



Identification and analyses of hidden transaction costs in project dispute resolutions

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Abstract

The hidden transaction costs in project dispute resolutions exert an important influence on the decisions about dispute settlement. In order to obtain the variables and their importance rankings, we firstly developed a thirteen-variable framework of the hidden transaction costs through a literature review and semi-structured interviews. Then we conducted a questionnaire survey to collect the importance of each variable. Based on the results, it is possible to group these variables into five factors – reputation, cooperation and trust, emotion, time, and execution of judgments – by factor analysis. Lack of future cooperation and contractors' reputation damage are the two most important variables, while for owners, project delay is the most severe hidden transaction cost. The findings provide construction practitioners with a deep understanding of the potential hidden loss. Therefore, they will resolve disputes more rationally.

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1. Introduction

Conflicts are inevitable because of the divergent interests, demands, or goals of different participants in the construction industry (Cheung and Suen, 2002; Ho and Liu, 2004). If the parties fail to manage a conflict, it may escalate into a dispute (Chong and Zin, 2012; Fenn et al., 1997; Kumaraswamy, 1997). Commonly used methods for dispute resolution consist of negotiation, mediation, arbitration, and litigation. The high cost incurred by arbitration or litigation has become a consensus (Cheung et al., 2010). The above-mentioned costs mean not only the money paid out in the settlement, but also the transaction costs incurred while resolving a dispute (Gebken et al., 2005), which

could be considerably high (Li et al., 2012, 2013; Yates, 1999). Reducing such non-value-adding costs is considered as one way to improve the competitiveness of project organizations (Cheung et al., 2000).

Williamson (1985) defined transaction costs as a combination of ex ante and ex post costs. The latter contain “the setup and running costs of the governance structure to which monitoring is assigned and to which disputes are referred and settled.” Some scholars have mentioned the transaction costs in dispute resolutions in the literature about transaction costs in construction projects (Hughes et al., 2006; Li et al., 2012, 2013; Mitropoulos and Howell, 2001). For example, Li et al. (2012, 2013) divided transaction costs into pre-contract and post-contract transaction costs, of which dispute resolution costs are one kind of post-contract transaction costs. However, they did not carry out further research into dispute resolution costs. Moreover, Marzouk and Moamen (2009) proposed a framework for estimating the acceptable negotiation amounts. The calculation of the costs incurred by litigation only covered several explicit costs, which can be determined directly, such as court fees and lawyers' fees.

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Yates (1999) pointed out that conflicts and disputes in the construction industry will produce large amounts of costs, including “direct costs (lawyers, consultants, management time and delays to project completions) and indirect costs (degeneration of working relationships, consequences of mistrust between participants and lack of teamwork).” This statement reveals that the transaction costs for dispute resolution comprise direct costs as well as costs that cannot be determined directly. The University of Texas at Austin has conducted several studies of the transaction costs in construction dispute resolutions (Gebken, 2006; Gebken and Gibson, 2006; Gebken et al., 2005), classifying them as direct costs, indirect costs, and hidden costs. We can understand the former two kinds of costs as explicit costs, involving outside and in-house lawyers’ fees, outside consultant and expert witness costs, management and staff salary and benefits allocated to supporting the dispute resolution effort, arbitration/mediation/court fees, and so on. They also identified some hidden costs by conducting semi-structured interviews, such as emotional costs, business relationships, and time loss. Notwithstanding, they neither developed the variable framework of the hidden transaction costs for dispute resolution nor analyzed the level of importance of those hidden costs.

In this research, the transaction costs for dispute resolution refer to the non-value-adding costs arising from dispute resolution and incorporate both explicit transaction costs and hidden transaction costs. We consider hidden transaction costs as a kind of hidden loss that can be measured to some extent.

Although it is difficult to measure the hidden loss caused by dispute resolution accurately, hidden transaction costs play an important role in the participants’ decisions about receiving or rejecting offers, and may even produce a long-term impact. Regarding the construction industry, which values quantitative results highly, many scholars have provided suggestions for choosing appropriate dispute resolution methods through qualitative analyses (Chan et al., 2006; Cheung, 1999; Cheung and Suen, 2002; Chong and Zin, 2012), and a few scholars have analyzed and quantified the explicit transaction costs of dispute resolution (Gebken, 2006; Gebken and Gibson, 2006; Gebken et al., 2005). Nevertheless, there is a lack of studies that develop a comprehensive variable framework of the hidden transaction costs of dispute resolution to help participants recognize and estimate such hidden transaction costs, probably because of the difficulty of identification. In response to this knowledge gap and to analyze the influence of the hidden transaction costs on the decision-making process, the objectives of this research are: 1) to develop a framework to identify the hidden transaction costs in project dispute resolutions; and 2) to investigate the level of importance of different variables of the hidden transaction costs.

We expect this research to benefit both academia and industrial practitioners in relation to the transaction costs for dispute resolution. It not only lays a foundation for further studies by identifying the variables of the hidden transaction costs, but also provides an insight into the perceived differences of the participants regarding the level of importance of the

variables. Construction practitioners can benefit from understanding the hidden transaction costs that different dispute resolution methods incur and thus being able to follow more rational strategies in dispute resolutions. Consequently, unnecessary transaction costs can be minimized.

2. Research methodology

The data collection procedures consisted of three steps, as presented in Fig. 1. The first step was to obtain preliminary variables of the hidden transaction costs in project dispute resolutions through an extensive literature review. Then we performed qualitative research, specifically semi-structured interviews, to improve the framework proposed in step one. We followed a quantitative method, namely a questionnaire survey, to determine the level of importance of the final variables. The following subsections will provide a detailed description of the semi-structured interviews and questionnaire survey as well as the data analyses.

2.1. Semi-structured interviews

A limited amount of literature is retrievable on the hidden transaction costs in the construction industry. Therefore, semi-structured interviews were performed to modify, add, or delete the preliminary variables obtained in the literature review. We contacted five experts (two from contractors, two from owners and one from legal consultants) who specialize in construction project dispute resolution and asked for their agreement to participate in the semi-structured interviews. The experts we selected are practitioners who have more than twenty years’ working experience in project management. All of them have participated in construction dispute resolution personally and mastered the detailed information during the process of dispute resolution. As a result, we carried out three interviews with three experts (from contractors, owners and legal consultants, respectively), each of which lasted around one hour. Based on the interview results, we made the following modifications to the proposed framework: 1) two variables were added accordingly: “Expenditure spent on favorable measures taken” and “Difficulty in executing judgments”; 2) the variable “Reputation damage” was divided into two variables from the perspective of contractors and owners, respectively: “Contractors’ reputation damage” and “Owners’ reputation damage”; 3) every variable was defined and stated in the questionnaire survey for clarity. The new framework of the hidden transaction costs in project dispute resolutions is given in Table 1, with a total of 13 items.

2.2. Questionnaire survey

We conducted a questionnaire survey and designed a questionnaire in the third step. The purpose of the questionnaire was to determine the level of importance of the variables, which facilitated the subsequent analyses of the hidden transaction costs.

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