instead, we suggest that framing influences how the elements of the contract will impact the exchange and the ongoing relationship between firms.

Contracts have a clear economic impact on an exchange. They capture the agreed upon terms when one party receives a product or service in return for valuable consideration from another party, and they provide a mechanism to safeguard the exchange (Macaulay, 1963). However, contracts can also psychologically influence exchanges. Contract frames can induce specific emotions, behaviors, and views of the relationship. They can set specific expectations about the exchange and relationship (Rousseau & Parks, 1993), which subsequently may be met or

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violated, leading to additional emotional reactions. To address the role of framing and expectations in contracts, we use two theories from cognitive and social psychology: regulatory focus theory (RFT; Higgins, 1997, 1998) and expectancy violation theory (EVT; Bettencourt, Dill, Greathouse, Charlton, & Mulholland, 1997; Burgoon, 1993; Jussim, Coleman, & Lerch, 1987).

RFT differentiates between a prevention frame and a promotion frame, each of which leads to distinct interpretations of goals in the exchange, emotional and behavioral reactions, and views and expectations of the exchange and the relationship. A prevention frame leads to an interpretation of a goal as minimal (something that must be met), which induces high-intensity negative emotions if the goal is not achieved and low-intensity positive emotions if the goal is met. Thus, under a prevention contract frame, both parties display vigilant behavior in the exchange in an effort to avoid missing the minimal goal. The focus on detecting negative behavior in the exchange leads to neutral to negative emotions, which form the basis of arm's-length relationships. Extant research on contracts implicitly views them as prevention-framed devices, focused on inducing vigilant behavior in both parties to prevent potential opportunistic behavior and avoid missing minimal goals (Ghoshal & Moran, 1996; Malthotra & Murnighan, 2002).

Conversely, under a promotion frame, parties view the same goal as maximal (something that would be ideal if reached). If a maximal goal is missed, low-intensity negative emotions are experienced, whereas if a maximal goal is reached, high-intensity positive emotions are induced. Thus, in an effort to reach the maximal goal and avoid sins of omission, parties display more flexible and creative behavior. Promotion contracts focus on positive behavior in the exchange, inducing positive emotions, which set the stage for closer ongoing relationships. Thus, we argue that the decision to frame a contract in a prevention or promotion manner impacts both the focal exchange and the broader relationship between firms.

We complement our application of RFT to contracts with EVT, which suggests that meeting and violating expectations set by contract framing lead to specific emotional reactions that further influence the exchange and relationship. By combining these two theories, we are able to offer a more nuanced look at how contracts influence transactions and exchange relationships, thus addressing the debate about the effect of contracts on relationships and relational governance (e.g., Poppo & Zenger, 2002). We also provide insights into how to strategically use contracts to better manage exchanges and partner relationships. In order for contract framing to be strategically important, we focus on transactions in which the contract plays an important role in defining and governing the exchange and relationship, particularly when the parties have to interact to complete the transaction.

We begin the article by briefly discussing the psychological impact of contracts and then proceed to an overview of RFT and EVT. After this we describe the prevention role for contracts (an implicit assumption in most prior contract research) and offer an alternative promotion role for contracts. We then use these insights to develop a series of propositions regarding the effects of framing and expectations on the exchange and ongoing relationship between parties.

THE PSYCHOLOGICAL IMPACT OF CONTRACTS

Although we know a great deal about how contracts have been used to mitigate exchange hazards by enacting specific safeguards (see Shelanski & Klein, 1995, for one review of work in this area), we know very little about the psychological impact of contracts. Contract framing may offer one potential mechanism to psychologically impact the exchange or ongoing partner relationship. For example, a duration safeguard can be framed as a shorter contract with an extendability option (seen as a potential gain) or as a longer contract with an early termination option (seen as a potential loss). The payoffs are identical regardless of the frame, but the impact on the exchange is still very different (Weber, Mayer, & Macher, in press). An IT service manager revealed that when a customer terminated a contract early, one of the engineers got angry and took it personally, although the same engineer did not react negatively when parties did not extend a contract. Similar reactions occur if a financial incentive is framed as a bonus or a penalty. If a bonus is missed, people are less upset than if they have to pay a penalty, even if the net financial impact is the same (i.e., a higher up-front amount with a penalty or a lower up-front amount with a bonus). Thus, people have very different perceptions of the same contract clause, depending on how it is framed.

We also often observe many contractual safeguards framed in different ways that can lead to alternative perceptions of the exchange (see Table 1 for some common examples). Taken together, these examples highlight the importance of understanding how contract framing psychologically impacts the parties involved in the exchange. Using RFT and EVT to examine contract framing enables us to understand why certain contract frames lead to positive transaction outcomes and relationships while others negatively impact the focal exchange and ongoing relationship.

RFT AND EVT

RFT suggests that people view the world through a prevention focus or a promotion focus (Higgins, 1997, 1998). The prevention view is guided by oughts and leads to the perception of a goal as minimal—something that must be reached (Brendl & Higgins, 1996). Alternatively, the promotion view is guided by ideals and leads to the perception of the same goal as maximal—seen as a gain if met (Brendl & Higgins, 1996). Because the same goal is perceived as a minimal goal under a prevention view or a maximal goal under a promotion view, reaching or missing the goal leads to very different emotions, behaviors, and views of the relationship.

TABLE 1
Differential Framing of Common Contractual Safeguards

Safeguards	Prevention	Promotion
Payment for performance	Penalty	Bonus
Performance milestones	Specific, detailed	Higher level, general
Duration	Early termination	Extendability
Quota	Take or pay	Bonus for meeting
Price adjustment	Increase with negative events	Decrease with positive events
Exclusivity	Penalty if violated	Bonus if honored
Contract type	Fixed fee	Time and materials

Dispositional versus Situational Regulatory Focus

Most people have a dispositional tendency to view the world from either a prevention or a promotion perspective. In addition, the tendency to view a goal in one way or another can be overridden through a situationally induced regulatory focus. Loss framing can induce a prevention focus, while gain framing can induce a promotion focus. Of primary importance, however, is that despite the origin of the regulatory focus (dispositional or situational), the outcome is identical. Both dispositional and situational prevention frames lead to the perception of a goal as minimal—something that must be met—leading to emotions and behaviors specific to this view. Additionally, promotion frames that are dispositional or situational lead to the view of a goal as maximal—an ideal—which induces emotions and behaviors specific to this view. Thus, both a dispositional and a situational regulatory focus will produce the emotional, behavioral, and relationship differences discussed below.

Emotional Differences

Under a prevention view, missing a minimal goal leads to high-intensity agitation,[1] whereas reaching it leads to low-intensity contentment (Higgins, 1998). In contrast, under a promotion view, reaching a maximal goal results in high-intensity happiness, whereas missing it leads to low-intensity disappointment. Evidence for these emotional differences can be found in a variety of studies. For example, Higgins, Shah, and Friedman (1997) demonstrated a positive correlation between a situationally induced promotion view and disappointment-related emo-

[1] In the original work on RFT, Higgins (1997, 1998) used the terms *agitation* and *quiescence* to describe the emotions experienced under a prevention focus and *dejection* and *cheerfulness* to describe those experienced under a promotion focus. In this article we use the term *contentment* in place of quiescence, *disappointment* in place of dejection, and *happiness* in place of cheerfulness since we have found it easier to convey the essence of RFT to a strategy audience using these terms.

tions when subjects listed ideal traits they felt they did not possess, and a prevention focus and agitation-related emotions when subjects listed ought traits they felt they did not possess. In a second study in the same paper, the authors induced regulatory focus through loss- and gain-framed task instructions. They found that when the instructions were promotion framed, attaining the goal led people to experience high-intensity happiness; however, when the instructions were prevention framed, goal attainment led to an experience of low-intensity contentment.

Behavioral Differences

The emotions induced by different regulatory views directly influence behavior as well. Under a prevention view, the desire to avoid high-intensity agitation outweighs the desire to experience low-intensity contentment. Therefore, a prevention frame induces vigilant behavior in order to meet the minimal goal and to avoid sins of commission. In contrast, under a promotion view, the desire to experience high-intensity happiness outweighs the desire to avoid low-intensity disappointment. Thus, a promotion frame induces greater creativity and flexibility in an effort to meet a maximal goal and to avoid sins of omission.

Providing evidence for these ideas, Förster, Higgins, and Taylor-Bianco (2003) showed that people with a dispositional promotion focus completed more pictures but missed more dots when connecting them (creativity), whereas prevention-focused people finished fewer pictures but connected more dots (vigilance). Additionally, Higgins et al. (2001) showed that dispositionally promotion-focused people were more likely to avoid an error of omission than prevention-focused people in a scenario concerning changing travel plans after a deposit was already made. However, they also showed that people high in dispositional prevention focus were less likely to commit an error of commission in an investment scenario than people with higher promotion scores. Furthermore, Shah, Higgins, and Friedman (1998) showed that when task requirements match regulatory view (dispositional or situational), task performance is enhanced, compared to when there is a mismatch between these two items. Hence, using contract framing to induce a regulatory view that matches the task requirements (prevention for vigilance and promotion for creativity or flexibility) should positively influence exchange performance.

Relationship Differences

The different regulatory frames impact the perception of the relationship as well, in two ways. First, the different frames lead to different foci within the exchange. A promotion view leads to an emphasis on positive aspects of the exchange, whereas a prevention view highlights negative aspects. The predilection is demonstrated in a study in which dispositionally prevention-focused people listed greater numbers of negative thoughts about a partner or a relationship whereas promotion-focused people generated more positive thoughts (Tykocinski, Higgins, & Chaiken, 1994). Different foci lead parties to interpret ambiguous behavior as negative under a prevention frame and positive under a promotion frame, impacting how the parties perceive one other.

Second, the different frames lead to different emotions, which form the basis of more arm's-length or close, cooperative relationships. Under a prevention frame, parties experience high-intensity agitation if the goal is not met and low-intensity contentment if the outcome is successful. As a result, the emotions experienced by the parties range from slightly positive to extremely negative, none of which form the basis for a close, cooperative relationship (Gross & John, 2003). In contrast, under a promotion focus, parties experience high-intensity emotional upsides if goals are met and low-intensity emotional downsides if they are not, resulting in slightly negative to extremely positive emotions. Since positive emotions between parties can serve as a potential basis for higher levels of perceived personal closeness and commitment (Gross & John, 2003), promotion frames are more likely to lead to higher levels of partner satisfaction and commitment in exchange relationships (Winterheld & Simpson, 2006).

Prior Application of RFT

Because of its dispositional elements, RFT can be used to predict when someone's dominant regulatory focus will impact his or her behavior or performance. RFT's situational elements can also be used to strategically induce desired behaviors to increase performance. Investigators in many fields have examined how dispositional and situational regulatory foci impact various phenomena in managerial contexts.

Dispositional

Researchers have examined how a dispositional regulatory focus influences the probability of certain behaviors in a business context. Entrepreneurs have been shown to be more successful when they can shift between prevention and promotion foci (Aidis, Mickiewicz, & Sauka, 2008). Additionally, Kark and Van Dijk (2007) have theorized that leaders' dispositional regulatory foci influence their leadership style.

Situational

Situational regulatory focus has been investigated in a business context. In entrepreneurship, Baron (2004) has suggested that idea generation is more successful under a promotion view than a prevention view, while others have shown that due diligence performance is enhanced when approached with a prevention focus (Brockner, Higgins, & Low, 2004). Additionally, Kark and Van Dijk (2007) have theorized that a leader's regulatory focus can situationally induce a regulatory focus in his or her employees, which influences individual- and group-level performance. Galinsky, Leonardelli, Okhuysen, and Mussweiler (2005) also have shown that framing negotiation issues as gains/nongains leads to more integrative, cooperative outcomes than framing them in terms of loss/nonloss. Additionally, greater effort (Roney, Higgins, & Shah, 1995) and greater search for creative solutions (Pham & Higgins, 2005) are evidenced with gain/nongain frames than with loss/nonloss frames. Finally, Weber et al. (in press) used RFT to empirically show when extendability clauses are more likely to be used. The scope of the study was limited, however, given that it only considered the promotion framing of one particular safeguard.

RFT AND EVT IN CONTRACTS

Framing contractual safeguards in terms of losses or gains situationally induces a prevention or promotion focus (Roney et al., 1995; Tykocinski et al., 1994) in an exchange, which can be used strategically to activate the desired behaviors and attitudes associated with each of the profiles. Thus, RFT (Higgins, 1998) suggests that the safeguards in a contract can be framed as a loss (e.g., a penalty) to induce intense vigilance and monitoring (a prevention frame) or as a gain (e.g., a bonus) to incite cooperation and flexibility (a promotion frame), without significantly changing the economic impact of the safeguard. Prevention and promotion contracts set very different expectations for exchange outcomes and behavioral manifestations of the relationship between the exchange partners. Because contract framing sets different expectations, meeting or violating these expectations also shapes the impact of the contract on the relationship.

EVT (Bettencourt et al., 1997; Burgoon, 1993; Jackson, Sullivan, & Hodge, 1993; Jussim et al., 1987; Kernahan, Bartholow, & Bettencourt, 2000) suggests that when an expectation is met, people experience medium-intensity emotions in the direction of the expectation. Initially, an individual experiences a slight positive reaction if his or her expectations are met, because predicting future events is important for survival. If a positive expectation is met, a moderately intense positive emotional reaction then occurs. So, overall, the individual reacts positively to the event. In contrast, if a negative expectation is met, the individual experiences the initial slight positive emotion followed by a moderately intense negative emotional reaction as a result of the negative event. The situation changes drastically, however, when expectations are violated.

When expectations are violated, the individual experiences high-intensity emotions in the direction of the violation. If a positive expectation is negatively violated, then a very intense negative emotional reaction occurs. The reaction is a combination of negative feelings stemming from the experience compounded by additional negative emotions due to violated expectations. However, when a negative expectation is positively violated, a very intense positive emotional reaction ensues (Bettencourt et al., 1997; Burgoon, 1993; Kernahan et al., 2000), and this overcomes any initial negative feelings generated by the violation of expectations.

As suggested above, prevention and promotion contract frames from RFT set different expectations for behavior within the transaction and the exchange relationship. Prevention and promotion frames also create very different expectations for the exchange and the relationship between the parties. In the exchange a prevention frame sets the expectation that minimal goals will be achieved. In contrast, a promotion frame sets the expectation that a maximal goal will be pursued vigorously, although not necessarily attained. Additionally, a prevention frame sets an expectation of an arm's-length relationship where neutral to negative behaviors are anticipated. Alternatively, a promotion frame sets expectations of a close, cooperative relationship where both parties are more likely to display positive behaviors that are beyond the letter of the contract. EVT addresses the effects of meeting or violating these expectations. So, when taken together, the two theories form the basis for determining when a contract will have a positive or negative impact on the focal exchange and the relationship. The key constructs and effects of these two theories are summarized in Table 2.

Prevention Role for Contracts

Loss-framed contracts play a prevention role because the objective in the exchange is perceived as a minimal goal that must be met, which induces vigilant behavior. The choice to frame a contract in a prevention manner also influences the type of details outlined in the agreement. If the parties choose to frame a contingent payment as a penalty (prevention frame), RFT suggests that the contract will contain highly detailed specifications, including potential contingencies, because a prevention frame induces detail-oriented (or local) information processing (Förster et al., 2003). Thus, the supplier will be vigilant in meeting the detailed specifications in the con-

TABLE 2
Key Constructs and Assumptions

	Prevention Contracts		Promotion Contracts	
Requirements	**Predominant Loss Framing**		**Predominant Gain Framing**	
Framing effects	View of goal:	Minimal goal	View of goal:	Maximal goal
	Emotional:	High-intensity agitation if goal is missed; low-intensity contentment if goal is achieved	Emotional:	Low-intensity disappointment if goal is missed; high-intensity happiness if goal is achieved
	Behavioral:	Vigilance	Behavioral:	Creativity, flexibility, cooperation
	Relational:	Arm's-length, impersonal, business-like	Relational:	Close, personal, trusting
Expectation effects	Exchange expectations set:	Neutral to negative behaviors	Exchange expectations set:	Neutral to positive behaviors
	Relationship expectations set:	Arm's-length, impersonal, business-like	Relationship expectations set:	Close, personal, trusting
	Expectations met:	Initial low-intensity positive emotion followed by medium-intensity negative emotion = overall medium negative reaction	Expectations met:	Initial low-intensity positive emotion followed by medium-intensity positive emotion = overall medium positive reaction
	Expectations violated:	Initial low-intensity negative emotion followed by high-intensity positive emotion = overall high positive reaction	Expectations violated:	Initial low-intensity negative emotion followed by high-intensity negative emotion = overall very negative reaction

tract, and the buyer will be vigilant in monitoring the supplier.

Prevention contracts also set expectations for neutral to negative behavior in the exchange since they induce a focus on detecting negative behaviors. In addition, they set expectations of an impersonal, detached, business-like relationship between the exchange partners for three reasons. First, the emotions experienced by the parties range from neutral, when the goal is reached, to very negative, when the goal is missed (Higgins, 1998). These negative emotions have been shown to lead to lower ratings of closeness and emotional satisfaction in relationships (Gross & John, 2003). Second, the focus is on negative as opposed to positive behavior in the exchange (Higgins, 1998). This negative focus colors ambiguous behavior in a more negative light, leading to the accumulation of even more negative information. Also, negative information more strongly impacts evaluations than comparably positive information (Fiske, 1980), so the development of positive evaluations of the other party is extremely unlikely. Finally, when an exchange outcome is successful under a prevention contract, a desire to avoid penalties is perceived to have driven the positive outcome, not goodwill between the parties.

The expectation of neutral to negative behavior can be met or violated. Likewise, the expectation of an impersonal relationship can either be met or violated. If the expectations for either the exchange or the relationship are met, the parties experience neutral emotions, which serve to reinforce the business-like relationship in the exchange. However, if these expectations are positively violated (e.g., the supplier goes out of its way to be flexible for the buyer), the parties experience high-intensity positive emotions, which potentially lead to very high partner satisfaction and emotional closeness.

Additionally, a prevention contract sets a positive expectation for the exchange outcome. That is, the parties expect to meet the minimal goal under the prevention contract. If the minimal goal is not met, the positive expectation is negatively violated, leading to even more negative emotions than predicted by RFT itself. As a result, the arm's-length relationship, induced by the negative emotions from the prevention contract, is further reinforced.

Implicit Assumptions in Extant Research on Contracts

Extant research on contracts primarily draws from two theoretical perspectives—TCE and the relational view of governance. TCE focuses on the use of contractual safeguards to overcome exchange hazards and enable an exchange to occur. In contrast, the relational view tends to view such safeguards as having a detrimental effect on the exchange and the relationship between the parties. As a result, it focuses more on informal (noncontractual) governance mechanisms (mainly trust) to facilitate cooperation during an exchange.

TCE. TCE does not explicitly consider framing in its evaluation of contracts as safeguards that enable exchanges to occur. However, in TCE the purpose of the contract is consistent with an implicit prevention assumption. A prevention contract sets the expectation for neutral to negative (e.g., opportunistic) behavior in the exchange. It attempts to safeguard against the negative behavior to allow the exchange to occur. Additionally, a prevention contract positions the task in the exchange as a minimal goal that must be reached, which induces vigilant behavior by the supplier and vigilant monitoring by the buyer. This vigilance, in an effort to avoid sins of commission (failing to deliver on the task), allows the exchange to occur, even in the face of transaction hazards. Thus, prevention contracts play the same role that contracts play in TCE. They are necessary because of either the potential for opportunism (Williamson, 1985) or unintentional misunderstanding due to bounded rationality (Mayer & Argyres, 2004), while ensuring that transactions are able to take place. In spirit, TCE contracts are not used to strive for an ideal (avoid a sin of omission) but to avoid a negative outcome (a sin of commission) by reaching a minimal goal (i.e., completing the transaction), which is consistent with a prevention focus.

The implicit prevention assumption is evident in many TCE contracting studies. For example, take-or-pay provisions (DeCanio & Frech, 1993; Hubbard & Weiner, 1986; Masten & Crocker, 1985), price adjustments (Goldberg & Erickson, 1987; Joskow, 1988), and exclusivity clauses (Gallick, 1984) have all been shown to mitigate specific exchange hazards (i.e., deter specific opportunistic actions). Additionally, Crocker and Reynolds (1993) have shown that firms use less ambiguous safeguards when there is a history of opportunism in the relationship.[2] In fact, even TCE studies showing evidence that contracts do not substitute for trust tend to frame contracts in a manner that is more consistent with a prevention focus (e.g., Lazzarini, Miller, & Zenger, 2008; Poppo & Zenger, 2002).

Because TCE focuses on economic, not psychological, ramifications of the contract, it predicts that contracts containing appropriate safeguards will have a positive impact on the exchange. However, TCE does not explicitly address the impact of the contract on the exchange relationship. Ghoshal and Moran (1996) and others were critical of this conclusion, being much more concerned with the psychological and social impact of the contract on the parties, the transaction, and their overall relationship.

Relational view. The relational view of governance (Dyer & Singh, 1998; Ghoshal & Moran, 1996; Malhotra & Murnighan, 2002; Ring & Van de Ven, 1992, 1994) examines how contracts impact both the transaction and the exchange relationship. Unlike TCE, this view explicitly allows for the influence of emotions on the exchange relationship. However, similar to TCE, it implicitly assumes that contracts play a prevention role.

Several examples in this literature demonstrate the implicit prevention role assumption. Ghoshal and Moran (1996) suggest that contractual safeguards induce negative behaviors in exchanges, which increase the likelihood of opportunism. However, only prevention-framed contracts set expectations for negative exchange behavior, not promotion-framed contracts (an argument we develop below). Additionally, Dyer and Singh (1998) suggest that exchanges governed by trust generate more successful transactions and exchange relationships than those governed by contracts. Here, the argument is that contracts with extensive detail encourage monitoring, prevent flexibility, or inhibit joint value creation initiatives. These issues are primarily characteristic of prevention contracts. Finally, other researchers propose that contracts act as substitutes for informal governance, so contractual safeguards are not necessary if informal governance mechanisms are in place (e.g., Barney & Hansen, 1994; Gulati, 1995; Malhotra & Murnighan, 2002). Again, these scholars make the implicit assumption that contracts do not promote cooperative relationships in exchanges but, rather, drive negative perceptions of monitoring and vigilance.

Promotion Role for Contracts

A promotion-framed (gain-framed) contract plays an entirely different role than a prevention-framed contract. Promotion contracts[3] promote flexible and creative behavior in an exchange. Again, the choice of frame influences the detail used to craft the contract. A promotion frame encourages big picture (or global) information processing (Förster et al. 2003), so instead of the detailed specifications typically found in prevention-framed contracts (e.g., how specific tasks will be performed), promotion-framed contracts contain detail more focused on aligning overall interests than clarifying how to perform specific tasks. Therefore, if the parties choose a penalty frame for a contingent payment (a prevention frame), RFT suggests that the contract will typically include detailed specifications, including potential contingencies; however, if the same contingent payment is framed as a bonus (promotion frame), the contract is more likely to focus on general milestones or the big picture (i.e., aligning expectations by understanding the other party's goals and context) instead of detailed specifications regarding how to complete the project. For example, a contract that provides a large up-front payment but subjects the supplier to a penalty if it does not finish by the deadline will be highly detailed. In contrast, a contract with a smaller up-front payment that offers a bonus if the supplier completes the project on time will contain key milestones, but often will not include all the detail

[2] See Shelanski and Klein (1995) and Macher and Richman (2008) for more thorough reviews of the empirical contract literature that draws on TCE.

[3] Ring and Van de Ven's (1992) idea of relational contracts differs from promotion contracts. Relational contracts are open, incomplete contracts used when a trusting relationship has already been established between the partners. Trust is not a necessary prerequisite for the use of promotion contracts; however, promotion contracts may complement the development of trust between the contracting parties.

on how tasks will be performed that is typical of a penalty contract.

Promotion contracts set expectations of positive exchange behaviors and close, nurturing, interactive relationships between the exchange partners for three reasons. First, the positive emotions experienced if the transaction outcome is positive lead to higher ratings of emotional relationship satisfaction (Winterheld & Simpson, 2006) and commitment to the exchange partner, as well as higher ratings of perceived closeness in the relationship (Gross & John, 2003). Second, a promotion contract creates a focus on positive exchange behaviors instead of opportunistic behavior (Higgins, 1998), which leads to a more positive interpretation of ambiguous behavior. Finally, a promotion frame encourages more integrative or cooperative outcomes between exchange partners when disputes arise (Galinsky et al., 2005), because focusing on ideals discourages parties from settling for a nonoptimal solution, leading them to explore more mutually beneficial outcomes. Because promotion contracts set expectations for close, cooperative relationships, they also set an expectation of positive behavior in the exchange that goes beyond the letter of the contract.

If the positive behavioral or relationship expectations set by a promotion-framed contract are met, the parties experience medium-intensity positive emotions, which further reinforce a positive close, cooperative relationship. However, if those expectations are negatively violated (e.g., the supplier holds the buyer to a time line delineated in the contract to the detriment of the buyer), the parties experience high-intensity negative emotions, which undermine the relationship. Extreme negative emotions decrease feelings of partner satisfaction and closeness, possibly leading to termination of the exchange relationship.

The differential impact of prevention and promotion contracts can be seen in practice. For instance, in an interview with one of the authors, a Silicon Valley project manager said that "failing to get a bonus can get you in trouble but suffering a penalty can get you fired," because management's perception of the two clauses was very different. Another example is a recent paper by Weber et al. (in press) suggesting that firms deliberately frame duration safeguards in contracts in line with RFT. While changing the framing of one clause is unlikely to change the framing of the entire contract, it does suggest that contract framing matters in practice. The parties, however, must consider the overall contract frame, not just that of individual safeguards, to determine its net impact on the exchange and relationship. Additionally, there are many other factors that threaten the potential benefits of a promotion-framed contract, which we discuss in more detail below.

PROPOSITIONS

In developing our propositions, we examine how contract framing and expectancy violation or fulfillment lead to a prevention or promotion role for contracts. We believe that prevention-framed contracts can lead to distrust and even suspicion between parties, whereas promotion-framed contracts have a more nuanced impact on trust. Thus, taking these effects into account leads to a greater understanding of how contracts impact exchanges and relationships.

Impact of Contract Framing on the Exchange and Relationship

There are three TCE assumptions about contracts, the first two of which are explicit while the third is largely implicit: (1) contract designers are boundedly rational, (2) contracts contain appropriate safeguards to mitigate the potential for opportunism, thus enabling the exchange to occur, and (3) contractual safeguards only impact how the parties carry out the exchange and have little effect on the relationship because both parties understand the need to enact barriers to mitigate opportunism. This perspective is in line with the old adage "It's not personal; it's business."[4]

The bounded rationality assumption of TCE only embraces cognitive deficits (limitations in receiving, processing, storing, and accessing information) and verbal limitations (difficulty articulating ideas because correct words do not exist or are not known), leading to incomplete

[4] Even if there were an impact on the relationship and employees of one firm took offense from the inclusion of certain safeguards, proponents of TCE argue that such an emotional response would have much less of an negative impact on the exchange than ignoring hazards that could potentially be mitigated (Williamson, 1996).

contracts and the need for vertical integration in the face of high levels of exchange hazards, such as asset specificity (Williamson, 2000). Not considered in TCE are other psychological influences in the exchange, such as emotions, or cognitive biases, such as framing effects (Weber & Mayer, 2010). While Williamson acknowledges that other psychological influences exist, he believes that they have a relatively minor impact on the make or buy decision central to TCE as compared to this main effect. Thus, the assumption in TCE is that a contract designed to prevent opportunism (playing a prevention role) positively impacts the exchange (ensures it will take place) but does not significantly impact the relationship since there is no psychological implication of including safeguards in the contract.

The relational view also makes the same implicit assumption that contracts play a prevention role. However, because of its emphasis on the psychological impact of the contract, this approach asserts that contracts have a different effect on the exchange and the relationship between the parties. Because prevention framing induces vigilance about strict specifications, it encourages monitoring and a focus on preventing negative events. Together, these effects on exchange behaviors lead to negative emotions between the exchange partners, which Ghoshal and Moran (1996) believe may increase opportunistic behavior in the exchange and undermine the relationship between the parties. Therefore, the combination of the two assumptions (i.e., contracts play a prevention role and have a psychological impact) leads proponents of the relational view to suggest that contracts have an overall negative effect on both the exchange and the relationship. Thus, the main difference between TCE and the relational view, as developed in the extant literature, is not as much about how the contract is framed as it is about whether or not the contract psychologically impacts how the parties feel and behave during the exchange and how they perceive their relationship.

TCE and relational view scholars agree that contracts provide a form of safeguard, but their differential emphasis on the psychological impact of the contract leads to very different conclusions about the overall role of the contract. Both RFT and EVT, however, suggest that contracts psychologically impact the exchange relationship through the different emotions, behaviors, and expectations induced by framing and the fulfillment or violation of the expectations set by the contract. Thus, we begin with the foundational proposition that the design of the contract influences the exchange *and* the ongoing relationship between the parties.

Proposition 1: The design of the contract (inclusion and framing of safeguards) impacts both (a) how the parties feel about and behave during the exchange (thus influencing exchange success) and (b) the development of the relationship between them.

The Impact of Prevention and Promotion Contracts on Relational Governance

Acknowledging the psychological impact of contracts naturally leads to an examination of how they impact transactions and exchange relationships. While many scholars assert that formal contracts impede the development of relational governance (e.g., Ghoshal & Moran, 1996; Gulati, 1995), others see them as complementing relational governance by providing a framework that may aid in developing a close, cooperative relationship (Lazzarini et al., 2008; Poppo & Zenger, 2002; Ryall & Sampson, 2009). Thus, the core issue here is whether formal contracts crowd out the development of trust and relational governance (substitution[5]) or whether they can facilitate the development of relational governance (complementarity). We believe that a great deal of the debate can be addressed by introducing prevention and promotion frames in formal contracts.

[5] Poppo and Zenger suggest that formal contracts and relational governance can be either (1) performance substitutes, "if both relational governance and contract complexity positively influence performance, but negatively influence one another" (2002: 711–712), or (2) governance substitutes, if "formal contracts signal distrust of your exchange partner and by undermining trust, encourage, rather than discourage, opportunistic behavior" (2002: 707). We focus exclusively on governance substitutes (formal contracts crowd out the development of relational governance). While we do mention performance implications in our argument, we argue that under some circumstances using a prevention contract increases performance while trust decreases it (or vice versa), and under other circumstances using a promotion contract increases performance while trust decreases it (or vice versa).

With the differentiation of these two roles (prevention and promotion), parties can now choose among a prevention contract, a promotion contract, and no formal contract, instead of just between a formal contract and no formal contract. The more nuanced view of formal contracts shifts the discussion from *whether* contracts complement or substitute for relational governance to *when* we may observe complementarity versus substitution.

Prevention-framed contracts. The relational view of governance suggests that with repeated interactions the exchange parties supplant formal safeguards in the contract with informal mechanisms, such as trust, or replace contracts with trust entirely (e.g., Dyer & Singh, 1998; Ghoshal & Moran, 1996; Gulati, 1995; Malhotra & Murnighan, 2002). The implicit assumption in this view is that trust and formal safeguards cannot effectively coexist because safeguards create neutral to high-intensity negative emotions between the exchange partners, which hurt the development of trust in the exchange relationship. Prevention-framed contracts contain detailed specifications that dictate exactly how the supplier should meet the exchange goal. Because the supplier's actions are prescripted by the buyer, the supplier is likely to feel that the prevention contract signals the buyer's distrust, which impedes the development of relational governance.

Additionally, prevention contracts create a focus on avoiding negative behaviors (i.e., looking for and seeking to avoid sins of commission), which frequently leads to the interpretation of ambiguous events as negative. A focus on detecting negative behavior generates high-intensity negative emotions, leading to less satisfaction and commitment between the parties, as previously shown (Gross & John, 2003), which again impairs relational governance development. While low-intensity contentment may arise when the transaction is successfully completed in exchanges governed by prevention contracts, the buyer feels the safeguards in the contract, not the character of the exchange partner, led to the positive outcome, so deep feelings of emotional satisfaction and closeness do not develop. Thus, a prevention contract inhibits the development of strong positive emotions, even when exchanges go well, making it difficult for trust (and, thus, relational governance) to develop.

Additionally, prevention contracts set expectations of an impersonal, business-like relationship, leading to neutral to negative exchange behaviors. The expectation of an arm's-length relationship is confirmed in the ongoing exchange, since vigilant behavior and performance to the letter of the contract are seen as business-like but not friendly or personal. The neutral to negative emotions, which result from meeting the expectations, do not increase relationship satisfaction or feelings of closeness (Gross & John, 2003). Thus, a prevention frame crowds out relational governance because it does not aid in the development of trust.

> *Proposition 2: A prevention contract acts as a substitute for relational governance.*

Promotion-framed contracts. In contrast, under promotion-framed contracts, task goals are seen as maximal goals, so creativity, flexibility, and cooperative behavior are induced in the exchange. Promotion contracts specify what the exchange goals are, not how a supplier should specifically accomplish them. As a result, the supplier does not feel that the contract signals distrust, because the buyer is giving the supplier more behavioral autonomy and is not attempting to pre-script the supplier's behavior in the exchange. Additionally, if task goals are met, high-intensity positive emotion (happiness)—previously linked to higher partner satisfaction and commitment to the relationship (Gross & John, 2003)—is experienced. These elements further support the development and maintenance of trust in the exchange relationship. A promotion-framed contract also creates a focus on collaboration (Galinsky et al., 2005) and highlights the detection of positive behaviors (Higgins, 1998). Thus, ambiguous behaviors in the exchange are also interpreted in a positive light, creating even more positive emotions, which further reinforce feelings of partner satisfaction and closeness (Gross & John, 2003), hence building a stronger foundation for relational governance.

Positive behaviors in the exchange also fulfill positive expectations for the relationship set by promotion-framed contracts. When these positive expectations of a close, personal relationship are met, medium-intensity positive emotions are experienced, in addition to the high-intensity positive emotions from successful completion of the transaction, further strengthening the close, personal relationship (Gross & John, 2003) and increasing the possibility that trust will develop, thus facilitating relational governance. When the task that is the subject of the exchange requires flexibility, creativity, or cooperation, a promotion contract is more likely to lead to positive interactions, confirming positive behavioral expectations and providing a solid foundation for the development of relational governance. Thus, under these circumstances, a promotion contract is likely to complement relational governance.

> *Proposition 3a: In a transaction requiring flexible, creative, or cooperative behavior, a promotion contract will complement relational governance.*

However, when the transaction characteristics suggest that vigilant behavior is necessary for the success of the exchange but the parties use a promotion contract to govern it, the contract may either build up (complement) or crowd out (substitute) relational governance. When vigilance needs are high, a promotion contract is unlikely to induce behavior necessary for the success of the exchange; thus, the exchange is more likely to encounter performance difficulties than if the contract governing it were prevention framed. Problems in the exchange will likely result in medium-intensity negative emotions (disappointment) when the minimal goal is not met, which can lead to less relationship satisfaction and commitment (Gross & John, 2003). Because the exchange outcome is more important when vigilance needs dominate, the impact of negative emotions is greater than any other outcome from the promotion contract. Thus, trust development is unlikely if a promotion contract is used. Additionally, if the buyer perceives the supplier's actions as opportunistic, even if that was not the supplier's intention, the buyer will believe that the positive behavioral expectations set by the promotion frame have been violated. When positive behavioral expectations are violated, high-intensity negative emotions are experienced, further acting to undermine the development of relational governance. Thus, under these circumstances, a promotion contract will typically crowd out the development of relational governance.

The effect may be quite different, however, if the parties consciously use a promotion-framed contract in an effort to maintain a long-term, personal, collaborative relationship. When the need to maintain the relationship is significantly greater than the need for an individual transaction to succeed, the parties may use a promotion contract, despite the mismatch of the contract frame with the transaction attributes. The mismatch increases the likelihood of low performance in the individual task, which leads to negative emotions, but these are trumped by the high-intensity positive emotions from meeting the positive behavioral expectations set by the promotion contract. Using a promotion contract in this manner likely complements relational governance if the parties have already established a trust-based relationship.

The key to the success of this strategy is that a prior positive relationship must exist. When starting with a new partner, the performance of the initial exchange plays a key role in forming the relationship, and, thus, the parties will want the frame that best fits the transaction to ensure a successful exchange. A closely related second factor is the prior use of promotion contracts. If promotion contracts have been used in the past, which is likely if the firms have a close, collaborative relationship, then switching to a prevention-focused contract may send a signal of distrust to the exchange partner. Finally, when the success of the transaction is absolutely critical to the health of one or both firms, the needs of the transaction dominate the needs of the relationship, and a prevention-framed contract should be used to minimize the probability of problems in the transaction. Only when the needs of the relationship dominate those of the transaction (i.e., maintaining a close relationship with the partner is more important than the outcome of the current exchange) will positive emotions leading to a close, collaborative relationship be generated, complementing the development of relational governance.

> *Proposition 3b: In a transaction with attributes requiring vigilant behavior, a promotion-framed contract substitutes for relational governance when the needs of the focal exchange dominate or complements relational governance when the needs of the relationship dominate.*

Figure 1 summarizes Propositions 2, 3a, and 3b. These propositions suggest when formal

FIGURE 1
Circumstances Under Which Formal Contracts Will Crowd Out Relational Governance (Substitute) or Facilitate Relational Governance (Complement)

Contract used in exchange	Contract dictated by exchange and relationship characteristics	
	Prevention	Promotion
Prevention	Substitute	Substitute
Promotion	Substitute if exchange needs dominate; complement if relationship needs dominate	Complement

contracts will crowd out the development of relational governance (substitute) and when they will facilitate the development of relational governance (complement). Thus, introducing a promotion role for contracts provides a more nuanced explanation of when contracts complement or substitute for relational governance.

Impact of Promotion Contracts on Exchanges and Relationships

A promotion contract positively impacts an exchange when the supplier suspects that it will not be able to deliver a successful transaction outcome. If a supplier suspects ex ante that it is unlikely to meet the task goals either because the project is in a new area for the supplier or external forces are likely to interfere with its efforts to complete the exchange, it can use a promotion contract to mitigate damage to the relationship by setting appropriate expectations for the exchange outcome (i.e., that the project specifications are ideal goals rather than minimum standards). Using a promotion-framed contract sets expectations of striving for an ideal goal but not necessarily achieving it. As long as the buyer believes that the supplier has acted in good faith and given its best effort, a negative transaction outcome is more palatable to the buyer under a promotion frame than a prevention frame, because the negative emotions from missing a minimal goal are less intense than those experienced from missing a maximal goal.

It is important that the buyer be able to observe the supplier's effort in this situation. If the buyer believes the negative transaction outcome is due to the supplier's negative behavior, a promotion contract will actually harm the relationship, because a violation of positive behavioral expectations will induce high-intensity negative emotions. However, if the buyer believes the supplier is acting in good faith, a promotion contract will set appropriate expectations for the exchange—that the parties will work hard and possibly go above and beyond the call of duty for one another but the outcome is still an aspirational goal that may not be achieved.

Thus, when there is a reasonable possibility that a firm might not be able to properly complete a job, it must factor that reality into how it frames the contract to manage its partner's expectations and subsequent emotional reactions. Such a situation might arise, for example, if a supplier takes on a project outside its core capabilities. Completing the project is going to be a challenge, but the supplier may still want the job to gain high margins, keep it away from a competitor, or enter or increase penetration in a new market. In this situation the supplier should carefully consider the consequences should it fail to complete certain aspects of the transaction, and it should frame the contract appropriately to minimize any potential damage to the relationship. A promotion-framed contract, by setting realistic transaction outcome expectations (i.e., task goals as ideals, not as minimum standards), is preferred when the supplier suspects ex ante that it may not be able to meet performance expectations in the exchange.

> *Proposition 4a: When parties know ex ante that they are unlikely to meet the expectations set by the contract (e.g., failure to meet goals specified in the contract), a promotion contract is more likely to positively impact both the transaction and the exchange relationship than a prevention contract.*

We believe that promotion-framed contracts will lead to more successful exchanges and better relationships when used in situations that call for cooperation, flexibility, and creativity. However, some factors not only vitiate the positive effects of a promotion-framed contract but also cause harm to the relationship. This is the case when there is a high probability that at least one firm's behavior may be perceived as opportunistic, even if opportunism is not intended.

As discussed above, promotion contracts positively impact the relationship when parties' behaviors are positive (i.e., high effort to fulfill their obligations to the partners), even if the transaction outcome does not meet the stated goals. However, when there is an increased likelihood that one or both parties may have their behavior perceived as opportunistic, even if that is not the intention, promotion contracts will negatively impact the relationship—even if the goals of the transaction are met. Promotion contracts set expectations for positive behaviors in the exchange. If these expectations are violated because one party perceives the other's behavior as opportunistic, even if that was not the intention, then high-intensity negative emotions are experienced, damaging the relationship. One instance when such a situation may occur is when a party in an exchange has a reputation for acting opportunistically.

Sometimes a firm must enter into an exchange with another firm that has a history of opportunism. For example, parts suppliers may still enter into deals with GM, even if they have been treated badly in the past or are aware of other suppliers that GM has treated badly. If one of the exchange partners has an established reputation of prior opportunistic behavior, a promotion contract can negatively impact the exchange and relationship, as compared to a prevention contract, even if it is used when creativity, flexibility, or cooperation is required for transaction success. This harm can happen for two reasons.

First, a promotion contract tends to have less detail regarding *how* each party will fulfill its obligations, although the obligations of each firm generally will be clearly specified. Additionally, a promotion contract involves no induction of vigilance in an effort to avoid missing a minimal goal, typically leading to less monitoring by the buyer firm. Hence, if a firm with a history of opportunism actively campaigns to use a promotion-framed contract, the buyer (supplier) firm may see it as an attempt by the supplier (buyer) firm to have more room to act opportunistically. Thus, if a firm with a known reputation for opportunism wants to use a promotion contract, its motivation is already perceived as suspicious.

Second, the perceived negative (opportunistic) behavior violates the positive behavioral expectations set by the promotion contract. The violation leads the parties to experience high-intensity negative emotions. These emotions hurt the relationship between the two parties by undermining partner satisfaction and feelings of closeness (Gross & John, 2003). The core issue is that the expectations of each party are influenced by more than just the contract frame—the contract is not designed in a vacuum. If one firm is already suspicious of the motives of the other, then a promotion contract may not be enough to alter that perception. The overall expectation set by the promotion contract is that the firm will act in good faith, but when the partner has a reputation for opportunism, the exchange partner is likely to interpret the other firm's behavior through the lens of its bad reputation.

Thus, even if managers at the firm with an established reputation for opportunism truly want to turn over a new leaf, using a promotion contract is still likely to negatively impact the exchange relationship. The established reputation for opportunism overshadows the contract's focus on positive events, so the other party will still concentrate on detecting deviations from specifications. The negative focus from the reputation leads ambiguous events to be interpreted negatively, so even unintentional breaches may be seen as intentional. These breaches are even more damning in that the positive behavioral expectations set by the promotion contract are now violated, leading to high-intensity negative emotions toward the partner.

In such a situation a prevention contract, with an expectation of neutral to negative behavior, better fits what the partner is likely to expect from the firm with a history of opportunism. If the firm with the bad reputation is perceived to have acted opportunistically, but that behavior has not impacted the final outcome of the exchange, then the positive expectations for the transaction outcome and the negative behavioral expectations set by a prevention contract are confirmed. The parties will not become close partners, but they could develop a productive, arm's-length relationship. Additionally, if the firm with the negative reputation has gone out of its way to positively violate the negative behavioral expectations, it might induce high-intensity positive emotions in its exchange partner, which will aid in the development of a close, committed relationship. Thus, one partner's reputation for opportunism is a significant challenge to the positive effect of promotion-framed contracts on the exchange and relationship.

> *Proposition 4b: When one party to the exchange has a reputation for behaving opportunistically, a promotion-framed contract is more likely to negatively impact both the transaction and exchange relationship than a prevention contract.*

Using Formal Governance versus Relational Governance

Thus far, we have focused on how contract framing and expectations impact the exchange and relationship. But our ideas have additional implications for the debate on the relationship between formal contracts and relational governance by addressing how contract framing influences the choice of using a formal contract versus the no contract option that is the preferred alternative of many relational governance scholars. We begin with a brief comment on the no contract option.

A no contract option in an exchange is primarily a legal fallacy, since the vast majority of agreements involving a mutual decision to accept and give consideration (e.g., money in exchange for a good or service) are considered legal contracts. Irrespective of whether they are written or oral, the agreements are also legally enforceable (Yonge, 1976). Although it is much harder to do so, oral contracts can be enforced, and there is precedent for their enforcement in both U.S. and international courts. Thus, almost all exchanges use some form of contract. So when scholars in the formal and relational governance debate discuss a no contract option, they are actually referring to a no formal contract option or an oral contract.[6]

While we have extensively discussed the implicit framing assumptions of formal contracts, we have not yet mentioned the framing assumptions in oral contracts. Many relational governance scholars assume that the spirit of oral contracts is more in line with a promotion focus than a prevention focus (i.e., a desire to foster collaboration and flexibility), and we agree with this assumption. First, unlike prevention contracts, oral contracts do not document every detail of how a party's tasks will be carried out in the agreement, so it is more difficult for the parties to perform to detailed specifications. In fact, when oral agreements are used, the parties are less concerned with vigilance issues and are likely more focused on flexibility and cooperation in the exchange. Additionally, parties using oral contracts may have other means (e.g., social sanctions) to address enforcement beyond legal recourse. All of these traits are more consistent with a promotion frame than a prevention frame.

In contrast to an oral contract, the two purposes of a formal (written) contract are to define the exchange and to provide an explicit means for enforcing it or resolving disputes within it (Macaulay, 1963). Additionally, oral and written contracts set different expectations for the exchange and the relationship (which we detail below). Managers must weigh all of these factors, in light of the exchange characteristics, to choose whether a formal prevention contract, a formal promotion contract, or an oral contract best suits the needs of the exchange and the relationship between the firms.

Formal prevention contracts versus oral contracts. When vigilance concerns dominate an exchange, there are a number of key elements determining whether a formal prevention contract or an oral contract will lead to a more successful transaction and exchange relationship. First, when avoiding sins of commission is the top priority in the exchange (e.g., the product or service is mission critical to the buyer), vigilance to strict specifications is necessary, since the parties must have well-defined criteria to perform against. A well-defined exchange is

[6] Even if there are no enforcement mechanisms in place (e.g., weak institutional environment), the firms must choose whether to document their agreement in a contract. Because a contract can serve a valuable role in defining an exchange, the parties may still choose to write one in this situation. Our point is that this choice (written or oral agreement) is not just about a particular enforcement mechanism or institutional environment; firms can write a formal contract that is enforced by social sanctions, or they can rely on an oral contract when court enforcement is available.

therefore important for overall transaction success. Formal prevention contracts include detailed performance criteria (typically including details down to the level of how specific tasks will be completed) and deadlines, due to induction of detailed processing (Förster et al., 2003). They also induce vigilance to these specifications. In contrast, oral agreements usually do not include much discussion regarding the details of the exchange and focus on the high-level responsibilities of the parties with an expectation that they will adapt as they go along.

Second, when the task requires vigilance, the parties become more concerned with enforcing the details in the contract, so it is important to have the option for third-party enforcement. Although they are legally binding, oral contracts are difficult and highly uncertain to litigate because they rely on the perceptions of the parties involved rather than a written document that can be consulted by a third party. Because enforcement of oral contracts is problematic, significant enforcement concerns increase the desire to codify the deal.

Finally, when vigilance concerns are key in an exchange, a deeply embedded relationship can actually hinder a firm's efforts to hold the partner accountable (Uzzi, 1996), whereas a more arm's-length relationship facilitates these efforts. Thus, when the attributes of the exchange call for vigilance and monitoring, a formal prevention contract induces the most appropriate relationship for the exchange and, therefore, has a positive impact on the transaction and ongoing relationship. As discussed earlier, an oral contract is more in line with a formal promotion contract, and both options would be less appropriate for this type of exchange. Thus, when vigilance concerns are high, formal prevention contracts are preferred over oral contracts that rely on trust (relational governance).

> *Proposition 5a: In a transaction with attributes requiring vigilant behavior, a prevention-framed contract leads to a more successful exchange and exchange relationship than when the parties rely on relational governance.*

Formal promotion contracts versus oral contracts. When creativity, flexibility, and/or cooperation is key to the success of a transaction, a different criterion plays a role in determining whether formal promotion contracts or oral contracts lead to more successful exchanges and relationships. Although it is unlikely that parties under an oral or formal promotion contract will intentionally display opportunistic behavior, these parties may still have disputes owing to perceived opportunism resulting from bounded rationality (Weber & Mayer, 2010). This is particularly true in more complex exchanges, where the contract plays an important role in defining and governing the relationship, particularly when the parties have to interact to complete the transaction. Thus, there is a high probability of perceived opportunism, even in the absence of intentional opportunistic behavior.

Trust alone can have a hard time mitigating these disputes, for two reasons. First, the oral contract sets expectations of a trust-based relationship, so a violation of this expectation in the form of perceived opportunism leads to high-intensity negative reactions, undermining the relationship. Second, unlike a formal promotion contract, an oral contract does not provide mechanisms to work through disputes. Thus, we propose that using a formal promotion contract leads to more successful transactions and relationships.

> *Proposition 5b: In a transaction with attributes requiring flexible, creative, or cooperative behavior, a promotion-framed contract leads to a more successful exchange and exchange relationship than when the parties rely on relational governance.*

DISCUSSION

We make several contributions to the literature on contracts and interorganizational governance in this paper. First, by suggesting that contracts can play a promotion role as well as the prevention role implicitly assumed in extant contract research, we shed new light on the role of contracts as devices for governing exchanges and influencing relationship development between exchange partners. Research drawing from both TCE and the relational governance perspective has implicitly assumed that contracts function primarily to deter opportunism (i.e., negative behaviors by the exchange partners), which is consistent with a prevention-framed contract. An important implication for TCE is that contracts do have a psychological impact on the exchange and ongoing relationship. Thus, contract design needs to account not only for sufficient definition of the exchange (e.g., roles and responsibilities, contingencies) and inclusion of proper economic safeguards but also for appropriate framing to induce emotions and behaviors that aid in reaching the exchange and relationship goal. With the introduction of a promotion role, formal contracts do not have to engender distrust and create a negative, self-fulfilling prophecy, contrary to Ghoshal and Moran's (1996) suggestion.

We contribute to the debate on the impact of formal contracts on relational governance by suggesting that the impact of contracts on the exchange and the partner relationship depends on how the contract is framed and in what context (i.e., the attributes of the transaction and the type of relationship desired) the contract is used. Thus, we seek to move beyond discussing *whether* formal contracts and relational governance are complements and substitutes toward *when* (i.e., in what situations or conditions) they may be complements or substitutes. While some work in this area has taken a contingent perspective (e.g., Hoetker & Mellewigt, 2009), much of the focus is still on when to use formal contracts or relational governance rather than the conditions under which they will be complements or substitutes.

Our approach of considering contract framing and expectations complements another approach to understanding how contracts influence relationships that examines how different parts of the contract are more or less likely to signal distrust. Vanneste and Puranam (2010) separated technical detail (coordination) from legal detail (enforcement) and showed that only the latter is perceived in a negative light. Gulati and Singh (1998) also theorized that managing appropriation concerns (related to opportunism) impedes relationship development, while addressing coordination concerns does not. Additionally, in a case study following the evolution of contracts between two parties, Mayer and Argyres (2004) showed that contracts got longer and more detailed but that such efforts were primarily related to clarifying responsibilities and contingencies rather than adding penalties or legalese and, thus, had no negative effects on the relationship between the firms.

While we agree that different parts of the contract can be inherently more contentious (and therefore more likely to interfere with relationship development) than others because they address issues of potential malfeasance, we argue that they do not have to be if they are framed in a promotion manner. Additionally, we suggest that when framing is taken into consideration, even coordination sections of the contract can derail exchange success and relationship development if they are framed in a strong prevention manner. For example, some contracts contain so many detailed specifications that parties execute to the letter of the contract rather than strive to meet the overall exchange goal. Interviews with executives suggest that this issue is particularly problematic with government contracts. Thus, we suggest that under specific circumstances that create a need for creativity, flexibility, and/or collaboration, a promotion-framed contract can simultaneously safeguard an exchange while helping to develop a closer relationship between the parties, thus complementing relational governance. In contrast, under these same circumstances, when a contract is framed in a prevention manner, it substitutes for relational governance.

One key strategic issue that arises in deciding how to frame a contract is balancing the needs of the transaction with those of the overall exchange relationship. For example, when the transaction attributes call for vigilance but the parties want a close, cooperative relationship, the parties must look closely at whether the needs of the transaction outweigh the needs of the relationship to determine the optimal framing for the contract. When the need for a trust-based relationship dominates, the parties should use a promotion contract to continue the positive expectations for the exchange relationship. However, when the need for vigilance in the transaction dominates, parties should use a prevention contract to minimize the probability of problems with the exchange.

In the tradition of behavioral economics, we demonstrate the value of a multidisciplinary approach (integrating psychology with economics) to ask new questions and create new perspectives in our field. By examining psychological aspects of an economic situation, our work is similar in spirit to research in behavioral economics and finance (e.g., Camerer & Loewenstein, 2003; Thaler, 1980). While behavioral economists typically examine how biased perceptions impact economic behavior (e.g., Camerer, 2005), we uncover significant benefits of applying psychological theory to economics-based contracting. First, the combination of different disciplines allows strategy researchers to examine the appropriateness of assumptions commonly used in strategy research and to develop new assumptions. Second, this approach allows strategy researchers to ask different questions than they could if examining strategic issues with only one theoretic lens, potentially leading to novel insights and a greater understanding of organizations and interfirm relationships (Agarwal & Hoetker, 2007).

In addition to combining economics and psychology, we combine two theories from social and cognitive psychology to generate new insights. We turn to RFT and EVT to address the role of contracts on the exchange and the ongoing partner relationship for three reasons. First, both theories address emotional reactions that can impact the development of relationships. Because contracts set the groundwork for an exchange relationship between the buyer and the supplier, this aspect is particularly relevant. Second, safeguards can be framed in either a promotion or a prevention manner, so contracts can induce specific behaviors and views of the relationship. RFT addresses how these issues can be framed to achieve specific types of relationships with contracting partners. Third, contract framing sets specific expectations for exchange behaviors and transaction outcomes; EVT offers guidance on how meeting or violating these expectations may impact the exchange and the relationship.

Applying RFT to the study of contracts has produced several insights (Weber et al., in press), but integrating it with EVT produces additional insights that could not be generated by RFT alone. RFT is very effective at describing the effects of situationally induced prevention or promotion frames, but it does not address what happens if the events transpiring, after the frame is set, significantly deviate from expectations. In particular, the value of considering expectations is that it leads to a better understanding of when a promotion-framed contract is less likely to lead to a positive outcome for the exchange or the relationship—that is, when a firm is perceived to act opportunistically (because of bounded rationality). Thus, there is a potential downside of promotion contracts that is not considered by RFT—a downside that only comes to light when RFT is integrated with EVT.

Combining RFT and EVT also leads to a better understanding of the transacting process in which framing plays a key role. First, transaction characteristics and relationship goals influence the decision to use a particular contract frame (along with an assessment of the supplier's ability to meet or exceed the buyer's expectations). Second, framing influences how the buyer and supplier behave during the exchange, thus directly impacting exchange performance. Additionally, framing also affects how the parties interpret the behavior that takes place while the transaction is executed. In general, a promotion-framed contract leads ambiguous events to be interpreted in a more positive light and engenders a greater tolerance for ambiguity in the exchange.[7] In contrast, a prevention-framed contract leads to more vigilance and monitoring and a more negative interpretation of any ambiguity during the project. These perceptions not only influence exchange performance but impact the relationship between the firms as well.

Another important benefit of combining RFT and EVT is the understanding that using framing to improve the outcome of interfirm transactions is not as easy as simply switching from penalty clauses to bonuses or from early termination to extendability provisions. While these framing choices can be important elements in implementing a framing strategy, there are many other factors that influence whether a promotion frame will actually increase performance. These elements include matching the frame to the transaction attributes and desired relationship, as well as considering whether expectations set by the contract will be fulfilled or violated during the execution of the exchange.

Consider the case of the U.S. automobile manufacturers in the 1980s. GM, Ford, and Chrysler dominated the U.S. auto industry for decades but were struggling because of more reliable, lower-cost imports. One aspect of the Japanese production system (or Toyota Production System) that was noted as a competitive advantage was its close relationships with suppliers. Even when GM, for example, wanted to replicate the

[7] There are exceptions to this positive interpretation under promotion contracts. See Proposition 4 for an example.

Japanese model, it faced many challenges. First, GM had a long-term reputation for acting opportunistically with its suppliers, which, as discussed previously, leads to continued vigilant behavior even under a promotion contract. However, if GM had used a promotion contract, it would have likely contained less detailed specifications against which to perform, so both parties would have likely perceived the other's performance as negatively violating the positive expectations set by the contract framing. As a result, a promotion contract would have had a negative impact on the already tense relationship.

Second, even had management wanted to utilize framing as part of an attempt to repair its negative reputation and build a positive relationship with suppliers, it would have had to have everyone in the firm on board to meet these positive expectations. While upper management may have wanted to change how GM did business, it could not immediately change the culture and processes guiding the daily interactions between GM and its suppliers to mimic the Japanese partnership model. If GM management had publicly discussed developing a close, trust-based relationship with suppliers, but the GM employees that the suppliers interacted with were treating them in the same manner as always, GM management's attempt to change the relationship would have likely resulted in further harm, because positive expectations would again have been negatively violated. Thus, even if new contract framing were used, GM would have had to change many other aspects of the interaction to truly change the nature of the relationships, which would likely have taken years and significant employee turnover. Framing is not simple—it is a multifaceted issue that requires an understanding of the context and the goals of the firms involved.

As this example illustrates, framing is not a magic pill that can cure any ailing relationship or ensure a perfect transaction. Instead, a combination of contract framing and expectation management will increase the likelihood that the behaviors in a transaction will match those required by the exchange task and that the relationship between the parties will develop as desired. If firms really understand all of the nuances of framing, they have the potential to significantly improve their interfirm relationships. However, they have to make sure that all of the pieces are in place to support the framing choice in order to benefit from it.

Limitations and Future Research

Although a wide variety of contracts exist in the business world, our theory is not designed to apply to all of them. In the swollen middle (Hennart, 1993) of hybrid governance, contracts fall into a continuum, from those resembling arm's-length exchanges (e.g., Honda purchasing standardized bolts) to those with traits similar to integration (e.g., alliances such as the one between Nissan and Renault, which includes a lot of detail and extensive interaction). Our theory is most applicable to contracts on the latter end, because such contracts are critical in defining the exchange, and roles and responsibilities extend well beyond anything specified in a contract template. Contract framing has the greatest impact when the contract plays a key role in defining how the parties interact in a way that is specific to the transaction.

We believe that this paper has broad appeal for scholars in other areas of strategy beyond contract research. First, framing has the potential to significantly impact employee performance, which can influence firm performance. Employees incentivized by promotion contracts are more likely to display creative behavior, whereas those under a prevention contract are more likely to be vigilant. Since these behaviors are more appropriate for some job tasks than others, aligning incentive framing with task requirements can enhance firm performance. Additionally, framing has implications for mergers and acquisitions (M&As). M&A contracts shape interaction between parties in a way that is different from interfirm exchanges. For instance, when the acquiring firm wants the owner/CEO of the target firm to continue working for some transitional time, the framing of the contract may significantly impact that firm's willingness to perform beyond the influence of the financial incentives (Weber, 2010). In an effort to generalize these propositions from a buyer-supplier context to other areas of strategy, we have created Table 3, containing general implications for managers from this paper.

The theory developed here regarding when to use promotion versus prevention frames in contracts highlights the need for future empirical and theoretical research. Additional inte-

TABLE 3
Summary of Propositions and Applications for Managers

Propositions	Implications for Managers
1: Contract design impacts the exchange and the relationship	Managers should shape behaviors, exchanges, and relationships through employment, buyer-supplier, and M&A contracts
2: A prevention contract substitutes for relational governance	Managers should use prevention-framed employment, buyer-supplier, and M&A contracts only when they do not care about developing trust with the other party
3a: A promotion contract complements relational governance when a transaction requires flexibility, creativity, or cooperation and/or a personal, close, interactive relationship 3b: When a transaction requires vigilance, a promotion-framed contract substitutes for relational governance when vigilance needs dominate or complements relational governance when relationship needs dominate 4a: When parties know ex ante that they are unlikely to meet the expectations set by the contract (e.g., failure to meet goals specified in the contract), a promotion contract is more likely to positively impact both the transaction and the exchange relationship than a prevention contract	Managers should use promotion-framed employment, buyer-supplier, and M&A contracts to develop trust (except when vigilance needs dominate or when the supplier knows it will not successfully complete the transaction)
4b: A promotion contract negatively impacts the exchange and relationship when one party has a reputation for opportunism	Managers should use prevention-framed employment, buyer-supplier, and M&A contracts when their behavior is likely to violate the other party's positive expectations of the relationship
5a: When a transaction requires vigilance, a prevention contract leads to a more successful exchange and relationship than relational governance alone 5b: When a transaction requires flexibility, creativity, or cooperation, a promotion contract leads to a more successful exchange and relationship than relational governance alone	When contracts play a key role in defining the exchange, managers should use written contracts instead of trust alone

gration with TCE would be valuable since there is a subtle interplay between exchange hazards and framing. That is, some hazards require safeguards that may involve extensive vigilance and monitoring (e.g., expropriation) whereas others may require more flexibility and cooperation (e.g., interdependence).

Another important area for future research is determining what constitutes a promotion versus a prevention contract. Examining what clauses carry the most weight in driving people's interpretation would be very valuable for knowing how to effectively frame a contract as prevention or promotion. Surveys and experiments would both be viable methods for conducting research in this area. Experimental work in particular has the potential to provide valuable insights into how people perceive contracts and others' behaviors. A closely related step in examining a promotion role for contracts is to establish that firms actually frame contracts in both a prevention and a promotion manner, particularly in response to different transaction characteristics (see Weber et al., 2010, for an example). A link should then be established between each type of framing and the induction of the theorized behaviors and emotions. Again, an experimental approach would offer significant insight for this investigation.

In addition to basic contract framing research, we also believe there is a need for examining contract framing in different contexts. For example, interfirm governance research would benefit from more explicit examination of trust and contracts based on different types of contract framing. Most of the trust literature assumes contracts are prevention framed (they are detrimental to the relationship) and asks people to choose between governing with trust and governing with a contract (e.g., Malhotra & Murnighan, 2002). By allowing contracts to be designed with a promotion frame, we can broaden the research on how trust and contracts influence one another.

Additionally, exploring how firms use different personnel to institute framing in both contract negotiation and templates design is an important topic. Lawyers play key roles in contract negotiations but are trained in a prevention manner (Mayer & Weber, 2009). When a promotion-framed contract is needed, we need to know more about which type of employee (e.g., engineers, nontechnical managers) is best suited to conduct primary negotiations and how the choice of employee impacts the contract frame and the performance of the exchange.

Conclusion

In this article we suggest a new role for contracts. Instead of simply preventing breach or opportunism, we propose that contracts can also be used to promote cooperation, flexibility, and creativity in an exchange. We also argue that a promotion contract can facilitate or complement the development of trust in the relationship, under certain circumstances. As a result, we believe that contracts do not have to be seen as detriments to exchanges but can actually positively impact both the transaction and the relationship between the exchange partners when there is an alignment between contract framing on the one hand and the attributes of the transaction and the desired relationship on the other. Extant contract research, however, has provided little direction on how to most effectively utilize contract framing by either ignoring the issue of framing or examining only the framing of an individual clause. One key contribution of this paper is to highlight a variety of factors that guide the decision to use a promotion or prevention frame for a contract. Considering the effects of promotion-framed contracts presents new opportunities for firms to use contracts more effectively and not just as a legal hammer that results in distrust and negative expectations.

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