

Relational Governance: The Normative Element in Technology Licensing Contracts

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This paper investigates the role of social norms in the governance of licensing deals. In qualitative research using twenty-five executive interviews, we focus on behaviors that precede the amendment of licensing contracts. The paper examines what non-contractual behaviors are, how they relate to social norms, and what purposes social norms serve to facilitate particular exchanges. We then consider how these norms may be validated through social contexts. Evidence from this research demonstrates that behavior under licensing contracts relies to an important extent on social norms.

INTRODUCTION

Technology licensing contracts are relational contracts—formal agreements supported by a normative regime under which the parties adapt to unforeseen circumstances and resolve disputes. Any dispute is handled by a governance structure that includes both the black letter of the contract and the “case law” of precedent-setting behaviors that develop within the relationship.

Stewart Macaulay (2003) argues that contract law should recognize the distinction between the “paper deal” and the “real deal.” The formal contract is the paper deal, whereas the behavior in practice is the real deal. Law can solve the problems of cooperation by adjudication in any licensing contract, but social norms can be superior to judicial dispute resolution among people who have close social ties. This fact suggests that, in the case of technology licensing, the exchange relationship might be governed by social norms and rules as well as by the economic elements of the transaction and the letter of the contract.

Over the past a few decades, the “contract” has become a central notion in economic studies of organization. However, economists have been missing the point made by sociologists, namely that behavior under a contract might be governed by norms and values that are *not codified* in the black letter of the contract. This is “non-contractual” behavior. Economists look only at the contract, at the “statutory” component of the deal. They miss the potential for some analog of “case law” as a governing mechanism in the relational contract.

Technology licensing contracts are transactions in intellectual property (IP) undertaken to monetize the value of the licensor’s IP assets. It is therefore essential to analyze how non-contractual behaviors and licensing contracts govern the relationships around licensed technology, how firms can best manage their licensing deals.

Analyzing non-contractual behaviors requires an *in-depth understanding* of the process of interaction between the parties as a deal evolves over time. This type of detail can only be obtained through qualitative research. We pursue this idea with a set of specific research questions and a research design aimed at understanding how social norms facilitate the management of technology licensing deals.

In this paper, first, we review the empirical research on licensing and show evidence of non-contractual behaviors beyond the licensing contracts. Second, we explain the nature and impact of non-contractual behaviors that are guided by social norms in licensing contracts. Third, we call particular attention to the licensing parties' need to *validate* their norms through several contexts in which contractual parties recognize how social norms could best support cooperative behaviors.

RELATIONAL THEORY APPLIED TO LICENSING

There are two streams of literature that analyze relational contracts: the norms-based approach, and the transaction cost approach. The former focuses on contractual and relational governance (Macneil, 1974; 1978; 1980; 1981), and the latter focuses on contractual and exchange governance (Williamson, 1975; 1985; 1991; 1996; 2000).

Contractual and relational governance is brought out in Macneil's research. His findings indicate that any economic exchange involves social elements. The scholars in this line of thought suggest that norms play a very significant role in structuring effective relationships among independent organizations (Heide & John, 1992). Contractual and exchange governance was brought out by Coase (1937) and elaborated by Williamson (1979; 1981; 1985). They focus on defining the organization's boundaries by examining the transaction as the unit of analysis with one assumption: bounded rationality and opportunism in a context of uncertainty drive the form of the relationship.

In the late 1990s, scholars began to extend Macneil's research in order to study the design of contractual mechanisms and the role of the normative regime in governing licensing agreements. Several empirical studies have attempted to construct typologies of technology licensing contracts as interorganizational partnerships (Bessy & Brousseau, 1998; Anand & Khanna, 2000; Brousseau *et al.*, 2007; Bessy *et al.*, 2008). Using relational theory, these authors demonstrate how characteristics of these informal relationships mitigate hazards or reduce cost in a technology transfer transaction.

Bessy and Brousseau (1998) used both qualitative descriptions and quantitative statistical analysis to examine technology licensing agreements. They found that technology licensing agreements conform to Macneil's (1974) categorization of transactional (neoclassical) and relational contracts. A neoclassical contract is strictly a paper deal, but it allows the parties some flexibility in how they manage mutual interdependence and uncertainties by adjusting to unexpected events through mechanisms such as inflation-indexed price adjustments and the arbitration of disputes. In this regard, licensing agreements tend to be neoclassical or relational depending on whether the parties are arrayed horizontally or vertically in their industry. Neoclassical contracts are often seen in a "horizontal" license, a licensing agreement that occurs between organizations operating at the same level of production or distribution in the market. Horizontal licenses are likely to be characterized by a great deal of industry knowledge held in common by the participants and by strong technological interdependencies. Such transactions are repetitive and use negotiating processes that create mutual interdependencies.

On the other hand, relational elements of contracts are often seen in vertical licensing agreements, meaning licensing agreements where a patent holder is considered an upstream organization that licenses its innovation to some downstream organization for commercializing licensed products in a final market. This type of agreement focuses on a process of technology co-development. The main empirical observation of Bessy and Brousseau's study was that different transactions (horizontal or vertical) tended to be managed differently in ways that ultimately affect the features of licensing contracts, and their governance structures may be either neoclassical contractual or relational.

In the same vein, Brousseau, Coeurderoy and Chaserant (2007) explore the design of technology licensing agreements by identifying how contractual provisions are influenced by the characteristics of

transactions, the institutional environment, and the strategic behavior of agents. They attempt to assess the influences of transaction attributes, institutional frameworks, and strategic considerations on technology licensing agreements. Their analysis is based mainly on the logic of transaction costs economics (TCE), identifying the characteristics of partners, the institutional environment, and the transactions. This logic is related to neoclassical and relational concepts. When licensing transactions are managed by the inclusion of formal governance mechanisms such as payment formulas or safeguards, they exhibit the neoclassical governance structure.

The relational contract is characterized by non-contractual behaviors that invoke the relevance of history within the exchange relation and other local and general norms to manage unforeseen situations. In that sense, all contracts on paper are neoclassical. Brousseau, Coeurderoy and Chaserant (2007), however, do not address the interplay between neoclassical and relational mechanisms when contractual parties repeatedly interact.

Anand and Khanna (2000) studied the cross-industry (chemicals, industrial machinery and equipment, electronic and electrical equipment) differences in the incidence of contractual features. Their study analyzed how different licensing agreements influence *ex-ante* versus *ex-post* technology transfer. They attempted to use a neoclassical approach to explain research on the design of contractual mechanisms and on the role of past relationships in governing those mechanisms. Their paper did not distinguish the types of past relationship: (1) a relationship that is based on a simple licensing agreement, which structures essentially a technology, know-how transfer; versus (2) a relationship that is based on a cooperation agreement, which involves various forms of cooperative relation in order to improve the current licensed technology.

The recent paper of Bessy, Brousseau, and Saussier (2008) analyzed the way payment schemes are implemented in technology licensing agreements. The study followed a transaction-cost economics perspective, focusing on ex-post costs of enforcement linked to chosen payment schemes. They showed that a simple classical contract structure (lump sum fees) was chosen when moral hazard or uncertainty was high. This study has followed the logic of transaction cost theory, where markets, hybrids and hierarchies were viewed as the alternatives for governance alternatives. Payment schemes, however, are complex. These scholars only explain payment schemes in terms of the neoclassical variables of transaction cost economics. They do not examine the underlying relational factors such as bargaining processes and contract objectives, which may be influenced by norms.

Many examples of licensing research use a neoclassical approach. This approach disregards social norms. Social relationships can be the context for motivating and forming licensing contracts. These relationships do matter for many purposes. However, empirically as well as theoretically, we still know little about social norms in the context of licensing deals. More knowledge in this area is likely to help us understand which environment is likely to favor which norms and thus, when norms are stable, how they affect the licensing deals. Blois and Ivens (2006) note that there are twenty-three empirical studies that examined norms in exchange relations, but none of them examined antecedents to the norms. They also point out that these studies do not define norms precisely and misinterpret the meaning of Macneil's ten relational norms.

We respond to Blois and Ivens' point and follow Macneil's definition of norms as shared expectations. Accordingly, this study investigates adaptive behaviors in the amendment process as an example of adaptive behaviors in exchange relations where norms can be identified on both sides of the dyad (licensors and licensees).

We follow the model of Cannon *et al.* (2000) to examine the norms highly apparent in cooperation and interdependence. These norms include flexibility, reciprocity, solidarity, communication, and appropriate use of power. To that list we add another norm, *precedence*, which gives validity to the history of behavior in an exchange relationship as relevant to the solution of current disputes. Specifically, we investigate the following research questions.

1. In licensing deals that are subject to pressures for change over time, and where non-contractual behavior is evident, is there evidence of a normative element, meaning a relational contract, guiding adaptive behaviors in the amendment of a contract?

2. Where norms are invoked to deal with certain types of adaptive behaviors, which norms guide those behaviors? What evidence is there for the invocation of norms of solidarity, flexibility, communication, precedence, forbearance or other types in the amendment of a contract?

METHODOLOGY

As norms are social constructions, it is useful to study the phenomena in its context by qualitative methods. We used a qualitative-phenomenological approach to study licensing phenomena, their nature and meanings. Phenomenology emphasizes live experiences through descriptive analysis (Eagleton, 1983; Davidson, 2000; Caelli, 2001). It studies how things come to perception and how this perception predicts and controls behavior. Accordingly, this approach gives insights into people's motivations and actions and is thus a powerful method for understanding the process of amending a licensing contract. It examines:

- What is distinct in each person's licensing experiences?
- What is common to the experience of groups of people who have shared the same events or circumstances?

In this qualitative-based research, we conducted expert interviews in order to gain greater depth of information. The subjects for interviews in this research were selected among the members' of the Licensing Executive Society (LES): USA & Canada, and the interviews were conducted between October 2010 and June 2011. The interviewees came from high-tech, bio-tech and pharmaceutical industries and were chosen based on their licensing experience (at least 15 years), their positions in their firm in relation to licensing (attorneys, managers, or licensing executives), the geographic location of the licensor (the Midwest states), and convenience (e.g., easy access and a willingness to be interviewed and share information and documents for this study).

The interviewees were key individuals who determined the interaction of licensing activities among the stakeholders. They had direct knowledge and experience in licensing technology. The interview participants for this study included the chair of a company, executive and senior level management in alliance management teams, strategic managers and attorneys within an organization. These mixed participants provided data and interdisciplinary triangulation that added to the robustness of the data in the study. Interviews for this study were conducted face-to-face or by telephone using both open-ended and semi-structured interview questions. Each interview lasted between one and two hours.

The interviewees were promised anonymity. The interviews were recorded on tape and transcribed by a third party. A total of 28 top management executives were interviewed, but three of them did not agree to record their interviews. As a result, 25 interviews were used in this study. To improve the validity of the results, the number of interviews followed the rule of theoretical saturation (Patton, 1990): interviews continued until the later interviews introduced no new perspectives on the topic. The 25 interviews in this study provided sufficient depth of information and redundancy of data to meet our purposes and to address the three research questions.

A higher degree of reliability and validity resulted from using triangulating methods, whereby interview data were supplemented with file notes, archival information (Edgar Database and Pharmalive website), and relevant literature such as professional publications (Les Nouvelles, LES insights). The transcripts were then sent to the interviewees to be reviewed for accuracy—known as member checks—to provide evidence of validity (Baxter & Eyles, 1997). Also some experts, such as corporate analysts and licensing attorneys were interviewed for more general discussion on the formation of contractual relationships after the interviews had started.

The interviews were coded using Atlas qualitative research software—open, axial, and selective—to organize themes in the phenomenon based on Kleiman's (2004) model. This model seeks to learn about the most important meaning unit under a specific phenomenon. The process of analysis is as follows:

1. Read the whole interview transcript and gained a comprehensive sense of the whole.

2. Read the interview transcript a second time and divided the data into meaningful coding units, such as ‘unforeseen event’, ‘licensing amendment’, and ‘non-contractual behavior’, and ‘social norms’.
3. Integrated those units to similar categories and made sense of them. Examples of unforeseen events included environmental structure changes (regulation changes), and organizational structure changes (acquisitions and mergers). Both types of unforeseen events occurred and were not anticipated as contingencies in the respective licensing contracts.
4. Selected integrated meaningful units that identified phenomena in the data. For example, unforeseen events were handled in two different ways. One way was to amend the contract; another way was to change the behaviors or expectations of the parties to the contract.
5. Elaborated on the findings— e.g. the failure to perform some contractual duties, such as delay of payment or not being able to meet product standards, often is the main element that would require a retrospective approach to amendment. Cases of strategy and vision changes often resulted in using the prospective approach.
6. Revisited the raw data descriptions in order to justify interpretations of both the essential meanings and the general structure. We have to begin to discern how people structure their experience and patterns that hang together.

NON-CONTRACTUAL BEHAVIORS BEYOND THE LICENSING CONTRACT

Since licensing contracts are incomplete, the letter of the contract by itself is not sufficient as a governance mechanism (Macaculay, 1963, 1985.) Adaptive behaviors fill in the gaps in a contract and create a governance mechanism to guide renegotiation. This behavior is a social mechanism, hidden behind the letter of the contract, that influences contractual behavior and facilitates cooperative transactions.

Here, we use the term “non-contractual behavior” to signify the social mechanism. Non-contractual behaviors are behaviors that go beyond the role of descriptions (Kim & Mauborgne, 1996) and are oriented toward helping contractual parties solve problems. These behaviors have a particular adaptive value for a long-term contracting relationship, which is relevant to Macneil's (1974) relational contract theory. He notes that any change of an initial deal “...no longer stands alone as in the discrete transaction, but is part of a relational web.” (Macneil, 1974: 595)

Non-contractual behaviors are broadly characterized by the popular phrase “beyond the call of duty” (Kim & Mauborgne, 1996; Schaubroeck & Ganster, 1991). Non-contractual behaviors are driven by an intrinsic motivation. This motivation is a satisfaction process that develops mutual benefits of a licensing activity rather than being a result of licensing activity. During the process, social norms guide contractual behaviors to minimize the risk of falling afoul of contract obligations.

SOCIAL NORMS GUIDE NON-CONTRACTUAL BEHAVIORS

Developing a contract is a dynamic process (Hefetz & Warner, 2004). A clause in a contract does not reflect the social aspect of that process. As social norms play a more active role in the licensing deal, the process of licensing shifts from a legal matter to a process designed to sustain cooperative behaviors. Correspondingly, the parties allow contractual behaviors beyond the contract terms and focus on the parties’ future relationship. In this approach, an incomplete contract is desirable. It leaves the contractual terms open in order to allow flexible adjustments in the future. Two types of contractual behavior may influence a future adjustment. The first consists of non-contractual behaviors that are not addressed by the terms of contracts but that play an important role to govern an ongoing contracting process. The second consist of behaviors based on an “agree-to-agree” provision in the contract that requires parties to renegotiate or further specify their mutual obligations at a later point in time. This behavior is directly related to renegotiation.

The enforcement of a licensing contract is really a question about the governing mechanism that allows flexibility and efficient adjustment to contingencies. All adaptive actions, including all changes, can take place only within a social norms context. In the following section, we examine in more detail the various norms that influence the process of adjustment to unexpected situations in a licensing deal.

Flexibility

Flexibility refers to the willingness of parties to adjust obligations and terms in response to unforeseen events or some specific changing conditions (Boyle et al., 1992). Flexibility arises when contractual parties face an unexpected event that affects one of the parties' obligations (Iossa et al., 2010). For example, licensors who cannot deliver or licensees who cannot pay are allowed to renegotiate the contract and default from their original obligations. Flexibility is thus like a form of insurance to share risks, and it greatly affects the contract value.

The degree of flexibility depends crucially on the parties' beliefs about what is "fair" or "reasonable." According to the majority of interviewees, the longer the duration of a contractual relationship, the more flexible the royalty arrangements are. The VP of global alliance management of a large pharmaceutical company described how flexibility matters in sustaining contractual relationships. He stated, "...the degree of flexibility is often relating to the duration of relationship. A **longer relationship will create a solid trust** among the partners."

Swan et al. (2002) revealed that flexibility enhances high trust in both parties. This occurs when both parties are willing to adjust obligations that extend beyond contractual terms. This type of non-contractual behavior represents a core element of mutual cooperation to improve exchanges. Thus, licensing contracts can be characterized as exhibiting a higher level of flexibility.

In the biotech and high-tech industries, contractual parties often bring highly needed flexibility and options for the future (Young-Ybarra & Wiersema, 1999). This phenomenon leads a licensing contract to change from a neoclassical contract to more intense cooperation (a relational contract) in which the parties need to expose themselves to each other. As one director stated:

In our business, the basis for a lot of what we do is collaborations with our customers and collaborations with our suppliers. In those collaborative activities, by their nature, **you cannot foresee all of the things** that will happen in the process of that collaboration and so **you have to be flexible** in order to do business. (Senior Director Intellectual Property Management, Large Electronic Company A)

Further, the CEO from a small electronic company noted:

I think that one of the things that makes you favorable or unfavorable to a company, is **your flexibility or willingness to help them** in a situation. And likewise I think, from the other side, it works the same that you're going to enjoy working with the business if you could see them being flexible. **So I think flexibility is extremely important. From the very beginning and all the way through**, it's one of those criteria that would actually make a company more favorable to do business with.

Contractual behaviors can thus be explained without using any legal concept. Flexibility is a norm that is determined by the parties' motivations, strategic planning, and behaviors within the relationships. It also appears that flexibility is strongly related to solidarity. When parties change their priorities in order to sustain the relationship, they need to ask about their partner's commitment to the change. This cooperative attitude makes solidarity in relationships to be in the parties' self-interest (Macneil, 1986) as well as the interests of the other party. Both are non-legally related behaviors and establish the parties' perception about how to keep their promises under unforeseen circumstances. Thus, we would suggest that flexibility is a criterion for the effectuation of the norm of solidarity.

Solidarity

Solidarity is associated with a willingness to share problems and a commitment to improve a relationship (Heide & John, 1992). In simple terms, solidarity is the preservation of a continuing relationship for mutual benefits. This norm is reflected in the concept of togetherness and cohesion. Clearly, in a licensing deal, solidarity serves to enhance and sustain social cohesion.

According to interview data, solidarity relationships are likely to involve some social behaviors that affect the way in which a deal is drafted. For example, solidarity is very much person- and mandate-specific. It reciprocally links personal attitude and behavior within the partnership, such as being willing to adjust personal benefits in order to share another's need. This explains that parties desire to continue the relationship and adjust their behaviors. One director described the basis of their contractual procedures used to create loyalty with partners:

You have to create the relationship for people to understand you, understand what your needs are, and you **create loyalty**; you create this feeling of **being a part of the team**. (Executive Director Licensing Business Pharma Development, Large Pharmaceutical Company G)

One CEO explained solidarity in well-defined terms:

The other company has its **other position that's different**, and so our team if we see that situation, **we try to facilitate a process** where the companies can learn what the other company is really interested in, and then each company understands each other better and then based on that, together jointly we take those interests and then **create the solution together**. Then we can almost always reach agreement and move forward. Even if there was an impasse before, it can make the impasse go away and then we end up with a good win-win solution. (VP of global Alliance Management, Large Pharmaceutical Company A)

Obviously, solidarity is the idea that "we are all in this together." According to this concept, parties cooperate in a way that encourages them to seek long-term benefits, and they are often willing to sacrifice short-term benefits (Macneil, 1986). Thus, the duration of a contractual relationship is a matter of contractual solidarity.

Fairness

A president from the high-tech sector noted that if both parties have strong social relationships (such as close friendships), they tend to involve an expectation to tolerate greater sacrifices than under weak social relationships (such as a newly established contractual relationship), and the two also differ in distributional social norms (such as equity) to constrain "fair" or "reasonable" behaviors. One CEO from a small biotech company described a case in which they had been with their partner in a cooperative contractual situation before, and they were eager to reward the relationship by making sure their partners got a fair return in their investment:

We have to consider, are we pushing too much on the envelope about how much we charge and not letting them **get a fair return**. At the end of the day, it comes down to how much you're going to get through your product and service and how much does it cost them to provide that service and therefore, **are they getting a fair return on their investment**. (CEO of Small Bio-Tech Company A)

In this case, a fair return on investment is preceded by extra-contractual behaviors, at no extra charge, that get the work done. The norms of solidarity and fairness are important when one party receives an outcome against their interest. This is common in contractual relations. Depending on the nature of each

relationship, parties behave in one of two patterns: the pattern of tolerance and the pattern of contract adjustment (Pop, 2011). The purpose of these two patterns is to maximize the joint profit and thus maximize each party's own interest.

In summary, Macneil highlights the importance of solidarity in a long-term contractual relationship. It is commonly understood that parties can develop solidarity-type behavior from past interactions and use it to control future interactions. We often refer to these behaviors as the shadow of the past as distinct from the shadow of the future (Buskens & Raub, 2002). The effect of past interaction on adaptations under a contract is discussed in the following section.

Precedence

Precedence refers to the legitimate reference to past solutions to contractual problems as a guide to solving current problems. As parties learn about each other's past behaviors, they are able to formulate legitimate expectations about future interactions. Clearly, repeated problem-solving under the norm of precedence helps reduce anxiety and fear. Precedence is developed from goals, beliefs, and attitudes that have been shared in the past within groups of people or industries.

Precedence can be a simple and an efficient element for licensing contracts to be successful. However, there is no empirical work, including Macneil's famous relational contract theory that investigates the links between relational contract and precedence. It is important to recognize that most contractual behaviors involve past history. Many licensing deals are done repeatedly enough that many future decisions are made through non-contractual behaviors based on past experience. There are three general contexts of experience in which past history might establish the basic rule for managing licensing deals:

- (a) within the specific licensing deal itself
- (b) within the parties' organizations and concerning "similar" deals or similar re-negotiations
- (c) within the parties' industries and concerning "similar" deals or similar re-negotiations.

Some phrases from our interviews give evidence that a licensor or licensee intends to look within the history of a specific licensing deal itself for guides to the resolution of conflicts. Phrases such as "we look back at our deal," for example, may suggest that the licensor intends to apply the last successful experience to a current exchange. As the chairman of a small electronics firm said:

There is the situation where **what has been considered fair in the past—it makes what would be fair in the future.**

The second general possibility regarding past history involves a presumption that contractual behaviors are related to behaviors in similar deals within the parties' organizations. The drafting process could also develop by looking at an adequate amount of old contracts used in other similar deals within the organization. Most of the interviewed companies have standard contracting processes. They regularly go back to the contracts and evaluate them when similar deals have encountered a conflict situation. As one director stated quite pertinently:

This reminds me of a deal I did two years ago. **Same market, same technology, the same basic structure.** We had a dispute resolution section in the unit where, if we cannot agree between the executives of the companies then we can go to mediation or arbitration to resolve the dispute. So **we look at those provisions** as a tool of conflict resolution because **we can rely on our past successful decisions when dealing with subsequent similar instances.** (Director of Intellectual Property Licensing, Large Pharmaceutical Company D)

Parties also might intend to follow industry references—"similar" deals within the parties' industries—as their licensing strategy. Thus, the recognition of the industry's past history has played an important role in

the discussion of licensing deals. The stock of past history in the industry forms a safety net that acts as a control mechanism to prevent abuse as long as industry practice is taken as “precedent.”

One director described contractual procedures related to industry history:

You have to do your homework in advance and say, **you need to check if there have been some comparable deals or agreements done recently** and what were the returns and **you try to understand what others have done** and what were the driving factors. (Director of Intellectual Assets Strategy and Management, Large Chemical Company A)

Precedence gives legitimacy to the “case law” history of how problems have been solved as guidance in addition to the “black letter of the contract”—statutory law. Prior decisions often help contractual parties develop their legal minds to better absorb the facts of disputes and their alternatives.

Reciprocity

The norm of “reciprocity” refers to the situation in which parties anticipate that their partners will give them something back in response to their own behaviors (Macneil, 2000). Reciprocity is a cooperative or retaliatory behavior in repeated interactions (Fehr & Gächter, 2000).

These behaviors arise because parties expect future material benefits from their actions. Reciprocity, therefore, is a core element in relationship building, which focuses on building beneficial long-term sustainable relationships with contractual parties. In contractual relationships, “if both parties in a trade have the opportunity to reciprocate, reciprocal motivations have a robust and very powerful impact on the enforcement of contracts” (Fehr et al., 1997, p. 836).

The motivation governing reciprocity can be related to other preferences such as reciprocal guilt (e.g., we owed it to them) or reciprocal altruism (e.g., understand their needs) or to seek for efficiency gains through cooperation (e.g., a win-win situation). Under these perspectives, reciprocity relates to the mutuality rather than the transactions of fairness (Macneil 1978; Kaufmann & Stern, 1988).

A few empirical studies have illustrated how to operationalize the norm of reciprocity.

Reciprocity can be merely sophisticated self-interest (Fehr & Schmidt, 2001). It combines individual preferences and mutual benefits. The operation of reciprocity therefore can be mostly seen in interviews through phases such as “quid pro quo,” “we owed them one,” or “pay back,” and “returning a favor.”

The chairman of a small electronics company explained how they deliberately do more than necessary under the contract with the expectation that a norm of reciprocity will hold:

If one is doing more than is required in the agreement, then you are doing it to create goodwill, so you want that activity **to be seen and to be recognized and to be valued** by the other party. (Chairman of Small Electronic Company E)

The norm of reciprocity often leads to cooperation and a commitment that minimizes opportunism and thus reduces transaction costs. One of the interviewed VPs noted that once the reciprocity has been established, the parties strategically develop loyalty by their willingness to cooperate.

Given what their needs are when you consider their needs, what kind of deal is frankly a win-win situation, because in the win-win you’re going to **get loyalty**, you’re going to get when it comes time that you need **flexibility, then you can expect them to reciprocate** most of the time. (Marketing Executive, Large Pharmaceutical Company C)

Reciprocity can be related to past experiences (e.g., when someone from past contracts has been kind). Contractual parties prefer to use positive sanctions (e.g., return as a favor). Also, the parties are sensitive to the concept of “fairness” in order to achieve equal outcomes. The interview data provides evidence that reciprocity is an internalized motivation. We would expect that the norm of reciprocity could be embedded in behaviors that have less costly consequences of an economic nature.

Communication

Communication refers to bilateral expectation that parties provide their information to each other for future cooperation (Mohr & Nevin, 1990). This assumes that both parties are willing to exchange a broad range of information in order to solve the disputes. As we conceptualize our understanding of the communication process between parties, the phrases in communication should express expectation that parties will provide some particular information to benefit their cooperation. Several phrases indicate parties' willingness to share information. They are: "talk about," "sit down," "email," "pick up the phone," "try to facilitate a process," "to be available," and "a real person-to-person understanding." Under a sociological logic, these phrases can be considered to be expressions of value in the exchanges. Thus, the phrases comprise social criteria as (1) facilitators of cooperation and (2) reciprocal assessment for value creation in exchange performance. Clearly, we can say that communication improves contractual behaviors by creating mutual understanding as a resolution mechanism. One VP explicated the situation as follows:

I think in general, it's a matter of **sitting down** with people and just bringing out the points that you think are unreasonable and then **talking about** them and asking what their goal is. And a lot of times if you find out what their goal is, you kind of put yourself in their position, then you can help them come to a different position that you can agree to. (VP of global Alliance Management, Large Pharmaceutical Company A)

In most of the cases we studied, companies have been more open with their partners in exchanging information through oral communication rather than writing a formal letter, as noted by the following director:

If you communicate by **email**, the best you'll have is neutral results. You have to **pick up the phone**. (Director of Intellectual Assets Strategy and Management, Large Chemical Company A)

At another level of analysis, writing a formal letter can be identified as the party's intention to reject the common interest. The party motivated in this way is undermined by self-interest without considering the preservation of long-term co-operation. This is a neoclassical economic assumption that parties are seeking self-interest to produce social performance. Accordingly, there is considerable empirical evidence that adaptive behaviors will be formed less when there are written documents involved. A document often indicates what should be done for any changes; this can be harmful to any adjustment because it limits the flexibility for parties to express their needs for change. As one chairman said:

Well, more likely it **starts with a letter** saying that such and such term, reference in the contract and we noticed that your payments are not in line with your press release of how many products you're shipping according to such and such section of contract you're to pay us "x" amount for each one and you're claiming in your press releases you sold two million of these products and you're only reporting five hundred thousand to us, **please explain what's going on**. (Chairman of Small Electronic Company A)

In the empirical context of this study, behaviors in licensing contracts are seen as *the evolution of exchange processes*. Inevitably, these processes require non-legal dispute resolution for potential adjustment. The degree of making information available turns out to be an adaptive attitude to resolution. Without this attitude, parties cannot create an adaptive behavior when contingencies arise.

In the above discussion, we have shown that the communication channels—email and telephone contact—set a different tone for developing different adjustment behaviors. Moreover, the context of exchange can influence the relative social norms to develop the desired performance levels (Pauline et al., 1999). There are several studies that investigate the context of exchange through various communication

channels such as “day-to-day exchanges” (Larson, 1992), “joint problem-solving arrangements” (Uzzi, 1996), and “person-to person” interaction (Nohria & Eccles, 1992). Different communication contexts seem to have different outcomes for influencing contractual behaviors to resolve problems.

Thanks to communication, parties have less need to get involved in arbitration or formal amendments. In other words, this norm is efficient in the relational sense of the term.

This offers a useful means of explaining communication as one of social norms that “guide, control, and regulate proper and acceptable behavior” (Macneil, 1980, p. 38).

Forbearance

In an operational sense, forbearance can be viewed as one of Macneil’s common norms—the norm of creation and restraint in the use of powers. This norm refers to “forbearance from taking advantage of one’s bargaining position in an exchange” (Cannon, et. al, 2000, p. 183). According to Kaufmann and Dant (1992), forbearance reflects the restraint of using power over one or another of the parties that undermines mutuality and solidarity.

From this point of view, a number of phrases can validate forbearance behavior, which leads to future coordination. They are: “will not take advantage,” “don’t take advantage of,” “won’t press our advantage,” and “we are trying to maintain the relationship.” The VP of the large pharmaceutical company described the norm of forbearance with partners:

I think what happens in most companies is that the two learn about each other enough so they know what’s fair. Now whether or not they follow what’s fair may be beyond contract itself. Let’s say that I have the power to draw up the contract. And usually I can demand certain things but I **do not want take any advantage within my power** to execute what’s fair to **maintain the cooperation**. (VP of Global Alliance Management, Large Pharmaceutical Company A)

The norm of forbearance is highly related to adaptive behavior through the acceptance of influence, openness to communication, and reduction of control during the process of resolving any problems in a deal. In contrast, the lack of forbearance can be better described as selfish social behavior, such as “squeezing,” or “press our advantage,” that often ends up harming a contractual relationship. The CEO of the small bio-tech company described the same situation from his experiences:

There certainly are companies that have rather monopolistic positions in their area, and they **can really press their advantage in a pretty nasty way**. It is hard to deal with those people. (CEO of Small Bio-Tech Company A)

Lacking forbearance indicates the party’s orientation on immediate self-interests rather than ultimate values. By increasing dependence upon one’s own preference in this manner, reciprocity from the social relationship is lessened. From the above, we recognize many puzzling features of adaptive behaviors. Each feature involves its own social norms—flexibility, reciprocity, solidarity, precedence, communication, and forbearance—by which parties develop their contractual behaviors.

It is important to remember that all of these norms are intertwined, and they are all embedded in social contexts. According to March and Olsen’s (1998) “logic of appropriateness,” behaviors are based on value, practice, and norms that are in turn shaped by social context. In this perspective, authoritative referents validate the norms through the social context, which is an interesting subject for future research.

LIMITATIONS OF THIS STUDY

We validated our conceptual framework by operationalizing social norms in terms of specific indicative phrases. The process of developing these phrases was (1) to examine the literature for interpretations of each norm and then (2) to compare those to Macneil’s definitions. We used these phrases as indicators of social norms that might explain the amendment process in technology licensing

deals. According to Blois and Ivens (2006) twenty-three influential studies had tried to operationalize social norms. However, there is no consensus on how these norms should be operationalized.

Our study involves primary research with a small sample size and in which the information is collected directly from a respondent without involving much secondary data analysis, because parties are reluctant to reveal their licensing contracts due to confidentiality. Research findings based on primary data often involve the issue of *subjectivity*, which does not permit statistical generalization. Based on the phrases indicating social norms in our data, we will develop a questionnaire for future research. In doing so, we will empirically test the relevance of social norms in explaining adaptive behaviors on large-scale samples.

Drawing from the above discussion on methodological issues in measuring social norms, we expect this paper can provide a fruitful platform to develop a methodological tidiness and a multiplicity of explanatory concepts for the domain of contractual behaviors.

CONCLUSION

Today the licensing environment is challenging. It is complicated by changes, complexity, and competition. With this challenge, a normative approach is needed to complement the legal doctrine of a formal contract in order to manage an evolving deal. A complete description of the evolution of a licensing deal cannot be based on explicit incentives alone. The evolving deal will be reflected periodically in revisions to the black letter of the contract, but the mechanism of adaptation is inherently *non-contractual*. The *relational* governance mechanism of the deal consists, in its essence, of the norms and rules that evolve between the parties as they pursue their relationship.

Social norms do not emerge on the basis of economic exchange alone, but only through ongoing social interaction with others. Through this interaction mutual expectations can be recognized, and a shared vision can emerge. This social mechanism guides adaptive behaviors under the contracts and strengthens the relationship. With this perspective in mind, social norms are likely to lead to understanding with potentially wide ranging licensing consequences.

While neoclassical contract law examines licensing contracts as “paper” deals that specify a limited set of provisions for future negotiations, this research demonstrates evidence of relational elements in licensing deals that guide future adaptive behaviors without specifying those behaviors precisely. The importance of these relational elements in helping companies manage their evolving deals is what leads us to agree with Macaulay (2003) in calling these the “real” deal.

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