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Interorganizational agreements

Planners, politicians, and other public officials are perennially concerned with how profit-making organizations can be prevented from establishing agreements which restrict competition and how nonprofit organizations can be coordinated so that they provide better and more comprehensive services. Although social theorists have studied the role of agreements and contracts in forming, developing, and maintaining society (Coleman, 1964), organization theorists have devoted little attention to the general process by which agreements among organizations are created and maintained.*

Studies have focused on only limited aspects of interorganizational agreements, for example: (a) on particular types of agreements, such as joint programs (Aiken and Hage, 1968), joint ventures (Pfeffer and Nowak, 1976; Sebring, 1977), interjurisdictional municipal agreements (Friesema, 1970), domain agreements (Levine and White, 1963), price-fixing agreements (Scherer, 1970), and mergers (Felton, 1971; Pfeffer, 1972; Starkweather, 1970); (b) on the terms of agreements, such as price (Scherer, 1970) and legality (Wedderburn, 1965); or (c) on the negotiation of agreements, such as collective bargaining (Tannenbaum, 1965; Whyte, 1969) and trade-offs or logrolling (Coleman, 1964, 1966; Truman, 1971). Other work relevant to understanding interorganizational agreements can be found in diverse fields of study—economics, political science, organization theory, and social psychology. Studies of market structure, of coalitions and interest groups, and of decision making and information processing all exemplify work that can increase understanding of the general process of making interorganizational agreements. But differences in terminology, tradition, and purpose have camouflaged the contributions of this work to understanding interorganizational behavior.

This chapter attempts to overcome some of these disciplinary barriers and the limited focus of previous studies of interorganizational agreements by providing a logical structure for examining agreements. Agreements are considered in terms of a four-stage process: (a) identifying a relevant organizational environment, (b) selecting agreements as a means of coping with other organizations, (c) negotiating agreements, and (d) maintaining and renegotiating agreements. The chapter examines the constraints that promote or impede the agreement process at each stage. It evaluates and integrates existing knowledge and provides examples of useful information from diverse areas of study. It discusses implications for organizational research and design, and directs attention to activities which organizational decision makers might pursue to improve their own organizations' agreements.

This chapter concludes with a summary which highlights major points. Readers may find it helpful to read the summary first and then use it as a guide through the more detailed sections of this chapter.

General perspective

Because organization theorists differ considerably in their conceptions of organizations, this chapter's perspective or organizations, the constraints on organizational decision makers, and interorganizational agreements is summarized below.

Organizations

Three attributes characterize formal organizations: activities, resources, and rules.

An organization consists of a more or less stable pattern of activities carried out by employees, volunteers, or participants; these people usually being referred to as members of the organization. These activities are the essence of an organization and they include extracting, transforming, allocating, transmitting, and otherwise manipulating or controlling resources of an organization. Members participate in organizational activities in order to fulfill personal goals, whether they be prestige, money, public service, or a sense of purpose, and it is through organizational activities that members fulfill these goals.

The resources with which activities are carried out include people, data, and material objects. People are variously referred to as clients, patients, subordinates, or trainees. Data include accounts, technical knowledge, and other information. Material objects encompass

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machines, animals, raw materials, buildings, equipment, and so forth. Most of these resources must be obtained from outside an organization, so some members of an organization must arrange for, or directly handle, exchanges of resources with the environment—usually with other organizations. These resources vary in importance, some being critical to continuation of activities and others being relatively unimportant.

Each member is subject to rules. The term rule here refers to informal norms as well as to formal organizational rules. They include the explicit guides which are embodied in an organization's constitution or articles of incorporation, goal statements, job descriptions, employee regulations, and union contracts. They also include what is sometimes referred to as the informal organizational structure: productivity norms among workers, tradition, informal authority, and professional norms. Rules define criteria to which members are held accountable, and many other members of an organization—superiors, subordinates, and colleagues—impose and enforce them. These rules are not necessarily consistent or public, nor are they necessarily used to the benefit of an entire organization. Members devise, observe, and enforce rules to satisfy their own goals—whether selfish or altruistic. Conflict of interest and bribes are two instances of members employing rules selectively and pursuing their own goals at the expense of other members of an organization.

This characterization of organizations differs from some others primarily in its emphasis on the importance of activities and of tangible materials rather than of collective goals as constituting an organization. Once an activity has been established and equipment is in operation, personnel and materials have been procured, and contracts have been made—these constraints give an organization a semblance of collective goal orientation (White, 1974b).

Constraints on decision makers

The activities of organizational decision makers who are held responsible for managing or carrying out relations with other organizations are the focus of this chapter. These decision makers include administrators, managers, salespeople, and other boundary personnel.

Organizational activities, resources, and rules act as constraints or limits on the agreement-making activities of decision makers. These are not the only constraints upon decision makers, however. The activities, resources, and rules existing in the environment also constrain decision makers. Activities in the environment include not only the productive or service activities of other organizations, but also interorganizational activities such as buying, selling, and lobbying. For example, market structure—monopoly, oligopoly, or competition—is one way of describing patterns of selling and buying which affect a decision maker's options. The availability and location of different types of resources also influence a decision maker. Examples of rules which affect a decision maker include antitrust and consumer-protection laws, informal norms such as industry pricing customs and sizing standards, agreements previously made with other organizations, and the preferences of suppliers, regulators, and customers. As is true of rules emanating from within an organization, these external criteria of accountability vary in importance according to the ability of outsiders to enforce these rules by controlling resources important to a decision maker or a decision maker's organization. For example, the ability of regulated industries to impose costs upon regulatory agencies—just the reverse of what is intended—leads the regulators to compromise with regulated companies to a greater extent than other constituencies would prefer (Noil, 1971). This occurs because a regulatory agency is likely to prosper and maintain its budget and workload at acceptable levels only as long as there is no organized attack on its decisions, and the regulated companies are the most likely source of a concentrated attack.

Later sections of the chapter illustrate how these constraints affect the establishment and maintenance of interorganizational agreements. These sections will also illustrate how differences in internal and external constraints upon organizations lead to different patterns of interorganizational agreements. In particular, agreement making by profit-making and nonprofit organizations will be compared because they differ systematically in their patterns of constraints. For example, the laws governing interorganizational agreements are designed to limit the coordination and centralization of decision making and to promote competition among profit-making organizations; but among nonprofit organizations, laws are designed to promote coordination and centralization. Division of the market into exclusive product or territorial domains and the standardization of prices are generally illegal for profit-making enterprises but considered desirable for nonprofit enterprises. Decision makers in profit-making organizations are often held accountable primarily for monetary profit, whereas those in nonprofit organizations are generally held most accountable for adherence to professional norms or providing a given level of social services.

Different types of organizations, such as profit-making and nonprofit organizations, are often studied separately and with different models of behavior. The profit versus nonprofit dichotomy—though in reality a continuum—is used here to demonstrate how the same theory of organizational behavior can be used in explaining the behavior of each.
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The task of decision makers is either to adapt to or manipulate environmental constraints. They have a variety of tools at their disposal for doing so, one of the most important being the establishment of agreements.

An agreement between two organizations is defined in this chapter as the explicit specification of a mutually accepted rule for future behavior. As will be discussed later, agreements can take many forms. They can be formal or informal, oral or written. They can be simple or extremely elaborate, public or private, legal or illegal. The definition given in this chapter does not include understandings as agreements. Understandings are mutual expectations that are never explicitly stated but which may be mutually acceptable. Neither does the definition include rules such as laws, social norms, or organizational regulations of which people may not be aware but which can be used by others to constrain their behavior.

Agreements are tools which are wielded with varying degrees of skill and success. Interorganizational agreements are rules, and like other rules such as laws, rules of etiquette, and bureaucratic red tape, they are not always followed nor are the rule breakers always punished. They are used to build or modify relations among organizations. But they are no more than tools and they do not of themselves guarantee that future behavior will be as designed. They may also be used simply to stamp a public mark upon an ongoing relation or to create the illusion of interaction. They are sometimes just the finishing—and not particularly important—touch in the process of negotiating future behavior.

Identifying a relevant organizational environment

Decision makers do not concern themselves with all other organizations in their environments. A manufacturer will not be concerned with the same set of organizations as will be a hospital administrator, even though their organizations may be on the same street. It is not automatically clear, however, just which organizations these two decision makers do—or should—adjust to or attempt to influence. Therefore it is unclear with which organizations decision makers should establish agreements. This chapter’s discussion of the agreement-making process begins by asking the question: Which part of the organizational environment do decision makers find relevant and what implications does this selective attention have for managing the environment?

Organization theorists have recognized that only some limited part of the environment is relevant or important to organizations, as is implied by their use of the concepts of task environment (Thompson, 1967) and organization-set (Evan, 1965). Nevertheless, few concrete methods for identifying an organization’s relevant environment have been suggested (Evan, 1965; Smith, 1972) and most theoretical discussions continue to be vague about what actually constitutes the task environment of an organization.

In practice, operational definitions have varied widely and fail to represent adequately the organizations toward which decision makers direct their activities. The task environment has often been identified as the set of organizations with which an organization has already established some particular type of interaction, such as exchanging goods or services (Pennings, 1975). This operational definition overlooks organizations toward which decision makers have taken some other action. For example, manufacturers change prices or product lines in response to competitors, and they may try to avoid negative reactions from regulatory agencies, competitors, or constituencies by concealing agreements or other activities from them. Other criteria have been used to define task environments (Baldridge and Burnham, 1975; Kochan, 1975; Negandhi and Reimann, 1972), but they also exclude important segments of the environment. For example, although profit-making and nonprofit organizations may interact in many ways, studies of their interaction usually have focused either on profit-making organizations or on nonprofit ones, but not on systematic relations between the two types.

Speculative answers to two specific questions provide some hints about how decision makers might identify the most important elements of their environments. Firstly, what makes one organization more relevant or important than another? Secondly, how do information-gathering strategies influence the identification of important organizations?

The relevance of organizations

Managing interactions with the environment can be conceptualized as playing a game with other organizations: an action by one player affects both the rewards and the future moves of other players. Identifying the relevant environment is the process of determining what the goal structure of the game is and deciding which players—that is, which organizations—to watch out for. To judge the importance of another organization, a decision maker might ask three questions about a potential move by another organization: What are the utilities—possible costs and benefits—of the action? What is the probability that the other organization will take that action? What is the probability that those costs and benefits will actually occur if the action is taken? Decision
makers do not necessarily explicitly make each of these three assessments, but these three questions are one way for both researchers and decision makers to conceptualize task environments.

Organization theorists have focused primarily on the first question by asking what are the bases of organizational interactions. Three frequently mentioned bases of utility include: (a) complementarity of function—each organization providing resources that the other needs (Evan, 1965); (b) similarity of function—producing similar goods and services which may lead to competition for resources (Aiken and Hage, 1968); and (c) the imposition by policy planners or professionals of plans or regulations which require organizations to coordinate their activities (Litwak and Rothman, 1970). Organizations are often classified according to their functional relation to a decision maker's organization—for example, as competitors, cooperators, input affiliates, output affiliates, regulators, and economic claimants (Smith, 1972). These classifications essentially group organizations in the environment according to the major types of constraints they impose upon an organization or according to the major types of organizational needs they fulfill. An organization may have more than one functional relation with another and so be classified in several ways. For example, two manufacturing companies may be competitors within a particular market, and an increase in business for one may result in a decrease in business for the other. But they may also cooperate for their mutual benefit by fixing prices or lobbying together against governmental controls.

Organizations differing in constraints would be expected to differ in their relevant environments. For example, profit-making organizations usually receive most of their income directly from the organizations or individuals who consume their output, whereas nonprofit organizations such as schools and hospitals often receive much of their income from third-party organizations such as governmental agencies, insurance companies, community chests, or foundations. Nonprofit organizations are therefore likely to pay less attention to the demands of consumers than are profit-making organizations. Nonprofit organizations are constrained more often than profit-making organizations to serve clients in particular jurisdictions or service areas. The relevant environments perceived by decision makers in nonprofit organizations therefore may be more geographically bound.

Although decision makers may classify other organizations on the basis of costs and benefits to their organizations, these assessments are insufficient to explain why some organizations are of more concern than others. Many organizations in the environment are potentially important, but at any one time a decision maker pays attention to only some subsets of them. This occurs because some organizations are able to take actions that might bring great costs or benefits to another organization, but may be unlikely to take those actions. Decision makers may pay little attention most of the time to organizations with a high potential but low probability of doing great harm and orient themselves instead to organizations with lesser but more probable effects. Therefore both decision makers and organizational researchers should distinguish between three sets of organizations in the environment: (a) those organizations which potentially could significantly affect a decision maker's organization, (b) those organizations which actually are likely at any given time to affect a decision maker's organization significantly, and (c) those organizations to which a decision maker devotes considerable attention and activity.

Ignoring these distinctions, organization theorists have generally used concepts such as dependence and interdependence inconsistently when explaining interorganizational behavior (Blau, 1964; Emerson, 1962; Thompson, 1967). These terms are sometimes used to describe the constraints which lead to different types of behavior. For example, facilitative interdependence (Thomas, 1957) and partial independence (Litwak and Rothman, 1970) seem to refer to (a) or (b) above—the different patterns of utility that organizations might or do have for each other. But the terms dependence and interdependence have also been used to refer to actual behavior. (c) above, rather than to the constraints that lead to that behavior. In these instances the constraints, (a) above, have been referred to as the basis of interdependence or dependence (Emerson, 1962; Hasenfeld, 1972). Consequently, terms more specific than dependence and interdependence are needed to characterize different types of interorganizational behavior and the conditions leading to that behavior. Pfeffer and Nowak (1976) have, for example, distinguished competitive from symbiotic interdependence, and White (1974a) has defined several types of interdependence in terms of organizations' relative access to pools of resources.

Information-gathering strategies

Decision makers typically do not have complete information about all the constraints which they should consider when making decisions, nor is it always possible for them to obtain all relevant information. They may not know, for example, what the consequences of their decisions will be or be able to predict future market conditions. Smart and Vertinsky (1977) have presented a relevant conceptual model of the organizational decision process under crisis conditions. Stress, surprise, restricted amount of time for response, and threats to
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high-priority goals characterize crisis situations. Effects on the decision process include a narrowing of cognitive processes, information distortion, and rigidities in programming. Under realistic conditions, then, decision makers are not able to choose the best from among all possible alternatives. Instead, they conduct only a limited search for information about their constraints and alternatives, and they choose alternatives that satisfy certain minimal criteria (Cyert and March, 1963; Simon, 1957). Simon referred to decision making under such conditions as bounded rationality.

Information search can be characterized by two general principles: (a) the principle of relevance—gathering the most relevant information and (b) the principle of cost—gathering information that is readily available before gathering information that is more costly in time, effort, or money. The literature on problem solving and problematic information search (Cyert and March, 1963; March and Simon, 1958; Taylor, 1965) and on organizational scanning of the environment (Aguilar, 1967; Keegan, 1974) provides some clues about how these principles affect definition of the relevant organizational environment.

This literature best illustrates the principle of cost in information search. Decision makers generally search for information in familiar places. They search for new solutions which are similar to old ones (Cyert and March, 1963; Taylor, 1965), and they often routinely search trade journals and get information from friends, associates, and other familiar contacts (Aguilar, 1967; Keegan, 1974). In small organizations, information gathering may therefore appear unsystematic if the chief decision makers rely primarily on their own search for information rather than upon formalized organizational programs.

The more costly it is to gather information about another organization in the environment, the less information a decision maker is likely to have about the potential costs and benefits from that organization. A decision maker may therefore be less likely to consider that organization important. Costs of gathering information may increase with greater distance from a decision maker’s organization with more procedural rules within the other organization for releasing information, and with differences in types of personnel. Similarly, organizations which have been objects of attention and concern in the past may remain the most salient ones over time partly because they are the ones most familiar to a decision maker. Because decision makers often conduct only a limited search for alternatives and may choose one of the first satisfactory alternatives they find, they may be likely to establish new agreements with old exchange partners with whom they are already familiar.

Previous information search may influence orientation to the environment in other ways as well. For example, an organization may keep records or follow programs which routinely orient members of the organization toward particular segments of the environment (Cyert and March, 1963: 106), and which make it more likely that changes in the costs or benefits imposed by those segments of the environment will be noticed.

Studies of search and scanning provide little evidence, however, about the principle of relevance because, although they often ask respondents to state their sources of important information, they seldom ask respondents which types of information are important. Although interorganizational theory emphasizes the role of objective constraints on organizational interaction, it has ignored the process by which those constraints are identified. Neither constraints nor task environments are immediately obvious to decision makers, but the interorganizational literature leaves the impression that they are. Decision makers do not necessarily know what information is most important and they may not gather important information. For example, Emery and Trist (1965) documented how a canning company failed partly because its directors failed to investigate the possible consequences of the rise of frozen-food companies.

Also, decision makers in the same organization may have different opinions about what is important information, in part because they are subject to different constraints. Hallam (1975) found that managers of data-processing departments generally perceive the same important constraints upon their departments. However, Aguilar (1967) showed that functionally different departments within the same organization typically find different kinds of information important and use somewhat different sources of information. Aguilar’s work suggests that the task environment perceived by top executives may depend in part on the departmental or occupational composition of their organizations and upon the channels of communication within the organization.

Decision makers should be acutely aware of how their information-gathering activities shape the future of their organizations. A disadvantageous pattern of agreements may be avoided if decision makers periodically re-examine and make explicit their means of identifying which organizations in their environment are most important, perhaps by (a) occasionally reviewing lists of organizations in their geographic area for potential threats, opportunities, and influence on one another; (b) working from the resulting list of threats and opportunities to identify organizations outside the geographic area which might be important; and (c) reviewing how information is channeled to, and gathered by, decision makers responsible for making and maintaining agreements.

This perspective implies that both the actual co-
Selecting agreements as a means of coping with other organizations

Interorganizational agreements are an important means by which decision makers manage their organizations' relations with other organizations in the environment. But they are only one means. Some other means are described below because they can be used instead of agreements and because they can be used to obtain or support agreements. Sharp (1973) has presented an encyclopedic survey of nonviolent strategies for influencing organizations. Three general means of managing relations with another organization are discussed below—adaptation, indirect influence through third parties, and direct influence.

One alternative is to change some aspect of a decision maker's own organization. This is often called adaptation or innovation, and includes techniques for buffering an organization from the environment (Thompson, 1967). Internal changes include changing levels of production, changing or adding new product lines or services, or changing technology or administrative procedures so that production is faster, is more efficient, or results in higher-quality goods or services. Product differentiation—making goods or services distinguishable from those provided by other organizations—is another way of mitigating environmental influences through internal change. Using brand names or different supporting services for the same commodity decreases the variability in demand caused by changes in procedures of competitors (Scherer, 1970). Diversification of activities is also commonly cited as a strategy for dealing with the environment because it is a way of spreading risks (Scherer, 1970). Organizational procedures—sometimes called red tape—may be elaborated to buffer an organization from demands by constituents (Noll 1971).

A second alternative is for decision makers to influence other organizations indirectly through third parties. Changing prices charged to customers or increasing advertising often forces competitors to change pricing or production policies. Coalitions can be formed to promote products or policies. For example, trade associations and lobbies are formed to promote advantageous legislation and licensing practices and thereby to alter the number or type of competitors. Using mediators, bringing lawsuits, and registering patents and copyrights are also ways of indirectly controlling the activities or relevance of other organizations. Other indirect means include co-optation and overlapping membership—informally influencing the members of the other organizations by incorporating them as individuals rather than as representatives of other organizations (Thompson and McEwen, 1958) and influencing legislation and superordinate authority (Aldrich, 1976).

Thirdly, decision makers can influence other organizations directly by unilateral actions such as cancelling sales or purchase orders, withdrawing support or making donations. Agreements are a form of direct influence. A variety of agreements may be proposed to other organizations—domain agreements, price-fixing agreements, mergers, coalitions to pool resources, coordination of services and sales, and exchanges of goods and services. Because organizations interact in a variety of ways, the degree and nature of interaction influence the types of agreements made and the maintenance and renegotiation of these agreements.

Decision makers sometimes pursue more than one strategy initially or proceed a step at a time. An organization may try to manipulate the market through changes in production or prices or turn to a third party as well as employ strategies to force or entice the other organization to negotiate. International negotiations often involve preliminary agreements about the conditions of negotiation, such as when and where to negotiate and which third parties are to participate. The often turbulent unionization of factories also illustrates that many different tactics are employed to establish or influence negotiations. Organizations improve their bargaining positions by forming alliances with third parties before approaching a more powerful organization for an agreement. Initial use of an intermediary is common, with direct communication following. Thus, developing a strategy toward some segment of the environment frequently involves testing or using more than one alternative.

Unfortunately, the literature does not examine why decision makers choose one alternative rather than another. Alternatives such as overlapping board membership (Hannan, 1962) and international cartels (Edwards, 1967) generally have been studied individually, but alternatives have less often been compared. Discussion of why corporations diversify through merger rather than through internal expansion is one exception (Felten, 1971).

Specific constraints affect the likelihood that decision makers will pursue agreements rather than other strategies. Agreements may be unnecessary for achieving precise coordination among organizations if decision makers follow established industry customs. Scherer
(1970: 180) explained how the use of pricing customs probably accounted for the submission of identical sealed bids—$19.184 per bottle of tetracycline—by five different pharmaceutical firms. Laws may discourage or encourage certain types of agreements. As already noted, antitrust laws prohibit centralization of profit-making activities but other laws encourage centralization and standardization of services among nonprofit organizations. Lobbying for new laws and regulations is an alternative for decision makers when agreements are unlikely to be accepted or effective. The creation of fair-trade laws is an example in the profit-making sector: coordinating bodies are a more common device among nonprofit organizations. Laws prohibiting certain types of agreements do make those interorganizational agreements potentially more costly, lead to efforts to hide such agreements, or lead to different kinds of agreements. For example, one explanation for the increasing number of conglomerate mergers is that antitrust laws have discouraged the formation of vertical or horizontal mergers (Felton, 1971).

Market structure and the size and number of organizations are also important in explaining choice of interorganizational strategy. In a competitive market, individual organizations have little control over the market (Caves, 1967: 37), and more often react to their environment by making internal changes or relocating than by trying to influence other organizations. Explicit industry-wide agreements are more frequent and more difficult to maintain in a fairly competitive market than in an oligopoly (Caves, 1967: 51). Very large organizations can direct the activities of other organizations through unilateral actions such as price increases and production changes as well as through seeking agreements. Large organizations may, in general, have more options or discretion in interaction than small ones (Cyert and MacCrimmon, 1968: 600). Buying competitors and diversifying to provide themselves with resources formerly purchased from other organizations are strategies available primarily to the largest organizations.

Decision makers should not expect agreements to be sought or maintained in the face of constraints which make agreements more costly than beneficial—or not to be sought when the conditions do favor agreements. This caution is recognized by governmental officials and other individuals responsible for maintaining desirable patterns of interaction among profit-making organizations. But this caution is not so often recognized by individuals interested in fostering more coordination among nonprofit organizations. In a study of interorganizational conflict between a university and a state government, Sebring (1977: 521) concluded that organizations must either understand one another’s environmental characteristics and constraints, or overcome the effects of their separate environments through “deliberate and systematic efforts to understand how each institution’s environmental pressures and organizational structure affect their interorganizational relations.” The absence of desirable patterns of interaction, such as the referral and follow-up of clients, is often attributed to either a lack of information or poor attitudes among decision makers (White et al., 1973). It should be recognized, however, that many nonprofit organizations function quite well—even better from an administrator’s point of view—by maintaining only enough agreements to support organizational activities and to satisfy major constituents. Agreements calling for coordination of activities may be useful to clients, but they may represent a large drain on the scant resources of many nonprofit organizations. Many administrators complain that even the time required for planning meetings is sufficient to discourage efforts at coordination. When outsiders, such as coordinating councils and social planners, force agreements upon nonprofit organizations, they can expect these agreements to have the desired effects only if they ensure that it is either to the benefit of the organizations to pursue the agreements or costly for them not to maintain them—for example, by providing or withdrawing funds or legitimation. This seemingly obvious point is sometimes ignored in discussions of how agreements might promote coordination among nonprofit organizations (Litwak, 1970). Agreements which ignore pressing constraints upon decision makers are doomed to produce more frustration than coordination.

Negotiating agreements

Negotiating an agreement is the process of determining a mutually acceptable rule. In most cases an agreement is made with the purpose of making future behavior and outcomes more predictable and favorable for the participants, so participants not only seek a rule that is acceptable but also arrange conditions so that the other participants are likely to adhere to the terms of the agreement. Finding an acceptable rule ranges in difficulty from other parties readily accepting a simple statement of intention to time-consuming series of proposals and counterproposals. Two questions about the process of negotiating agreements are explored below. How do different constraints upon decision makers affect the probability that an agreement is reached? How are these constraints related to the form of the agreement made?

Reaching agreement

Negotiation has been discussed under a variety of broad headings—planning (Arnold and Hink, 1968), decision
making (Coleman, 1964), bargaining (Kochan, 1975), conflict (Assael, 1969; Goldman, 1966; Pruden, 1969), cooperation (Eichorn and Wysong, 1968), coordination (Mott, 1968, 1970), and collusion and conspiracy (Caves, 1967; Scherer, 1970). White (1974a) noted that negotiation is often referred to as conflict when it occurs among members within an organization but is referred to as cooperation when it is between organizations. Some writers on agreements and other processes of coordination ignore negotiation and imply that if desirable patterns of coordination can be devised, negotiations will not be a problem (Litwak and Rothman, 1970). But all agreements are compromises, each party promising something and each expecting something in return. And as the variety of terms for negotiation implies, some negotiations may be routinized and amiable—and so not even referred to as negotiation—but others may not be so effortless.

The problem in negotiation is either to find terms that fall within the acceptable ranges for all parties or to persuade some parties to alter their criteria of what is acceptable. One of the most obvious reasons for not reaching agreement is that decision makers or the other members they represent do not believe that the benefits of an agreement justify the costs. Organizational rules, criteria established by funding or regulatory agencies, or limits on resources or productive capacity may limit the resources that can be committed by an agreement and thereby make reaching an agreement unlikely. It should be noted, however, that decision makers may consider their personal costs and benefits when evaluating the terms of agreement. Possibilities of personal gain—through bribes or conflict of interest—may influence decision makers’ judgments of the merits of an agreement. Requirements that agreements be ratified by members of an organization do not necessarily decrease the chances of reaching agreement, but they lengthen negotiations and require negotiators to convince the members that their interests have been met optimally under the circumstance (Tannenbaum, 1965; Whyte, 1969). Difficulties of finding terms acceptable to all parties increase as the number and heterogeneity of organizations increase (Adrian and Press, 1968; Wren, 1967).

The acceptability of an agreement’s terms also depends upon the perceived equity of the agreement for all parties involved. Some decision makers try to maximize their benefits within the limits of their bargaining power, that is, to get the best deal possible. Such an assumption is consistent with statements that interorganizational linkages will not occur if there is extreme asymmetry of dependence (Litwak and Rothman, 1970). This is, however, only one criterion decision makers use to judge an agreement’s equity. Other criteria include maximizing the sum of benefits to all parties, maximizing the other parties’ benefits, benefiting in proportion to contributions required by an agreement, maximizing the differences in gains, and minimizing differences in gains (Meeker, 1971). Although decision makers in profit-making organizations often try to maximize their financial gain, there are negative consequences of trying to take advantage of the other parties. When profit-making organizations have established durable ties with other organizations or when sales staff come to know each other, they prefer fair agreements so that they maintain goodwill or can ask for favors in the future. Attempting to maximize returns to their organizations may be even less common and less legitimate among decision makers in nonprofit organizations. Friesema (1970) found that large metropolitan jurisdictions usually receive little if anything in return for their supply of fire, police, or other services to smaller jurisdictions.

A less obvious constraint on reaching exchange agreements is the degree to which organizations can alter their activities to produce goods or services that other organizations can utilize. Many profit-making organizations routinely modify their activities to produce the type or amount of goods required by their customers. In contrast, nonprofit organizations accountable for given activities are less able to modify them. This means either that one organization routinely must produce what the other one needs or that the requirements of the other be flexible. Nonprofit organizations therefore often cannot establish agreements unless there is an antecedent complementarity of need between their activities (White et al., 1973).

Because making agreements is a process of responding to and modifying constraints, it is important to examine the modifiability of different constraints. Characteristics of resources and technology have often been treated as basic and unalterable constraints on organizational behavior. Attempts to explain variations in organizational behavior using generic characteristics of resources and technology, however, have had limited success (Rushing, 1968; Sünichombe, 1965; Woodward, 1973). One reason for this failure is that material or technological constraints are not as basic or unalterable as they may first appear. Two illustrations of this point are provided below.

Firstly, the attributes of resources considered important may vary according to social or professional definition and according to the types of resource transformations attempted. Advertising is devoted largely to defining and redefining particular attributes of products—beauty, durability, costs—to make them salient to customers. Also, people-processing organizations—prisons, hospitals, welfare agencies, and employment agencies—are subject to special constraints (Hänsfeld, 1972; Perrow 1965), but these constraints
vary considerably according to the client attributes upon which they focus. For example, Lefton (1970) pointed out that within tuberculosis-treatment organizations, decision makers with different philosophies of treatment focus on different patient characteristics and so seek auxiliary services from different organizations. Rushing (1968) found that the hardness of materials used by different organizations is not related systematically to differences in organizational behavior. The constraints imposed by the characteristics of resources, however, result not so much from their attributes at the time they are acquired as from the difficulties of transforming them into the desired output. Soft materials may be as difficult as hard materials to transform or process. Furthermore, attributes such as liquidity or universality (Perrow, 1967; Yuchtman and Seashore, 1967) do not actually refer to inherent characteristics of resources. They refer to social characteristics of resources, to the nature of transactions that customarily accompany those resources. For example, the liquidity of resources is actually the ease with which people usually can exchange those resources.

Secondly, rules about what can or cannot be done by decision makers or their organizations may take precedence over the costs imposed by material constraints. Costs of conversion provide one example. It is not clear how the actual financial costs of conversion differ from profit-making to nonprofit organizations. Some costs of conversion in profit-making organizations may be absorbed by laws allowing tax exemptions for depreciation and capital investments. Nevertheless, it is likely that the same costs of conversion are treated differently in the two settings because nonprofit organizations customarily place less emphasis on economic costs and more emphasis on professional criteria in deciding to pursue certain activities than do profit-making organizations. Attractive, but expensive, new technologies are perhaps more likely to be adopted in nonprofit than in profit-making organizations despite the financial costs. Expensive changes in activities may, in fact, be necessary for nonprofit organizations to demonstrate that they provide modern and adequate services and to convince external constituencies to endorse or fund them. Thus, the same objective financial costs may inhibit the modification of activities in some organizations but not in others where constraints such as external criteria of accountability may be more basic and unchanged.

Negotiators must consider not only the possible outcomes or utility of different terms, but also the likelihood that the other parties will act in the future as specified by an agreement. They must assess existing constraints upon the other organizations and, if necessary, create other constraints to ensure compliance. Constraints existing prior to an agreement often assure decision makers that the other party will comply with the agreement. In such cases, an agreement is useful primarily for clarifying what future behaviors each party expects from the other so that they may coordinate their actions in a mutually desirable manner. But in other cases, decision makers rely on an agreement itself to assure an acceptable level of risk.

The constraints introduced by agreements include: legal sanctions or loss of collateral for breaking the agreement; benefits contingent upon fulfilling the agreement; values or beliefs of decision makers that agreements should always be honored; the loss of personal or business reputation and thus the loss of friends, esteem, or future business; and the unpleasant experiences of dealing with irate customers, superiors, subordinates, or other provoked constituents should the agreement be broken. These constraints are not necessarily reflected by a document's contents or by oral statements. Legal sanctions or loss of collateral may be specified in a contract, but other penalties—such as loss of reputation—remain implicit.

Writers have pointed out that many agreements depend upon trust (Stinchcombe, 1965). What this means essentially is that a decision maker believes that there are sufficient antecedent constraints on an agreement to induce the other party to the agreement to comply. This belief may be based on familiarity with the other party's past behavior or on a similarity between the two parties which leads a decision maker to predict favorably the other party's behavior. This is consistent with the finding that similarity between decision makers negotiating an agreement is helpful in reaching merger agreements (Starkweather, 1970).

**Forms of an agreement**

Laymen and researchers often believe that the form of an agreement—whether it is a formal contract or an informal agreement and whether it is specific or vague—determines the effectiveness of an agreement. To some extent this belief is correct, but examining an agreement's form as a consequence as well as a determinant of constraints on behavior reveals that the form is sometimes relatively unimportant in guaranteeing compliance. Under some conditions, informal or verbal agreements may be just as effective as formal contracts, even when the agreements are important (Macaulay, 1963; Picton, 1952). This point is illustrated by examining the constraints that encourage or discourage formality and explicitness in agreements.

An agreement may be more or less explicit or specific about the behavior expected from the parties to the agreement. It may be relatively explicit about the types of services or goods expected: their quality, price, or amount; the contingencies that legitimize or require a change in specifications; the periods or situations in
which the agreement is operative; penalties for noncompliance; procedures to judge compliance; or procedures for grievance or renegotiation. The explicitness of each aspect of the relation may differ according to the other constraints present in the relation. Where products are standardized in an industry, little or no mention need be made of a product's specifications when purchasing that product. Where organizations are highly dependent upon others in a market or where there are customary procedures for settling disputes and renegotiating contracts, sanctions need not be specified. Macaulay (1963) found that business executives are more specific in their agreements about the exchanges to be carried out than about penalties for noncompliance. On the other hand, where compliance is difficult to assess—as in agreements that do not involve resource exchanges—assessment or inspection procedures may be explicitly specified.

Macaulay also found that organizational lawyers routinely advise decision makers to negotiate very explicit and formal agreements, but that the decision makers themselves often prefer less formal and less explicit agreements. Formality and specificity may be not only unnecessary, but may also be costly in time, effort, and goodwill (Macaulay, 1963); they may decrease the flexibility of decision makers (Picton, 1952); they may provide evidence that an agreement exists or has at least been attempted when such agreements are prohibited by constitutions, regulatory bodies, or statutes (Scherer, 1970); and they may decrease chances of reaching agreement (Truman, 1971).

Specificity introduced because of standardization of organizational procedure—such as the conditions of contract printed on purchase orders or invoices—may be ignored. Macaulay found that the terms of contract that are exchanged with the exchange purchase orders and invoices are often contradictory. He found, though, that when agreements are very important and the parties are unfamiliar with each other, much effort may be devoted to making the agreements explicit and unambiguous.

Macaulay (1963) also found that decision makers may create very specific agreements in order to constrain their own organizations. For example, carefully specifying the type of product to be produced may provide information to engineers within the company about what they are to do, and it may provide a tool by which decision makers of one department can exercise control over members of other departments.

Formality is another dimension along which agreements may vary. This word refers here to the form in which the agreement is ratified. Formality can be seen as a continuum from brief oral agreements, through informal written agreements or letters, to notarized contracts or deeds. The same principles apply to the formality as to the explicitness of agreements. Picton (1952) discussed the utility for an organization of creating formal contracts—they produce clearer thinking and more thorough examination and appreciation of future consequences. When decision makers with good reputations or high authority in their organizations make an agreement, however, less formality may be acceptable or even preferred.

Demands by third parties can also affect the formality of agreements. When agreements are made to satisfy third parties, they may be vague in scope in order to avoid costly commitments (Marrett, 1971). This is often the case with nonprofit organizations because they are frequently encouraged to coordinate for the general welfare despite the costs to an organization itself.

Maintaining and renegotiating agreements

How are agreements maintained and when are they renegotiated? A few definitions help to make clear what is involved in answering these questions. Maintaining an agreement involves all parties actually behaving—within some acceptable limits—as specified in a rule created by an agreement. Assessing compliance with agreements involves specifying a rule and then judging the correspondence of actual behavior with the behavior specified by the rule. Renegotiating an agreement is an attempt to change a rule itself, and is one way to decrease discrepancies between behavior and rules. If a rule specifies behavior that is similar to actual behavior prior to an agreement or if it is merely a recognition of previous behavior, then compliance with the rule may not be a problem. If, however, a rule specifies behavior that is difficult or costly to perform in the future, renegotiation of an agreement will be sought.

The maintenance of agreements is frequently discussed in terms of the legality, enforceability, and effectiveness of agreements. These discussions are of limited use in understanding when agreements will be maintained and when they will not. Firstly, the enforceability and legality of agreements are difficult to judge and are not always important aspects of agreements. The legality of an agreement is usually not a rule. It is tested in court (Wedderburn, 1965) and few breaches of contract among organizations are ever taken to court. Macaulay (1963) found that business executives did not even like to suggest the possibility of court action, and they felt that they were being treated like criminals if they were threatened with court action. Breaking a contract was often referred to as cancelling an order, and extralegal procedures which were not adversary in nature were taken either to enforce an agreement or to renegotiate it. Furthermore, many agreements are maintained even though they definitely are
not legally enforceable (Macaulay, 1962) or even legal (Scherer, 1970).

Secondly, asking about an agreement's effectiveness is misleading because it implies that the maintenance of an agreement depends primarily upon attributes of the agreement itself, such as its legality, formality, or explicitness. As already noted, none of these attributes is always necessary or important for maintaining agreements. Further, effectiveness is too vague a term. Effectiveness implies an evaluation of an agreement according to some criterion—which may or may not be that the agreement is adhered to in its original form. An effective agreement by some standards might be one that is flexible or one that satisfies all parties concerned regardless of occasional noncompliance. A more useful approach to evaluating agreements is to examine the constraints that promote or impede conformance to them. As discussed below, one problem in explaining the maintenance of an agreement is in specifying when decision makers define agreements as broken and what steps they take to maintain or renegotiate them.

Constraints maintaining agreements

Constraints that lead decision makers to seek and negotiate contracts—such as need for resources—contribute to the likelihood that the agreement will be maintained. Other constraints introduced when ratifying agreements—such as the possibility of legal or social sanctions—are also important in maintaining agreements. These constraints have been discussed in previous sections. However, equally important constraints are activated after an agreement is ratified. For example, the cost of implementing an agreement is important in maintaining the agreement. Once resources have been committed, withdrawing from an agreement may be financially costly. Contributors, members, and other constituencies may complain about the waste involved in such a move. And once parties have committed resources to an agreement, they are more likely to invoke sanctions when others fail to comply.

Maintaining particular patterns of agreements possibly has more subtle effects. Maintaining particular types of agreements over time gives an organization an apparent goal or mission. Among health organizations, particular referral patterns become defined as organizational domains because third parties develop the expectation that the referral patterns will continue. Agreements fulfilled over a long period can become standard organizational procedures. The origins of the agreement eventually being forgotten (Friesema, 1970). Long-time buyers, purchasers, clients, and other constituencies can come to feel that they have more global rights than those specified in agreements—for example, that they have priority over other customers when there are shortages.

Over time, however, the whole pattern of constraints upon the parties to an agreement may change. External constraints may change: laws may be more vigorously enforced; new organizations may enter a market as buyers, sellers, or regulators; new pools of resources may be discovered or other resources become scarce. Internal constraints may also change: new owners or managers may pursue different strategies of growth; new members may demand changes in goods or services produced. All such changes can render agreements less useful or favorable than they once were. Hills and Mahoney (1978) found that when resources became scarce, university administrators tended to ignore implicit agreements to use universalistic criteria in resource allocation and instead acted to departments' differential power. Decision makers must monitor or be aware of these changes so that they anticipate when to terminate or renegotiate agreements and when they can expect to terminate or renegotiate agreements and when they can expect other parties to an agreement to modify or evade the terms of an agreement.

Assessing compliance

The first problem in assessing compliance with an agreement is to specify a rule; that is, the behavior that constitutes compliance. Agreements that are written and very explicit may clearly define such behavior. If they are unwritten, both outsiders and decision makers themselves may have difficulty in determining what constitutes compliance. This is a practical problem for decision makers new to an organization and for governmental officials trying to discover what agreements have been established and if they are being followed. In addition, many breach-of-contract cases are probably brought to court because of disagreements about what the agreement entailed rather than because of a clear failure to meet the terms of the agreement.

Another source of difficulty in determining compliance is that an agreement may govern a variety of activities not even specified in the agreement. Signing an agreement subjects people to the laws and customs regulating that type of agreement (Durkheim, 1933). Custom and precedent may substitute for explicit statements in a contract. For example, employment contracts are often quite vague or informal, but determine for both employers and employees quite specific rights and duties (Wedderburn, 1965).

The second problem in assessing compliance with an agreement is to determine the actual behavior subsequent to an agreement. Procedures for monitoring behavior may be created by an agreement itself and they may involve neutral third parties. Special procedures to monitor behavior may not be necessary in some agreements, such as in cash purchases, but may be important in others. For example, organizations which have estab-
lished a price-fixing agreement are usually concerned about discovering clandestine agreements in which competitors offer goods at a special price to large customers. Organizational decision makers must be concerned not only with assessing the compliance by the other parties to an agreement, but also with assessing compliance by their own organizations. Record keeping, inspections for quality control, and other procedures are employed to ensure that specifications are being met satisfactorily. Where contracts are important to an organization, decision makers may be concerned with not providing an excuse to other parties to an agreement to terminate the agreement.

Decision makers may tolerate considerable deviation from an agreement, so it is not always possible to predict when they will decide that an agreement has been broken. If an agreement was created to satisfy external sources of constraint, such as funding agencies, decision makers may not show concern with violations. But where an agreement was negotiated because of pressing internal needs, they may be quick to assess performance as inadequate.

Reactions to noncompliance vary, but initiating legal proceedings is generally the last resort (Macaulay, 1963). The offending party may first be approached in a manner customary within the social, professional, or industrial network for handling such deviations. Scherer (1970) noted that manufacturers are often reluctant to prosecute violators of fair-trade laws out of fear of alienating large customers and out of fear that the fair-trade laws—which are advantageous to industry—might be changed. Extralegal actions are often less costly and more effective in restoring compliance than are legal actions. Powerful members of cartels and illegal price-fixing arrangements can force competitors to reverse price reductions by swiftly and drastically reducing their own prices to a level which the smaller competitors cannot sustain (Scherer, 1970).

Decision makers should not rely on either the formality or legality of agreements. Two parties to an agreement are generally also related in other ways. They may have other commitments to each other or belong to the same network of organizations. Organizational networks are much like family or friendship networks, and can exert strong pressures to sustain or modify agreements. Members can damage their reputations and lose important contacts within the network by insisting that legally binding agreements be fulfilled after circumstances have changed or by finding technicalities to justify evading a promise. Conversely, agreements which are in themselves no longer advantageous may be continued to avoid negative reactions by third parties.

Compliance with an agreement may be judged against different sets of rules—family relations, friendship, business custom, specific laws. Choosing to judge one party as not in compliance according to legal standards may in essence be rejecting or nullifying the rules which decision makers usually apply. As noted before, business executives prefer to use extralegal procedures to settle disputes—such as do friends or relatives. Trust is fostered when parties invoke expected rules; it is destroyed when parties invoke unexpected rules. It is not so much the nonfulfillment of an agreement that produces distrust as the unexpected invoking of rules which a party believed would not be applied.

Summary

Interorganizational agreements are of concern to both decision makers within organizations and to interested parties outside organizations. Agreements are an important means by which organizational decision makers cope with, or adapt to, organizational environments—obtaining materials, selling goods and services, coordinating activities, and so on. Planners, politicians, officials, and other third parties focus on the wider social effects of agreements among organizations rather than on their value to the organizations themselves. For example, how can profit-making organizations be prevented from establishing agreements which restrict competition? And, how can nonprofit organizations be coordinated so that they provide better and more comprehensive services?

This chapter provides a logical framework—based on the agreement process—with which to analyze interorganizational agreements, and it reviews varied types of studies that are useful in better understanding the agreement process. Some basic definitions are provided first. An organization consists of rules, resources—data, people, and material objects—and activities. Members participate in organizational activities in order to fulfill personal goals, but are constrained in the activities they can carry out. This characterization of organizations differs from some others by emphasizing that activities and tangible materials, rather than collective goals, constitute an organization and that organizational activities are carried out—not by the organization per se—but by individual members who are pursuing their own goals—whether selfish or altruistic—within the constraints imposed upon them.

The task of decision makers is either to adapt to, or to manipulate, the environment to the benefit of an organization. They have a variety of tools for doing so, one of the most important being the establishment of agreements with other organizations. An agreement is defined as the explicit specification of a mutually accepted rule for future behavior. The definition itself raises several questions about agreements. With whom should they be made? What future behavior will be
constrained? What are the sources of constraint? The agreement process may begin, therefore, long before the different parties even discuss the possibility of agreement.

Most of the chapter is devoted to analyzing the stages of the agreement process and to examining the constraints from within and outside an organization that determine whether, and in what form, decision makers create and maintain agreements. Specifically, four stages or components of the agreement process are discussed: (a) identifying a relevant environment, (b) selecting agreements rather than other means of coping with the environment, (c) negotiating an agreement, and (d) maintaining and renegotiating an agreement.

Identifying a relevant environment

The organizations which are most relevant to an organization are not obvious, and decision makers must make judgments about relevance with only limited information about the environment. Game theory is particularly useful for analyzing judgments about relevance because it suggests three questions that a decision maker might ask about a potential move by another organization in the environment: (a) what are the utilities—possible costs and benefits—of the action? (b) what is the probability that the other organization will take that action? and (c) what is the probability that those costs and benefits will actually occur if the action is taken? Answers to these questions indicate that decision makers orient themselves to other organizations not only on the basis of objective possibilities for interaction but also on subjective assessments of how those organizations are likely to behave in the future, and that information-gathering strategies influence which organizations are identified as most important. Two general principles can be used to describe information search: the principle of relevance and the principle of cost. The first principle refers to gathering the information which is the most useful, for example, about particular classes of organizations such as competitors or regulatory bodies. To the extent that two organizations are subject to the same pattern of constraints, their decision makers will tend to identify the same organizations as relevant. The second principle refers to the fact that information gathering is costly and may be restricted primarily to particular geographic areas or to particular personal or published sources of information. To the extent that decision makers settle for less expensive but less useful information, their judgments about relevance may be more idiosyncratic.

Selecting agreements as a means of coping with another organization

Making agreements is but one possibility out of three general classes of actions: (a) adaptation—that is, to change some aspect of a decision maker's own organization; (b) indirect influence on other organizations through third parties such as trade associations, mediators, or legislators; and (c) direct influence, either unilateral, such as canceling orders, or bilateral, such as negotiating an agreement.

Decision makers must assess the costs and benefits of the different actions they can take. Some constraints promoting or impeding the creation of agreements are discussed to illustrate the importance of analyzing such constraints and include, for example: laws prohibiting or requiring explicit coordination, such as antitrust laws; the possibility of affecting the environment because of market structure, such as oligopoly versus competitive market; the financial investment required to fulfill agreements, such as capital investments to increase production; and the expectations of third parties, such as coordinating and funding agencies.

By analyzing the rules, the activities, and the resources that constrain decision makers, practical problems become apparent, such as how to facilitate coordination among nonprofit organizations but how to discourage it among profit-making ones. Third parties should not expect agreements to be sought or maintained in the face of constraints which make agreements more costly than beneficial to an organization itself—or not to be sought when conditions do favor agreements—unless the third parties change either the actual or the perceived balance of costs and benefits.

Negotiating agreements

The negotiation, maintenance, and effectiveness of agreements can only be understood within the context of the forces which led to the creation of an agreement. These constraints affect both the probability that negotiations will result in an agreement and the form of an agreement itself.

All agreements are compromises. Three types of judgments are examined which influence the acceptability of a compromise: equity, the ability of the organization to modify activities to fulfill the agreement, and the expectation that the other party will fulfill its part of the agreement. Social norms and industrial customs may determine what each party will perceive as fair; for example, large nonprofit organizations sometimes will bear greater economic costs than the smaller nonprofit parties to an agreement. The modifiability of constraints is often a matter of social definition rather than an inherent characteristic of even physical resources. Judgments about the future compliance by the other party—the third component of acceptability—depend on an assessment of whether the constraints existing prior to the agreement—such as the need to exchange
resources—the constraints embodied in the agreement itself—such as legal sanctions for noncompliance—and the constraints activated but not embodied in the agreement—such as loss of reputation for noncompliance—are together sufficient to ensure compliance. Where prior constraints and the constraints that are activated by but not embodied in the agreement are strong, less attention may be given to the constraints detailed in the agreement itself.

Neither formality nor explicitness is always necessary—such as for parties with a favorable history of exchanges—nor are they always desirable—for instance, where agreements are being kept secret from third parties. Formality and explicitness should be sought to the degree that they are useful and should not be expected to produce by themselves a particular pattern of interaction in the face of strong material or social constraints which press for a different pattern of relations.

Maintaining and renegotiating agreements

Understanding the maintenance of agreements requires understanding two important points. First, agreements often generate activities or conditions that support their continued maintenance. For example, once activities are implemented and resources are committed, it may become quite costly to withdraw from those activities. Second, maintaining an agreement means, in effect, using or acting on the agreement. The process of maintaining an agreement involves several activities: (a) specifying what rules for behavior were agreed upon, which may be difficult if an agreement was not very formal or explicit, (b) determining what the behavior of the other party actually is, which may be difficult if it does not involve a material exchange, (c) deciding when the behavior deviates from a rule to a sufficiently large degree to be considered noncompliance, and (d) reacting to the noncompliance, perhaps approaching the offending party informally and only as a last resort invoking sanctions specified in an agreement.

References

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