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Abstract

Implicit contracts are "invisible handshakes" that are not legally binding but are grounded in mutual understanding between the parties of what they expect from each other. These contracts are very common both within the firm (e.g. between managers and employees) and in business relationships (e.g. between a firm and its suppliers). Typically, implicit contracts arise in relationships that are in some way open-ended. An extensive literature has showed that implicit contracts allow firms to create value by encouraging relationship-specific investment and motivating effort by stakeholders. This chapter focuses on how sustainability satisfies existing implicit contracts (including a broad social contract with society at large) and facilitates a firm in entering new implicit contracts by improving its trustworthiness. I argue that the adoption of sustainability is directly related to industry- and firm-level variables that make implicit contracts important to a firm's strategies, and inversely related to the strength of overriding factors that make a firm trustworthy. Based on this reasoning, I analyse four areas in which rates of sustainability adoption can vary according to the importance of implicit contracts.

Keywords: Contract theory; trust; stakeholder theory; benevolence; integrity; long term

Sustainability and Implicit Contracts

1. Introduction

Stakeholder theory has frequently advanced the view that a firm is a nexus of explicit and implicit claims, where explicit claims consist in laws and explicit contracts, while implicit claims stem from implicit contracts between the firm and stakeholders (Klein, Mahoney, McGahan, & Pitelis, 2012). The defining characteristic of implicit contracts is that they cannot be enforced in courts (Cornell & Shapiro, 1987). An implication of this view is to present pro-social action by firms as fulfilling implicit contracts with stakeholders, including a broad social contract with society at large, which grants firms access to natural, social, or political resources.

The literature has showed that implicit contracts allow firms to create value, by enabling relationship-specific investment and effort by stakeholders (Klein et al., 2012). However, firms need to be *trustworthy* to enter and maintain implicit contracts (Gibbons & Henderson, 2012). Stakeholders expect to appropriate part of the rents generated by implicit contracts; so, stakeholders are interested to contribute to the relationship as long as they trust the firm to adhere to the agreement. In this chapter, I show that trustworthiness has two consequences for sustainability. First, being socially and environmentally sustainable facilitates a firm in entering implicit contracts by improving its trustworthiness. Second, sustainability can be superseded by alternative ways of demonstrating trustworthiness in implicit contracts, leading certain firms to underinvest in their social and environmental efforts.

In developing this position, I try to move beyond the economic interpretation of implicit contracts, which reduces the trustworthiness of the firm to the expectation that it will be profitable for the firm to honour the contract. In this interpretation, stakeholders have *calculative trust* (Williamson, 1993), i.e., a rational assessment of the conditions that may drive the firm to fulfil promises. This interpretation is too narrow, because trust research points at other types of trust that are founded on personal ties and social rules, rather than calculation (Fulmer & Gelfand, 2012). Moreover, calculative trust is actually more typical of arm's-length relationships than the open-ended relationships that usually harbour implicit contracts (Poppo, Zhou, & Li, 2016). While the theoretical premises of the economic interpretation of implicit contracts and the trust literature are often at odds, I try to show that these views can be usefully combined.

By drawing from both, I examine the reasons why stakeholders expect a firm to honour agreements and how sustainability improves trustworthiness of firms.

The chapter also tries to contribute to our understanding of why firms and industries vary in their commitment to sustainability. Under the premise that sustainability is costly, because it absorbs resources that could serve other purposes, the degree of adoption of sustainability should be directly related to industry- and firm-level variables that make implicit contracts important to a firm's strategies, and inversely related to the strength of overriding factors that make a firm trustworthy in implicit contracts. Based on this reasoning, I analyse four areas in which rates of sustainability adoption should be higher or lower.

The remainder of this chapter is organized as follows. In section 2, I present the economic interpretation of implicit contracts and explain how the notion of trustworthiness used in this interpretation can be enriched by a realistic consideration of the sources of trust identified in the literature. In section 3, I discuss the place of implicit contracts within stakeholder theory and how firms can use sustainability to increase their trustworthiness and, as a consequence, facilitate implicit contracts. In section 4, I identify and examine the areas in which the implicit-contract perspective explains variance in sustainability adoption. Section 5 concludes.

2. Theoretical background

2.1. Implicit contracts and trustworthiness

Implicit contracts have been defined as "arrangements that are not legally binding but that give both sides incentives to maintain the relationship" (Okun, 1981). These contracts are "invisible handshakes" that are grounded in mutual understanding between the parties of what they expect from each other. Implicit contracts are very common both within the firm (e.g. between managers and employees) and in business relationships (e.g. between a firm and its suppliers). Typically, implicit contracts arise in relationships that are in some way open-ended, rather than in spot-market exchanges. Open-ended relationships – that is, continued or repeated – are exposed to future contingencies that may change the payoffs of the parties and impinge on their willingness to honour obligations. Complete contracting of future contingencies, which are often hard to describe in advance, is notoriously costly. This is where implicit contracts offer a flexible and convenient alternative for governing the relationship.

Macaulay (1963) was the first to present anedoctical evidence of the pervasiveness of informal and good-faith agreements in business. The widespread acceptance of implicit contracts can be puzzling when considering that they cannot be enforced in courts (Cornell & Shapiro, 1987). Implicit contracts are essentially promises: each party must trust the other to deliver on the contract without being legally required to do so. Godley (2013) reports how U.S. manufacturer Singer created a market for domestic sewing machines in Europe at the end of the 19th century by promising customers an after-sale service that was not written in a formal product warranty. Singer did not want to be legally forced to provide assistance to European customers if the market failed to develop. Therefore, Singer needed to make after-sale service contingent on a future state (achieving a sufficient number of customers), which, however, was difficult to contract. Merely promising to provide service bypassed the problem. The implicit service contract was grounded in the customer's general understanding that Singer was interested in word-of-mouth publicity and in growing its business. A part of Singer's success was due to its innovative selling system, in which sales staff visited households, establishing face-to-face relationships with customers and providing both the pre-sale demonstration and the after-sale service. The other part was that customers were allowed to pay in instalments, which were collected by the sales staff, giving customers some bargaining power, since they could block payments if the machines were not serviced.

This example shows that implicit contracts do not have to be tacit. Verbal promises or actual handshakes are implicit contracts, because they do no create legally enforceable obligations. This is why some speak of 'self-enforcing contracts' (Telser, 1980), emphasizing that parties enforce the contract themselves without going to courts, or 'relational contracts' (Baker et al., 2002), emphasizing that the contract rests on a protracted relationship between the parties.

The economic interpretation of implicit contracts has been that parties honour the terms of the agreement as long as it is beneficial for them to do so (Gibbons & Henderson, 2012). First, fulfilling the promises keeps a productive relationship alive. Second, those who fulfil promises develop a reputation for trustworthiness and are able to enter new implicit contracts, with the same party or others (Kreps, 1990). This logic can be modelled as a repeated cooperative game in which the implicit contract yields streams of income for the parties, originating from ongoing or future business. The stream defines the *value of the relationship*. At each stage of the game, parties will deliver on the implicit contract if their respective value of the relationship is larger than their immediate payoffs of reneging on it. The model has many testable implications, for example that large firms are more likely than small firms to adhere to implicit contracts, because the former have bigger streams of income to lose if they harm their own reputation (Klein, Crawford, & Alchian, 1978).

The economic interpretation reduces the trustworthiness of a party to the expectation that the party will find advantageous to honour the contract. In the trust literature, this expectation is called *calculative* trust (Williamson, 1993), *deterrence-based* trust (Rousseau et al., 1998), or *cognitive* trust (McAllister, 1995). However, decades of trust research indicate that other types of trust exist which are not founded on calculation but on personal ties and social rules (Fulmer & Gelfand, 2012). So-called *affective* trust (McAllister, 1995) stems from the positive emotions of the trustor generated by the relationship with the trustee; this type of trust makes the trustor especially prone to engage in relationships when control systems (such as legal enforcement) are absent (Johnson & Grayson, 2005). Affective trust develops over time and so is likely to affect the long-term relationships that harbour implicit contracts. In fact, calculative trust is more typical of short-term or exchange-oriented transactions (Poppo et al., 2016).

Gibbons & Henderson (2012) suggest that implicit contracts may also be supported by *social* trust, which is the propensity to trust others when individuals share a culture or participate in certain institutions. In an atmosphere of social trust, implicit contracts are facilitated by a sense of mutual respect and a consensus on principles of fair play. Social trust might explain why firms from some countries (such as Germany and Japan) find it easier to build long-term relationships with stakeholders (Hall & Soskice, 2001).

Finally, it is implausible that parties always have detailed information about how valuable the relationship is to the other party (Halac, 2012). The value of the relationship depends on factors that can be largely unknown, such as the other party's plans, business opportunities, and whether the reputation costs of reneging on the contract are large enough to prevent exit. For example, workers may find it difficult to predict whether the employer, in face of cost pressures, will find it convenient to honour implicit contracts with the local community or shut the factory down and offshore production. Moreover, the value of the relationship is sensitive to discount rates (Gibbons & Henderson, 2012): the other party might be a 'patient' type (low discount rate), who is interested in staying on the market and entering new implicit contracts in the future, or an 'impatient' type (high discount rate), who looks for a quick payoff and is open to short-term opportunistic behaviour. The type of the party is hard to assess, especially at the beginning of the relationship. The general lack of information on the value of the relationship for the other party suggests that non-calculative forms of trust, involving some ‘leap of faith’ (Möllering, 2001), are often needed to initiate and uphold implicit contracts.

2.2. Benefits of implicit contracts in relationships with stakeholders

Implicit contracts allow firms to engage in value-creating relationships (with employees, suppliers, customers, local communities, public authorities, and other stakeholders) that would be less efficient if governed through market transactions or formal long-term agreements. A first benefit of implicit contracts is to encourage relationship-specific investments by stakeholders (Dyer & Singh, 1998; Klein et al., 1978). An investment is relationship-specific when the stakeholder cannot redeploy it to an alternative use without bearing substantial costs (Williamson, 1985). A typical example is an employee who learns skills that are tailored to the processes of the firm.

Relationship-specific investments create rents, because specialized resources are usually more productive than generic resources. After stakeholders make the investment, the firm may recur to opportunism to appropriate the whole rent, because stakeholders cannot threaten to exit the relationship without losing the investment. In principle, explicit contracts could state how the rent is to be divided between the parties, but they are inferior to implicit contracts when the conditions to be specified are too complex. For example, the employee who learns specialized skills needs to be assured that the firm will not lay her off, as long as she does a good job, but what constitutes a ‘good job’ is generally too nebulous and state-contingent to be written down in an explicit contract (Cornell & Shapiro, 1987). Implicit contracts allow parties to leave these terms unspecified and use mutual understanding and direct knowledge of the situation to establish whether or to which extent the agreement is being respected. Additionally, implicit contracts give parties the flexibility to adjust their conceptions of appropriate execution in response to change in relevant circumstances (Uzzi, 1997).

Second, implicit contracts can be used to elicit stakeholder effort when the required actions cannot be specified *ex ante,* or even verified *ex post*. In the Toyota production system, workers are expected to identify quality issues and pull an *andon* cord to ask for real-time help, and if necessary, to pull the cord twice to stop the production line. It is not possible to specify exactly the cases in which the cord must be pulled; the system depends on the workers' ability to evaluate when an issue is serious enough to require intervention (Helper & Henderson, 2014). Relatedly, the firm cannot reward workers who pull the cord with monetary incentives, which might lead to abuses. Instead, the system is based on an implicit contract in which the firm asks workers to take responsibility for quality and reward them with lifetime employment. Here relationship-specific investments are absent. The implicit contract aims at motivating stakeholders to situationally complex behaviour that rests on tacit knowledge or expert judgement. These contracts may arise in any relationship in which parties interact repeatedly, develop common understandings and expect each other to act according to shared priorities (Poppo et al., 2016; Saparito, Chen, & Sapienza, 2004).

A third benefit of implicit contracts is to obtain consent to a firm's activities by local communities or broader society. The implicit contracts that firms agree with these stakeholders are "social contracts". These real-world agreements should not be confused with the hypothetical social contracts that political theorists devise to provide rational justification for social institutions (Demuijnck & Fasterling, 2016). Real-world or "extant" (Dunfee, 1991) social contracts reflect incompleteness of the law, which cannot anticipate all the ways in which firms may have an impact on society (Regan, 1998). Even when public regulation of certain activities is possible in principle, it may be more socially efficient to grant firms leeway in how they conduct their business, due to costs of specifying, monitoring, and enforcing complex rules. This leeway is granted under the common understanding that the local community, or society at large, consent to the activities of the firm if they deliver desirable societal outcomes (Morrison, 2014). These outcomes may consist in social welfare creation (including prevention of negative externalities) or in the conformity of a firm's activities to values and goals of relevant social groups (Dunfee, 1991). For a firm, consent corresponds to having a "license to operate" (Demuijnck & Fasterling, 2016). Firms may enter social contracts by the sheer fact of establishing operations in a community and drawing on local resources, or, when looking at society at large, by the sheer fact of starting a business (Dunfee, 1991).

To summarize, many implicit contracts are ways of using trust and relational knowledge to promote investments and efforts by stakeholders, or to obtain a license to operate by local communities or broader society. Firms that find it difficult to recur to implicit contracts can be at serious competitive disadvantage, because stakeholders will avoid relationship-specific investments, ask to negotiate costly explicit long-term contracts, or expect to be paid a premium for making the investment under the risk of opportunism by the firm. Additionally, these firms may face lower effort by stakeholders, or have to pay them higher compensation to obtain the same degree of motivation as firms that use implicit contracts. Finally, a firm's failure to deliver on social contracts may result in the loss of its license to operate, i.e. in local resistance, political protest, and public opposition to its activities, or introduction of new and costly regulation.

The literature has emphasized that implicit contracts are difficult to build and maintain and that firms are widely heterogeneous in their ability to do so (Barney & Hansen, 1994; Dyer & Singh, 1998). Apart from size and other firm characteristics that impact on the value of the relationship (Klein et al., 1978), managers differ in their understanding of which implicit contracts are valuable, their skills in communicating the contracts effectively to stakeholders, and their ability to change the terms of the contracts when needed without giving the impression they are betraying old agreements (Baker, Gibbons, & Murphy, 2002; Gibbons & Henderson, 2012; Halac, 2012). In the next section, I suggest that firms may also enhance their access to implicit contracts by becoming trustworthy in ways that exceed mere calculative trust. In particular, I will look at how sustainability and pro-social activities in general may influence stakeholder perceptions of a firm's purposes and intentions, contributing to the ability of the firm to use implicit contracts.

3. The role of sustainability in implicit contracts

3.1. The firm as a nexus of explicit and implicit claims

Stakeholder theorists suggest that firms must satisfy both explicit and implicit claims, in contrast to the canonical property-rights view that treats shareholders as the only proper claimants on the residual income of the firm (Klein et al., 2012). Explicit claims include laws and private contracts, which protect the rights of shareholders and other stakeholders, to the extent that they trade with the firm. Implicit claims are stakeholder expectations without legal force but with a legitimate basis for deserving consideration (Baker, Gibbons, & Murphy, 2001; Hill & Jones, 1992; Kim & Mahoney, 2010; Klein et al., 2012).

As other propositions of stakeholder theory, the suggestion that firms should meet their implicit contracts comes in (at least) two flavours, normative and instrumental (Donaldson &

Preston, 1995). Normatively, firms must satisfy implicit claims to compensate stakeholders for making value-creating relationship-specific investments under mutually understood anticipations of reciprocity. For such stakeholders as local communities or society at large, which is the claimant for environmental protection or other sustainability issues, social contracts commit firms to address societal demands in exchange for access to natural, social, or political resources (Donaldson & Dunfee, 1994). Instrumentally, fulfilling implicit claims allows firms to build value-creating relationships with stakeholders, as examined in the previous section. Moreover, it prevents stakeholders from exiting the relationship, damaging the firm's reputation by using voice, or making their claims explicit (e.g., governments could pass restrictive environmental regulation in response to failure by firms to address climate change or pollution issues).

Low levels of sustainability coincide with an inability by the firm to honour implicit contracts or a failure to address the anticipations of reciprocity by stakeholders who contribute investments and effort (Bosse, Phillips, & Harrison, 2009). However, it is important to notice that sustainability also significantly contribute to the ability of firms to recur to these contracts. The critical role of sustainability and pro-social attitudes in implicit contracts becomes clearer when acknowledging that these contracts are grounded in types of trust that are not always calculative.

3.2. Value of the relationship, benevolence, and integrity

Mayer, Davis, & Schoorman (1995) introduced *ability*, *benevolence*, and *integrity* as the three main dimensions of the trustworthiness of a referent. Ability consists in the skills that allow a referent to perform as promised. Benevolence is the referent's particularized attachment to the trustor, based on specific care and concern that do not necessarily extend to other parties. Integrity is defined as the extent that the referent is honest, fair, or adheres to values approved by the trustor. Ability is the 'can-do' component of trust; benevolence and integrity define the 'will-do' component that decides whether the referent will fulfil the trustor's expectation, on top of self-interest for doing so (Colquitt et al., 2007). Trust literature generally accepts these dimensions as a parsimonious and encompassing set of the relevant features of the trustee (Tomlinson & Mayer, 2009).

Let us assume that stakeholders believe that the firm has the ability to perform as desired. Then, by combining the value of the relationship for the firm and will-do trustworthiness attributions, there are at least three reasons why stakeholders could trust the firm to fulfil the implicit contract.

1. It is in the best interest of the firm to honour the contract (the relationship is valuable to the firm).
2. The firm has special care and concern for them (the firm has benevolence).
3. The firm has promised (the firm has integrity).

Given certain projected streams of income from its relationship with specific stakeholders or with society at large, a firm will honour implicit contracts to the degree that it is patient, because low discount rates make continued relationships look larger than immediate payoffs of defection. This long-term orientation is strictly associated with adopting a sustainability perspective in business (Crilly, 2013). A documented lack of long-term orientation damages a firm's capacity to engage in implicit contracts, because stakeholders will think that the firm gives a low value to continued relationships. When in 1984 General Motors (GM) wanted to change the union contract to introduce teams and implement Japanese-style lean production in factories, the firm's tradition of focusing on short-term financial results made unions reluctant to sign the agreement (Helper & Henderson, 2014).

Benevolence means that the firm integrates the welfare of (certain) stakeholders in its objective function. When the stakeholders are convinced that a firm is benevolent to them, it is more likely that they agree implicit contracts, providing relationship-specific resources and effort. For example, Southwest Airlines is well known for its 'Employees Come First' policy that includes a commitment to give them a stable work environment. Southwest has been one of the few airlines that refrained from reducing workforce in the aftermath of September 11 (Conlin, 2001) or during the recessions of 2008 and 2009 (Bridoux & Stoelhorst, 2014). This commitment can lead employees to attribute benevolence to the firm, which could explain Southwest's excellence in quality of service (Prince & Simon, 2015), which mirrors employees' effort.

Implicit contracts are always ethically coloured, since they are promises, which are universally seen as morally binding (Scanlon, 1990). When promises are broken, the victims feel offended, even if the promises were not explicit (Butler, Giuliano, & Guiso, 2016). The fact that implicit contracts do not specify the obligations of parties emphasizes the importance of good faith and reciprocity in interpreting whether the parties are honouring the contract (Bosse et al., 2009; Granovetter, 1985). Thus, a firm's perceived integrity provides a reason to stakeholders for expecting that the firm will want to fulfil implicit contracts. While the trust literature has understood integrity as largely co-extensive with ethical behaviour, implicit contracts invoke a more limited sense of integrity, i.e. keeping one's word. This sense is closer to a philosophical tradition that relates integrity to agents' respect of centrally important commitments, rather than to moral virtues. Bernard Williams (1981) showed that integrity is in opposition to consequentialist reasoning and requires agents to act on their convictions even when they clash with personal benefit. Respecting promises out of integrity is also different than David Hume's view that moral admiration for keeping one's word is artificial and derives from the social advantages of exchanging promises (Anscombe, 1978).

In the context of organizational trust, a firm's perceived integrity provides a basis to stakeholders for expecting that implicit contracts will be honoured in absence of economic interest. Conversely, the perception that a firm does not respect commitments will make stakeholders desist from entering implicit contracts with it or worry about the execution of contracts already in place. Volkswagen's emission scandal in 2015 revealed that the firm was lying to customers about its cars' emissions and had cheated regulators, violating basic business commitments. Almost immediately, concerns started to spread about the security of jobs in Volkswagen, which were protected by time-honoured implicit contracts between the firm, the unions, and the local authorities. Volkswagen's controlling families had to reassure the public that they supported "the guaranteeing of jobs" (Vasagar, Milne, & Jackson, 2015). These concerns indicate that, after the scandal exposed Volkswagen's lack of integrity, it would have not come as a surprise to see the firm pass the buck onto workers (McGee & Campbell, 2016).

3.3. How sustainability facilitates implicit contracts

Sustainability requires firms to integrate social and environmental issues in their strategies, and use their resources, capabilities, and power in ways that respect the interests and the values of all involved constituencies. By being sustainable, a firm orients its business in the direction of global societal welfare, in presence of systemic association of firms with important issues, such as climate change or human rights, or recurring narratives in which firms are depicted as amoral and ready to cheat (Harris & Wicks, 2010). Therefore, firms that adopt sustainability distance themselves from their less responsible peers and may elicit positive stakeholder attributions. Research has shown that stakeholders indeed associate pro-social firm attitudes to a higher degree of trustworthiness (Homburg et al., 2013). In turn, trustworthiness should facilitate firms in entering implicit contracts; however, the role of sustainability is different in each of the three reasons for trusting the firm to honour these contracts.

Sustainability and value of relationship. Stakeholders are often uncertain as to whether the firm is a patient type that values a continued relationship or an impatient type that aims at quick payoffs. Since impatient firms will try to disguise themselves as patient to enter implicit contracts, firms that are actually patient must signal their type to stakeholders. A way for firms to demonstrate patience is to engage in activities that are profitable only in the long term, such as R&D investment, entry in new markets at an immature stage, or building resources with no clear short-term worth (Wang & Bansal, 2012). Sustainability can serve the same purpose because the social and environmental issues to be addressed by firms are usually long-term (e.g., climate change) and require a corresponding enduring effort (Eccles, Ioannou, & Serafeim, 2014). Therefore, firms that invest in sustainability display an intention to stay around all the time needed to reap the results of their effort. This long-term orientation implies that a sustainable firm will want to honour implicit contracts.

In general, sustainability efforts that are perceived as driven by a firm's self-interest – such as green investment based on public incentives – will not be good predictors of future firm behaviour, because self-interest depends on circumstances that change. Moreover, trust is more likely to develop when an action is attributed to internal factors, such as the values of the trustee, rather than external situations, such as business opportunities (Malhotra & Murnighan, 2002; Tomlinson & Mayer, 2009). Therefore, targeting sustainability issues without direct connections to the core business of a firm, which is of little strategic value, may still help a firm enter implicit contracts, if these issues are linked to fundamental values of society.

Sustainability and benevolence. Implicit contracts arise in open-ended relationships that give stakeholders the opportunity to experience the degree of care the firm has for them. Sustainability efforts can drive attributions of benevolence when these efforts deliver what certain stakeholders perceive (not always accurately) as special treatment, e.g., volunteering initiatives that imply an interest in participating in the life of local communities, or a distinctive dedication to certain environmental issues. This is information that relevant stakeholders gather through repeated interaction with the firm or observation of its activities, a circumstance that is conducive to affective trust (McAllister, 1995). Moreover, human inclinations to personalism lead us to interpret the impact that others have on us as done on purpose (Jones & Davis, 1965). Sustainability is especially likely to reinforce personalism and benevolence attributions when is based on responsiveness to stakeholder requests or directly engages stakeholders (Mena & Chabowski, 2015).

Sustainability and integrity. Integrity is important because "one could collect plenty of evidence indicating that managers are quite capable of ignoring social concerns and breaching trust when doing so is in their own interest" (Holmstrom, 1988: 58). Assuming responsibility for social concerns means accepting basic rules of respect for the interests and values of others. Therefore, adopting sustainability implies a firm's commitment to solve social and environmental issues that are crucial for society, which supports attributions of integrity. A firm's integrity relates to organizational procedures, internal culture, leadership style, and other decision-making mechanisms at the firm level (Trevino, Weaver, & Reynolds, 2006). Direct experiences by a stakeholder with a firm are not sufficient to evaluate its integrity, because integrity is revealed by how the firm treats all stakeholders, and not only the stakeholder in question. Moreover, most stakeholders have to rely on second-hand sustainability information provided by firms, which may be interested in providing biased accounts (Lyon & Montgomery, 2015) and in publicizing adoption when it is only ceremonial (Lim & Tsutsui, 2011). Therefore, the interpretation of the motives behind sustainability activities – more normatively or more instrumentally oriented – is likely to figure prominently in the integrity attribution process (Donia & Tetrault Sirsly, 2016).

To summarize, sustainability can signal that a firm has a long-term orientation and cause stakeholder attributions of benevolence and integrity, although the characteristics of the firm, the activities, the issues being addressed, and the nature of the information available to stakeholders will act as boundary conditions on the production of these outcomes. Given that sustainability has the potential to impact on the reasons to trust a firm when entering implicit contracts, a further question to ask is how sustainability interacts with other variables that enter stakeholder calculations about the value of the relationship for the firm. Calculative and affective types of trust might be either complements or substitutes in facilitating implicit contracts (Gibbons & Henderson, 2012). As I examine in the next section, this question has important implications about the degree to which firms will want to engage in sustainability in different situations.

4. Implicit contracts as antecedents of sustainability adoption

Firms vary in the degree to which they adopt sustainability. An implicit-contract perspective suggests that, given that sustainability facilitates implicit contracts, the degree of adoption of sustainability by a firm should be directly related to circumstances that make implicit contracts valuable, and inversely related to the strength of other factors that help the firm enter implicit contracts without adopting sustainability.

In the following, I identify a number of (non-exhaustive) areas in which the implicit contract perspective can explain variance in sustainability adoption. The discussion rests on two assumptions. First, I assume that sustainability is costly, because it absorbs resources that firms could deploy to other purposes, including managerial attention. Moreover, even when sustainability is merely ceremonial, it exposes firms to backlash when stakeholders discover that adoption has been less than substantial. As a consequence, in an implicit-contract perspective, a firm will restrain sustainability adoption when better substitutes are available. Second, I assume that sustainability is not the only means to demonstrate integrity and benevolence. For example, integrity can be upheld by well-oiled internal audit procedures that are part of a firm's business as usual, rather than a commitment to sustainability. Similarly, benevolence can manifest in tacit no-layoff commitments that do not appear in formal statements or sustainability policies.

1) *Importance of implicit contracts in different industries*. Industries vary in terms of the amount of relationship-specific capital invested by stakeholders, depending on technologies and characteristics of products and services. Industries also differ in the degree to which knowledge is codified rather than tacit, and to which the performance of workers, suppliers or other stakeholders is easy to measure rather than ambiguous. These differences at the industry level are associated with different propensities of firms to embrace relational approaches to stakeholders (Dyer & Singh, 1998). So, it seems reasonable to assume that higher sustainability adoption might be observed in industries in which such relational approaches are more common, because firms in these industries could find it critical to recur to implicit contracts.

Research about industry-level determinants of pro-social attitudes is relatively underdeveloped (Short, McKenny, Ketchen, Snow, & Hult, 2016), but Siegel & Vitaliano (2007) provide evidence that firms that sell experience goods are more socially responsible than those that sell search goods. This evidence is in line with the prediction that industries that depend on relational approaches exhibit higher adoption of sustainability. Experience goods must be consumed before the customer can determine their value (e.g., healthcare); search goods can be evaluated before purchase (e.g., apparel). Experience goods are promises, because customers have no legal protection against frustrating quality that stays within an acceptable range. Even when the first impression is positive, the costumer who makes repeat purchases must trust the producer to provide the same quality as before. Therefore, customer loyalty to experience goods is an implicit contract with the producer; firms in industries that produce these goods might be especially interested in being sustainable to demonstrate that they deserve this loyalty.

2) *Importance of implicit contracts in a firm's strategy*. Firms in the same industry vary in the degree to which they rely on implicit contracts. Firms that rely more might exhibit higher levels of sustainability than those that rely less, because they are more interested in the trustworthiness-enhancing properties of sustainability. In particular, one could expect a more intensive use of sustainability that specifically aims at improving a firm's trustworthiness, and not simply of those activities that fulfil extant implicit contracts.

Luxury brands provide an illustration. These brands give customers a value that goes beyond the intrinsic quality of products, conveying exclusivity and prestige. Sustainability has no obvious associations with luxury; actually, the altruistic values of sustainability might harm the self-enhancement concept (dominance over people) that is intrinsic to luxury brands (Torelli, Monga, & Kaikati, 2012). "Sustainable luxury" can easily sound as an oxymoron. However, a luxury brand implicitly promises customers to preserve the intangible value of the product, by maintaining high standards and avoiding actions that may dilute the brand, such as cheap brand extensions. So, a long-term orientation is important to convince customers to pay the extra-price applied to these products. The decades-long history of brands like Chanel or Gucci witnesses this orientation. As a matter of fact, luxury companies have recently emerged as highly committed to sustainability and leaders in adopting new sustainability tools, such as Kering's Environmental Profit & Loss account (Gröschl, Gabaldón, & Hahn, 2019). This commitment suggests an effort by firms to present themselves to customers as a patient type that honours the implicit contract of luxury goods.

3) *Other signals of the value of relationship*. Other things being equal, the implicit-contract perspective suggests that large firms should be *less* sustainable than small firms, because as previously noticed large firms draw larger streams of income from implicit contracts. These streams increase the value of the relationship and make sustainability superfluous if the firm wants to demonstrate trustworthiness. However, one should also consider that large firms have financial resources that make it relatively easy for them to exit implicit contracts. Therefore, large firms can be suspected of being prone to opportunism, which might provide a reason for these firms to adopt sustainability to reveal benevolence and integrity. A further complication is that large firms are visible targets that attract external pressures when they are not sustainable (Bartley & Child, 2014).

A firm's profitability can also be a signal of the value of relationship, even though its relationship with implicit contracts seems complex. On one hand, profitability concurs with firm size in providing resources that can be used to breach implicit contracts, creating a motive for investing in sustainability to reassure stakeholders. On the other hand, profitability signals that the firm is gaining from its implicit contracts and, therefore, it is not interested in breaching them, de-emphasizing the need to invest in sustainability.

Firm age signals long-term orientation and makes sustainability less necessary, while young firms suffer from a liability of newness that they may try to mitigate through a pro-social attitude (Wang & Bansal, 2012). Any other firm characteristic or decision that implies a long-term orientation should reduce the value of sustainability and be inversely related to its adoption, but the effect can be confounded by concurrent mechanisms that go in the opposite direction. For example, family ownership is usually associated to a long-term orientation; however, family owners can derive affective value (so-called socioemotional wealth) from good relationships with stakeholders (Berrone, Cruz, Gomez-Mejia, & Larraza-Kintana, 2010). Preliminary support for the implicit-contract perspective comes from evidence that indicates that family firms are more socially responsible than non-family firms toward external stakeholders, but they seem to neglect internal stakeholders, such as employees, who are more involved in implicit contracts (Cruz, Larraza-Kintana, Garcés-Galdeano, & Berrone, 2014).

4) *Having a highly salient stakeholder*. Some firms depend on a particular stakeholder category, such as powerful suppliers with exclusive technologies, employees in professional or IT firms, or local governments in the extractive industry. When the relationship with these stakeholders is shaped by implicit contracts, a firm might choose to focus on demonstrating benevolence to these stakeholders, while displaying integrity or long-term orientation is less important. This situation could lead to lower sustainability effort, due to disregard for the other stakeholder categories.

5. Conclusion

An extensive literature has showed that implicit contracts allow firms to create value by encouraging relationship-specific investment and motivating effort by stakeholders. Moreover, implicit contracts give firms their social license to operate. Implicit contracts are commonly used both within the firm and in business relationships, due to complexities of contracting future contingencies. Since implicit contracts are hard to build, they allow firms to achieve competitive advantages over rivals that have an inferior capacity to recur to these contracts. Implicit contracts give stakeholder theory a way to propose a view of the firm – the nexus of explicit and implicit claims – that supports both normative and instrumental implications about sustainability and pro-social attitudes.

However, this view must be complemented by an understanding of how firms build trustworthiness, which is crucial to make implicit contracts feasible. Trust covers both calculative dimensions, related to the value of the relationship for the firm, and affective dimensions related to a firm's integrity and benevolence. Sustainability contributes to implicit contracts not only by fulfilling them, but also by signalling a firm's long-term orientation and its benevolence and integrity. I described four areas in which the interplay between industry characteristics, firm strategies, and different sources of firm trustworthiness can explain variance in sustainability adoption. In all the areas, I hinted at substitution effects between sustainability and other facilitators of implicit contracts. However, some complementarity is also possible. Consistency between factors (e.g., between adopting a long-term orientation and showing integrity) and among different domains of sustainability may contribute to positive reception of firms' efforts (Wang & Choi, 2013).

Much must be done empirically to test the validity of the theories that I presented in this chapter. A first general issue is that firms engage in a variety of activities that are beneficial to stakeholders, but a large part of them do not appear in the ratings that researchers generally use to measure the social and environmental performance of a firm (Chatterji et al., 2016). Therefore, the external validity of these ratings is to be disputed, especially if one wants to study pro-social attitudes, and not adoption of a list of recommended practices. Relatedly, trust is situation-specific, because stakeholders will trust the firm to adopt a certain action in certain conditions. Correspondingly, trust will relate to certain sustainability activities that stakeholders experience, observe, and to which they attach meanings within the complex relationship they have with the firm. A proper testing of the implicit-contract perspective requires a careful definition of what activities are expected to generate which reactions, given a general framework of trustworthiness in implicit contracts. My hope is that this chapter may lay the ground for further theoretical and empirical research on implicit contracts between firms and stakeholders. Given how pervasive implicit contracts are in business (and in everyday life), such research is likely to have numerous implications for our understanding of how organizations can productively contribute to sustainability.

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