

# THE INFLUENCE OF THE OPPORTUNISTIC BEHAVIOR ON THE CONTRACTUAL RELATIONSHIP

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## ABSTRACT

*The paper deals with the nature of influence of opportunistic behavior of economic agents on the implementation of contractual cooperation. Opportunism can apply to any form of interaction between economic subjects; it implies an increase of transactional costs including the costs of destructive behavior and the costs of protection against third parties; the complexity and dearness of personal protection from the opportunistic behavior of counterparties. The findings of the investigation were made by using the dialectical method, the scientific methods, the author economy. It has been proved that the level of asset specificity determines the particular manifestations of opportunistic behavior in the implementation of the contractual relationship. The acceptance of the precondition of the impossibility of complete removal of the probability of opportunistic actions by at least one party of the transaction leads to the need for incomplete contract. The results can be used in improving the economic policy in the educational activity. The revealed laws provide the basis for further research in the field of behavioral economic theory.*

**Keywords:** *economics, opportunistic behavior, contract, contractual relationship, transactional costs, abuse of trust.*

## INTRODUCTION

The importance of studying the behavior of economic agents is explained by high significance of social factors in economic decision-making. At the same time, there is scarcity of empirical studies on particularization and revelation of laws of certain types of economic behavior. Opportunistic behavior has been insufficiently studied.

The first scope of application of the term “opportunistic behavior” was political relationship. The approach to organizational relations in terms of opportunism was first described in 1986. Opportunistic behavior in this case is manifested in the fact that managers use the asymmetry of information in order to maximize their usefulness in determining the sum and contractual terms with contractors, loan agreements and relationships with regulators. The investors are led into error by inadequate information which is reflected in the documents. In addition, the opportunistic behavior of managers may become apparent in determining dividend policy.

R. Watts and J. Zimmerman first used the categories of opportunism to explain the behavior of managers when announcing their margin of profit by influencing the contractual relationships in order to thus affect the wages and bonuses which are paid by the shareholders to the manager. D. Fudenberg and T. Tirole have proved that the risk lover managers who do not have direct access to capital markets will have an incentive to participate in the receivership.

According to the studies the risks of opportunistic behavior are the key obstacles in the management of long supply chain in the field of transport logistics.

The most common treatment of opportunistic behavior is the definition by O. Williamson who understands opportunism as “adherence to one’s own interests, including on false pretences, including here such obvious forms of deception as lie, stealing, fraud”. Behavioral uncertainty is an important factor in building the contractual relationship. Opportunism is one of the key assumptions for the existence of transactional costs, risks of opportunism are taken into account when making decisions on carrying out investment. A huge number of economic problems can be misinterpreted if opportunism is ignored.

A. Buvik and T. Reve, De Vita, and A. Söllner point to the link between manifestations of opportunistic behavior and characteristics of the assets that are subject to contractual relationships. Moreover, the problem of opportunistic behavior in the implementation of the contractual relationship was considered in works by D. Parker, G. Baker, H. Xiao, S. Kunte, P. Casas-Arce, D. Campbell, D. Harris, K. Wathne, C. Cordes.

However, cause-effect relation between the scope of opportunistic behavior and characteristics of the implementation of contractual relations requires further proof.

## METHODS

Interpretations of the terms “opportunism” and “opportunistic behavior” were systematized by the representatives of different economic schools. We considered these relations by the contracts performed in the construction sector due to the availability of information on the distribution of the facts of opportunism in this area.

To study the laws of opportunism in the performance of contractual interactions we carried out via next actions: the selection of the object of study; the study of the legal requirements, the opinions of the expert community; the study of documents on the execution of the contractual relationship, court decisions; interviewing of the parties of contractual relations; exposing common forms of opportunistic behavior, the description thereof; the verification of the findings on the basis of judicial opinion.

## RESULTS

Based on the analysis carried out the key areas of usage of the term opportunism are presented in (Table 1).

**Table 1**  
**THE ANALYSIS OF THE OPPORTUNISM MANIFESTATIONS ACCORDING TO THE STANDPOINTS OF DIFFERENT SCIENTIFIC SCHOOLS<sup>i</sup>**

<b>№</b>	<b>Schools</b>	<b>Treatment of the content of the category “opportunism”</b>
1	Savage capitalism	The roots of opportunism are in the mindset, transformed into actions that lead to fraud
2	Marxist theory	Opportunism as abandonment of revolutionary struggle of proletariat (workers)
3	Constitutional economics	Opportunism as difference in behavior of politicians before and after election
4	Labor opportunism	Opportunism as behavior of wage laborers, conflicting with the interests of managers
5	Organizational relations	Opportunism as behavior of wage managers, conflicting with the corporate

		objectives on the whole
6	Economics of discrimination	Opportunism as discrimination of the subjects of contracting parties
7	Institutional theory	Opportunism as keeping on one's own interests, including fraudulently
8	Neo-institutional theory	Opportunistic behavior as masked element of transaction costs

Implementation of opportunistic actions by the subjects suggests the occurrence of loss in the form of additional costs. The influence of opportunism on costs has not been directly studied (R. Dahlstrom and A. Nygaard). As the result of the analysis of the documents related to the contracts on specific and idiosyncratic assets, interviewing experts, implementation of the contracts have been divided into three stages. At each stage of implementation of the contract the patterns of opportunistic behavior have been identified. The results are presented in Table 2.

**Table 2**  
**PATTERNS OF OPPORTUNISTIC BEHAVIOR IN DIFFERENT PHASES OF CONTRACT IMPLEMENTATION<sup>ii</sup>**

Stages of contract implementation / Subject of opportunistic actions	Signing a contract	Execution of works	Settlement for executed works
Customer	1. Omission of well-defined work statement	2. Task alteration for works	3. Payment delay for works; 4. Groundless claims to quality of work
Contractor	1. Input item manipulation	2. Application of less costly materials; 3. Appeal to less-skilled workers	4. Baseless inclusion of additional items of expenditure into acts; 5. Forming cost sheets, without correcting quantity of work put into cost but not executed

According to the results, input item manipulation often include widespread manifestations of opportunistic behavior, such as:

1. Inclusion of additional types of work due to excessively well-defined work statement;
2. Unjustified use of conversion factors of cost of works according then-current dollars;
3. The use of excessive overhead rate;
4. Record keeping in the project documentation or estimate for expensive materials overstating costs estimation.

It has been found that the expense ratio to payroll varies under contractor's agreement from 28.8 to 89.3% of the direct costs of the project implementation. At that, according to statistical data, labor costs with taxes account for 25.0% of the costs of construction organizations. Artificial setting the showing too high is the fact of opportunistic behavior.

The level of the estimated profit ranges from 15.0% in the estimates for maintenance of engineering systems, and up to 65.0% according to the standards of methodological documents in construction. The amount of overheads also signifies 35-95.0%. The materials expense ratio to the total value of factor costs is 5-68.2%. This variation may be caused by intentional actions of the economic agents, as well as accidental mistakes due to the limited cognitive capacities of man. In any case, all this generates behavior costs that influence financial performance of the preparation and execution of the contract.

## SUMMARY

It has been revealed that all the selected types of opportunism can be implemented both with third party practice and without. In the case of third party practice, there is a conspiracy with other persons who are not directly involved in the transaction but act as covert agents. For example, cost item manipulation on the cost estimates for the types of work constitutes abuse of confidence of the customer, as the contractor keeps, as a rule, more complete information regarding the estimate valuation mechanisms as compared with the customer. The influence of confidence on building economic relations between firms has been previously also considered in work by R. Woolthuis .

The preconditions of manifestation of opportunistic behavior at the conclusion of the contract are: 1) high cost of measurements of quantity and quality of the works performed, the services rendered, the materials used; 2) more complex mechanism of documentation of contractual relations in comparison with other types of contracts; 3) a wide variety of requirements of the customers to the percentage value of a number of indicators of estimate documents; 4) lack of knowledge of the technologies of implementation of works on creating a specific asset for the customer.

One way is the transference of certain operations to outsourcing.

## CONCLUSION

It is revealed that all the manifestations of opportunistic behavior in terms of contract relationship may be implemented with the involvement of third parties and without them. In the case of involvement of third parties, there is a conspiracy of one of the parties of contractual relations with other persons.

To neutralize the incentives to opportunistic behavior one suggests to specify in the contract measurable requirements for the quantity and quality of the working data; key parameters checkout mechanisms; requirements for professional skill level of the staff. However, more important is to raise the level of trust in inter-firm relationships. Thus, D. Deedsa, C. Hill have found the proof that stable relations between the partners are far more effective deterrent to opportunistic action than making investments in more detailed presentation of the terms of contracts and claims. The researchers S. Wuyts and I. Geyskens have come to the similar results.

Besides, Deligonul believes that tolerance limit for the opportunistic behavior for the international partnership should be higher due to the larger barrier diversion to another supplier in the international environment. Reputation effects provide group insurance for the buyers of opportunism of the supplier .

In some cases, it is reasonable to attract third-party organizations performing the role of a technical customer; the creation of self-regulatory organizations. This is consistent with the findings of M. Granovetter, according to his research the most effective ways to prevent opportunistic actions of economic agents is to strengthen network ties between the participants of the transaction. The researchers also point out that in this case, opportunism is constrained by notions of justice .

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