

CONFLICT AND DISPUTES IN THE DEVELOPMENT PROCESS : A TRANSACTION COST ECONOMICS PERSPECTIVE

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Introduction

In the procurement of their new building projects real estate developers increasingly experience conflict and disputes with contractors and/or consultants, usually resulting in delays to completion and higher costs of the project, accompanied by a degeneration of individual and corporate relationships between the participants. Indeed, the “problem” of conflict and disputes is of great concern in the construction industries of many countries (including Australia, USA, UK and Hong Kong).

This paper considers the application of transaction cost economics theory as a framework for rationalizing the nature, causes and management of conflict and disputes in the development and construction processes.

“Any issue that arises as or can be posed as a contracting problem can be examined to advantage in comparative contracting terms, and because so many problems have this structure, transaction cost economics can be used to illuminate a wide range of economic and noneconomic phenomena” (Oliver E. Williamson).

The “Problem” of Conflict and Disputes

Great concern has been expressed in recent years regarding the dramatic increase in conflict and disputes in the construction industries of many countries (including Australia, USA, UK and Hong Kong) and the attendant high cost to the industry both in terms of direct costs (lawyers, claims consultants, management time, delays to project completions) and indirect costs (degeneration of working relationships, consequences of mistrust between participants and lack of teamwork).

Whilst disputes arise between a variety of contracting parties within the real-estate development and construction processes (e.g. client/consultant, contractor/subcontractor) the focus of this paper is the problem of conflict and disputes which arise between the client and his (main) contractor, as seen mainly from the perspective of the client.

No official statistics regarding construction disputes are published in Hong Kong (other than the Auditor General’s Annual Report which regularly includes criticism of

particular public sector construction projects which have been completed late, over budget and contain excessive defects). The proliferation in recent years, however, of claims consultants and lawyers (barristers and solicitors) specializing in construction claims and disputes, together with the increased levels of related conference/seminar activity within professional associations and learned societies (e.g. CIARB, Lighthouse Club, Hong Kong Construction Association, HKIS, etc) suggests that the increase in conflict and disputes is as much a problem in Hong Kong as elsewhere.

However, in the UK, in a keynote address to the “Construction Conflict : Management and Resolution” conference held in Manchester in 1992, the Senior Official Referee, His Honour Judge John Newey QC, described the dramatic increase in construction related disputes in the UK since the 1970’s : *“The London Official Referees’ Courts deal with all High Court and some smaller construction cases arising in London and the South East and with many High Court cases arising elsewhere in England and Wales. Between 1973 and 1980 there was about 100% increase in the number of cases brought to the courts and in most years after that until 1989 there was an increase of about 15%.”* (Fenn & Gameson 1992)

The informal manner in which many disputes are resolved makes it impossible to reliably measure the level of conflict at any particular time. However, it can confidently be said that the incidence of conflict and disputes is rising in many countries and adversely effects the performance of the development and construction processes in those countries.

In the USA, The “Dispute Avoidance and Resolution Task Force” of the American Arbitration Association in its February 1994 Newsletter, commented as follows : *“During the past 50 years much of the United States construction environment has been degraded from one of a positive relationship between all members of the project team to a contest consumed in fault finding and defensiveness which results in litigation. The industry has become extremely adversarial and we are paying the price.... A positive alliance of the parties (involved in the construction process) constitutes an indispensable link to a successful project... Disputes will continue as long as people fail to trust one another.”* (AAA 1994)

The theme of (“lack” of) trust is taken further by Ridgway (1994). Australia’s construction industry, in his opinion, is “blighted with claims, disputation and costly resolution.” State and Federal governments have conducted a number of studies, most of which focus on technical matters such as conditions of contract and risk sharing. Ridgway, however, addresses the theme of moral degeneration and argues that the cause of conflict and disputes “may lie in the venality of the Australian character and lack of ethics in the building industry... Australia’s construction industry has lost its moral direction. Claims/disputation largely reflect greed, lack of commitment and lack of responsibility. A man’s word is given but not trusted.” (1994)

The emphasis on trust and teamwork (between the parties involved in the construction process) as a partial solution to the “problem” of conflict and disputes is one of the main themes of Sir Michael Latham’s (1993, 1994) extensive and thorough review of the UK construction industry. This review identifies many issues related to the problem of conflict and disputes, some of which undoubtedly have relevance to the

construction industries of Hong Kong, Australia and the USA. Latham's review is therefore of particular interest and relevance to this present study.

The terms of reference for the Latham Review were to consider the existing procurement and contractual arrangements, and the roles, responsibilities and performance of the participants in the UK construction industry with the objectives of "making recommendations regarding reform to reduce conflict and litigation and encourage the industry's productivity and competitiveness."

Latham's (1993) Interim Report "Trust and Money" identifies and analyses main issues and problems. Its scope is "trust and money and the problems which flow from a lack of both". The topic of "trust" (more correctly, "lack" of trust) and the problem of conflict are a primary theme. It was widely acknowledged (by industry participants who contributed to the Review) that the industry has "deeply ingrained adversarial attitudes. Many believe that they have intensified in recent years ... the culture of conflict seems to be embedded ... disputes and conflicts have taken their toll on morale and team spirit."

Whilst the Interim Report mainly concentrates on defining the problems, Latham nevertheless emphasises the importance of teamwork and concludes that "Teamwork reduces adversarial attitudes ... many of the concerns, fears and alleged grievances could disappear if the vital issues of trust, money and teamwork were addressed effectively"

The other main theme addressed by Latham relates to the standards of performance exhibited by the various participants, including the client, in the design and construction process. His Final Report, "Constructing the Team," (1994) makes extensive recommendations and proposals regarding the implementation of "good practice" at all levels and by all participants, in the industry. In this context he repeats and reinforces some guidelines for good practice "which have long been advocated (by earlier reports to the UK Government) but by no means always followed!"

Other relevant literature, reports and studies dealing with conflict and disputes in construction seek to classify the common categories of claims/disputes and identify their underlying causes. Some studies have found the choice of procurement method adopted to be a significant contributor to conflict and disputes. In a Canadian study Abdel-Meguid and Davidson (1996) found a positive correlation between project cost/time overrun and frequency of claims and disputes on the one hand, and the procurement strategy chosen, on the other. Conlin et al (1996) – in a study in the UK of 5 procurement types and almost 500 dispute events – similarly note a correlation between "type of procurement method adopted and the types and frequencies of disputes occurring".

A cross section of the relevant literature (Kumaraswamy 1996) identifies the main categories of claims to be consistent with the particular clauses in standard forms of contract providing for additional payment and/or extension of time for the contractor. The main categories of claim are thus cited as:

- variations
- ambiguities in contract documents

- inclement weather
- late issue of design information/drawings
- delayed possession of site
- delay by other contractors employed by the client (e.g. utility companies)
- postponement of part of the project

The main underlying causes of these claims are identified as :

- inaccurate design information
- inadequate design information/statement of client's requirements
- changes in design due to changes in client's requirements
- slow client response/decision making
- poor communications (e.g. client/consultant, consultant/contractor)
- unrealistic time targets
- inadequate contract administration
- inadequate site investigation
- uncontrollable external events (e.g. unforeseen ground conditions)
- incomplete tender information
- unclear risk allocation

The vast majority of these claims emanate from the contractor. Those which are rejected/refuted by the client (or his consultants) often develop into formal disputes. Some claims, however, originate from the client. These invariably relate to (alleged) defective workmanship/materials and slow progress/late completion.

In addition to identifying inefficiency and poor performance by many participants, including the client, as a main cause of the industry's "problems," much of the literature regards conflict and disputes as evils which ought to be avoided. The recurring message seems to be that participants should behave better, be more trusting, and be nicer to each other. Whilst it is obvious that improvements would result if this were so, it is extremely unlikely that the established values and behavioural patterns of the participants will change in the absence of positive (individual and corporate) motivation and appropriate organizational modifications and incentives.

Transaction Cost Economics

Overview

In recent years, increasing application of transaction cost economics (TCE) theory has been made by a number of writers (Eccles 1981, Gunnarson and Levitt 1982, Reve and Levitt 1984, Stinchcombe 1985, Winch 1989, Doree 1994, Chau and Walker 1994) in an attempt to gain better understanding of particular construction related issues. This paper summarises part of the author's ongoing research, the main objective of which is the application of TCE theory to the problem of conflict and disputes in the Hong Kong construction industry.

Over the last three decades TCE has become a mainstream theory in the field of organizational science. The most prominent and most cited proponent of TCE is

Oliver E. Williamson. Indeed many authors give Williamson the main credit for the development of TCE theory.

Williamson (1975) credits the origins of TCE to a series of independent but complementary developments – not only in economics, but also in law and organization theory – in the 1930's. Legal developments are attributed to Karl Llewellyn and Stewart Macaulay, whilst John Commons, Ronald Coase and Chester Barnard are credited with significant contributions in the areas of economics and organization theory.

The approach proposed by Williamson (1975) adopts a contracting orientation and maintains that any issue that can be formulated as a contracting problem can be usefully examined in transaction cost economizing terms. The problem of economic organization is posed as a problem of contracting. A particular task is to be accomplished which can be organized in any of several alternative ways. Explicit and implicit contractual and administrative mechanisms are associated with each. The key question is : which will be the most cost efficient?

The basic premise of TCE is that the choice among alternative organisational arrangements (governance structures) is determined by a comparison of the costs of transacting under each. Transactors choose governance structures in order to minimise the costs of making their transactions. These costs include both ordinary *production costs* (land, labour, capital and materials) and the *transaction costs* associated with establishing and administering the business relationship.

Some writers emphasize what may be termed *ex ante* transaction costs – namely the costs incurred before a transaction takes place. The *ex ante* costs are those incurred in drafting and negotiating agreements which vary with the design of the good or service to be provided. Others focus on *ex post* transaction costs – namely the costs incurred after the contract has been made but before the entire transaction has been completed. These include the “setup and running costs of the governance structure to which monitoring is assigned and to which disputes are referred and settled: the maladaptation costs that are incurred; the haggling costs that attend adjustments (or the lack thereof); and the bonding costs of effecting secure (credible) commitments.” (Williamson 1985).

Contractual Incompleteness

Complex contracts, particularly those which are executed over a prolonged period, (e.g. construction contracts) are invariably “incomplete”. A contract is incomplete in the sense that it does not specify unambiguously, at the outset, all the requirements and obligations of the parties in every possible future “state of the world”. As events unfold during contract execution, the full requirements and obligations of the parties become known and appropriate “adjustments and adaptations” are required. As expressed by Chernoff and Moses (1959) “the sequential process of successively revising *a priori* probabilities on the basis of new observations permits you to ‘cross your bridge as you come to it’ rather than phrase your detailed strategy in advance, thereby ‘crossing all possible bridges you might conceivably come to.’ ”

The factors which cause contractual incompleteness are identified by Williamson (1975) as *bounded rationality* and *uncertainty*. Bounded rationality refers to human behavior that is “*intendedly* rational, but only *limitedly* so.” (Simon 1961). It involves cognitive and perceptive limitations on the one hand and language limitations on the other. “*The physiological limits take the form of rate and storage limitations on the powers of individuals to receive, store, retrieve and process information without error. Language limits refer to the inability of individuals to articulate their knowledge or feelings by the use of words, numbers, or graphics in ways which permit them to be understood by others. Demonstrations, learning-by-doing, and the like may be the only means of achieving understanding when such language difficulties develop.*” (Williamson 1975).

Bounds on rationality are interesting only to the extent that the limits of rationality are reached – which is to say under conditions of environmental uncertainty. In the absence of uncertainty an appropriate set of contingent actions can be fully specified at the outset. It is bounded rationality in relation to uncertainty that occasions the economic problem.

In theory, if rationality were unbounded, contingent claims contracts could be readily achieved irrespective of the degree of environmental uncertainty. Similarly, given a sufficiently simple environment, bounded rationality constraints would never be reached. However, when transactions are conducted under conditions of uncertainty – in which event it is very costly, perhaps impossible, to identify future contingencies and specify *ex ante* appropriate adjustments and adaptations thereto – then the bounded rationality constraint is relevant and an assessment of alternative organizational arrangements (governance structures) becomes necessary.

Opportunism

Contractual incompleteness sets the stage for *ex post* performance problems. When contingencies occur that are not fully and unambiguously covered by formal contractual provisions, and the need for the parties to “adjust and adapt” arises, one or both parties to the transaction may have incentives to behave “opportunistically” by taking actions that increase the costs or reduce the revenues that will be obtained by the other party.

TCE takes the view that “contractual” man is self-interest seeking and opportunistic. Opportunistic behavior involves making “false or empty, that is, self-disbelieved, threats and promises in the expectation that individual advantage will thereby be realized.” (Goffman 1969). It involves subtle forms of deceit and also includes stronger, more blatant forms of behaviour such as lying, stealing, and cheating. Opportunism refers both to behavior that does not maximize joint profits when a particular contingency arises and also behavior that involves the (attempted) appropriation of wealth of one party by the other. Opportunistic behaviour predictably leads to conflict and disputes between the parties. Upon realization that opportunistic behavior may occur, organizational arrangements (governance structures) provide contractual and administrative mechanisms for “working things out” in order to ensure continuity of the trading relation.

The assumption that human agents are opportunistic “elicits a variety of reactions, ranging from abhorrence through easy acceptance to an insistence that this is yet another case where there is nothing new under the sun.” (Williamson 1985). Those who abhor the use of opportunism regard it as an unduly jaundiced view of human nature. Williamson does not insist *“that every individual is continuously or even largely given to opportunism. To the contrary, I merely assume that some individuals are opportunistic some of the time and that differential trustworthiness is rarely transparent ex ante. As a consequence, ex ante screening efforts are made and ex post safeguards are created. Otherwise, those who are least principled (most opportunistic) will be able to exploit egregiously those who are more principled”* (1985).

One of the implications of opportunism is that “ideal” organizational arrangements, (i.e. those where trust and good intentions are heavily relied upon), are very fragile. *“Such organizations are easily invaded and exploited by agents who do not possess those qualities. High-minded organizational forms – those in which trustworthiness is presumed, are based on nonopportunistic principles – and are thus rendered nonviable by the intrusion of unscreened and unpenalized opportunists. Studies of contract (problems) which rely almost entirely on assumptions of differential risk aversion, similarly ignore or suppress the hazards of opportunism”* (Williamson 1985).

Williamson recalls that Italian nobleman Niccolò Machiavelli’s efforts to deal with “men as they are” made distinct provision for opportunism. Upon observing that humans have a propensity to behave opportunistically, Machiavelli advised his prince that “a prudent ruler ought not to keep faith when by so doing it would be against his interest, and when the reasons which made him bind himself no longer exist.”

“However reciprocal or preemptive opportunism is not the only lesson to be learned from an awareness that human agents are not fully trustworthy. Indeed, that is a very primitive response. The more important lesson, for the purposes of studying economic organization, is this: Transactions that are subject to ex post opportunism will benefit if appropriate safeguards can be devised ex ante. Rather than reply to opportunism in kind, therefore, the wise prince is one who seeks both to give and to receive “credible commitments”. Incentives may be realigned, and/or superior governance structures within which to organize transactions may be devised” (Williamson 1985).

Governance Structures and Credible Commitments

Williamson (1975) credits Commons with recognising that economic organization is not merely a response to technological features, but often has the purpose of harmonizing relations between parties who are otherwise in actual or potential conflict. *“The proposition that economic organization has the purpose of promoting the continuity of relations by devising specialized governance structures, rather than permitting relationships to fracture under the hammer of unassisted market contracting, is thus an insight that can be credited to Commons.”* (Williamson 1975).

The objective, therefore, is to recognize the potential for conflict in advance and devise governance structures that forestall or attenuate it.

In the wider context of contractual integrity, Williamson (1985) considers why it is that man (in the main) honours his commitments, and refers to Thomas Hobbes' discussion of oaths and promises in the *Leviathan*: *"The force of words, being, as I have formerly noted, too weak to hold men to the performance of their covenants; there are in man's nature, but two imaginable helps to strengthen it. And those are either fear of the consequence of breaking their word; or a glory, or pride in appearing not to break it. The latter is a generosity too rarely found to be presumed on, especially in the pursuers of wealth, command, or sensual pleasure; which are the greatest part of man-kind"* (Hobbes 1651, republished 1928).

Hobbes concludes that "there must be some coercive power, to compel men equally to perform their convenants".

Williamson (1985) concurs with Hobbes' contemplations. He concludes that appropriate contractual safeguards, assurances and mechanisms are incorporated into governance structures to ensure that the parties will have confidence in trading with each other *ex ante* and that continuity of the trading relation will be maintained whenever the need to "adjust and adapt" is required *ex post*. Williamson refers to such safeguards, assurances and mechanisms as "credible commitments". (1985)

In developing the theme of credible commitments, Williamson expresses general concern regarding the use by social scientists of user-friendly terms, of which "trust" is one. *"The growing tendency to use trust to describe probabilistic events from which the expected net gains from cooperation are perceived to be positive seems to me to be inadvisable. Not only does the use of familiar terms (like trust) invite us to draw mistaken parallels between personal and commercial experience, but user-friendly terms do not encourage us to examine the deep structure of organization. Rather, we need to understand when credible commitments add value and how to create them, when reputation effects work well, when poorly, and why. Trust glosses over, rather than helps unpack, the relevant microanalytic features and mechanisms"* (Williamson 1996).

In similar vein, Granovetter (1985) takes the view that to craft credible commitments (through the use of bonds, hostages, information disclosure rules, specialized dispute settlement mechanisms, and the like) is to create functional substitutes for trust.

Williamson furthermore expresses the opinion that "transaction cost economics refers to contractual safeguards, or their absence, rather than trust, or its absence." He argues that *"it is redundant at best and can be misleading to use the term 'trust' to describe commercial exchange for which cost-effective safeguards have been devised in support of more efficient exchange ... user friendly terms, of which "trust" is one, have an additional cost. The world of commerce is reorganized in favour of the cynics, as against the innocents, when social scientists employ user-friendly language that is not descriptively accurate – since only the innocents are taken in."*

Summary

The foregoing discussion relating to (a part of) TCE theory can be summarised as follows:

- (1) Complex contracts are invariably incomplete due to bounded rationality and uncertainty.
- (2) As a consequence of contractual incompleteness, whenever events/contingencies occur *ex post* which are not fully specified *ex ante*, one or both of the parties may behave opportunistically. Such behaviour predictably results in conflict and disputes.
- (3) To ensure that the parties have confidence in trading with each other and in anticipation of the likelihood for *ex post* “adjustments and adaptations”, organizational arrangements (governance structures) are devised *ex ante* which provide appropriate safeguards, assurances and mechanisms (credible commitments) to ensure that the trading relationship does not “fracture” but is maintained until the transaction is fully completed.

The Development and Construction Processes : A TCE Perspective

The above summary of TCE theory can be re-cast in the context and terminology of the construction process as follows :

- (1) Construction contracts are invariably incomplete (due to bounded rationality and uncertainty).

As discussed earlier, deficiencies in tender and contract documentation (i.e. inaccurate and inadequate design information, inadequate statement of client’s requirements, inadequate tender information, unclear risk allocation) are almost routine industry practice and are the underlying cause of many claims and disputes.

In addition, uncertainty as to the client’s precise requirements necessitate the *ex ante* inclusion in contract documentation of “provisional” sums/items of work, “prime-cost” sums in respect of work to be executed by nominated sub-contractors and a “contingency” sum to provide for the cost of *ex post* changes and refinements in client’s requirements (i.e. variations). Uncertainty also exists regarding the degree of opportunistic behaviour which will be exhibited by each of the parties during contract execution.

- (2) As a consequence of contractual incompleteness numerous revisions and changes to the nature and scope of work, and consequent adjustments to the time for completion of the project, invariably arise *ex post*.

In view of the incentives for one or both parties to behave opportunistically, disagreement regarding the extent of the contractor’s entitlements to time and

money (in respect of such revisions, changes and adjustments) frequently ensues resulting in conflict, claims and disputes.

- (3) Tender prequalification measures together with (some) provisions of the contract (e.g. surety bond, payment/retention terms) provide assurances (credible commitments) which give confidence to the parties in contracting with each other.

The terms and conditions of the contract also provide administrative procedures and mechanisms (credible commitments) for adjusting the contract sum and time for completion to take account of the inevitable *ex post* revisions and changes to the nature and scope of the work. (e.g. clauses for : measurement and valuation of variations; granting of extensions of time for completion; ascertainment of loss and expense.) In the event that the parties fail to agree regarding the nature and extent of such adjustments, mediation and/or arbitration provisions (credible commitments) are also made for third party assistance in resolving any disputes.

All the above contractual provisions are devised to ensure that continuity of the trading relationship can be maintained – whatever the nature of the circumstances which arise – until completion of the project.

Discussion

As referred to in the introduction to this paper, the “problem” of conflict and disputes on construction projects is not so much that they arise, it is the increasing incidence and scale of conflict and disputes – and attendant high costs – that presents the problem.

A TCE perspective of the development and construction processes indicates that conflict and disputes on construction projects are indeed inevitable and they arise as a consequence of :

- contractual incompleteness (due to bounded rationality and uncertainty), and
- one or both parties behaving opportunistically.

Furthermore, “credible commitments” are incorporated into the organizational arrangements (governance structures) to ensure that the trading relationship is maintained until completion of the project.

It follows, therefore, that in order to reduce the incidence and scale of conflict and disputes, appropriate measures should be introduced which have the effect of :

- A. Limiting or reducing contractual incompleteness (bounded rationality and uncertainty);
- B. Attenuating opportunistic behaviour;
- C. Providing more efficient and effective “credible commitments”.

As discussed earlier, the Latham Review (1993, 1994) of the UK construction industry is of particular interest to the present study. Many of the issues identified and recommendations made by Latham are equally applicable to Hong Kong's construction industry, and may also apply to the industries of other countries.

Improved standards of performance by the participants, particularly by the client and his consultants, would clearly reduce contractual incompleteness (category A above). Other Latham recommendations – e.g. procedures for selecting the most appropriate procurement route, use of Coordinated Project Information, use of a “family” of interlocking contract conditions like the NEC, and improved dispute resolution procedures – which relate to more efficient organizational arrangements can be classified under category C above.

Some of the papers presented at the “Construction Conflict : Management and Resolution” conference held in Manchester in 1992 were subsequently categorized by Doree (1994) in TCE terms. His suggestions of measures to attenuate opportunistic behaviour (category B above) include :

- improved education and training to provide better mutual understanding of tasks to be performed,
- more involvement by women which could lead to a less “macho” culture,
- establish trading practices that support and signal longer-term “relational” intentions, and
- greater awareness of ethics and mutual trust.

As discussed earlier, the emphasis on the desire for greater trust between the parties is a recurring theme in much of the literature, including the Latham Report (1993). Also as stated earlier TCE theorists take the view that the use of “use-friendly” terms, like “trust”, is inadvisable and misleading when describing and examining aspects of commercial exchange.

The need for a more detailed approach and use of more specific terminology is required, therefore, in order to consider this theme further.

Williamson's (1996) analysis of trust is possibly of relevance. Williamson distinguishes “personal” trust from “commercial” (“calculative”) trust and identifies “institutional” trust as a sub-set of commercial trust. He parallels “personal” and “commercial” trust respectively with Dunn's (1988) descriptions of trust as a “human passion” and trust as a “modality of human action”, remarking that “trust as a passion is the confident expectation of benign intentions by another agent”, but as a “modality of action, ... trust is ineluctably strategic.” Personal trust is characterized as: the absence of monitoring; favourable or forgiving predilections; and discreteness. *“Such relations are clearly very special. Personal trust is reserved for very special relations between family, friends, and lovers. Such trust is also the stuff of which tragedy is made. It goes to the essence of the human condition.”* (Williamson 1996).

Personal trust is therefore excluded from any analysis of commercial exchange. The focus instead is on “commercial” or “calculative” trust “When trust is justified by expectations of positive reciprocal consequences, it is simply another version of economic exchange.” (March and Olsen 1989).

Gambetta (1988) defines (commercial) trust as “*a particular level of the subjective probability with which an agent assesses that another agent or group of agents will perform a particular action ... When we say we trust someone or that someone is trustworthy, we implicitly mean that the probability that he will perform an action that is beneficial or at least not detrimental to us is high enough for us to consider engaging in some form of cooperation with him*”

In similar vein, Coleman (1990) is of the view that (commercial) trust is warranted when the expected gain from placing oneself at risk to another is positive, but not otherwise.

Williamson (1996) expands his views of commercial trust in the context of institutional environments; societal culture, politics, statutory regulation, the professions, trading networks and “corporate” culture. His argument is that institutional environments which provide general purpose safeguards (in the form of institutional trust) relieve the need for additional transaction-specific supports. “The main import of culture, for example, for purposes of economic organization, is that it serves as a check on opportunism”. As an illustration of societal culture, Williamson refers to the degree of trading trust in Japan which is said to be much higher than in Great Britain, and in contrast, the villages of southern Italy are characterized by very low trading trust outside the family.

A further example of institutional trust is membership of a profession – doctors, lawyers, architects and so on – which are supported by entry limitations, specific ethical codes, added fiduciary obligations, and professional sanctions. “Such support features are highly intentional and have the effect of infusing trading confidence into transactions that are characterized by costly information asymmetries” (Williamson 1996).

The above discussion suggests that “personal” trust should be excluded from any analysis of commercial exchange. “Commercial” trust, on the other hand, makes a significant contribution, both in the context of “credible commitments” – i.e. contractual supports, safeguards and the like – which have the purpose of providing and enhancing confidence in the parties to participate in the exchange and transact with each other as well as serving as a check on opportunism.

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