

# Choice among Dispute-Resolution Mechanisms in Channels of Distribution

- A Conceptual Framework -

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## I. Issue

As many industry reports indicate, opportunistic behaviors in transactions cause industry systems to deteriorate. As described in more detail later, opportunistic behaviors in an economic transaction arise when a party behaves so as to gain an unfair price for the benefit from the transaction. This price is regarded as the resources the party abandons for the benefit. Opportunistic behaviors are characterized by false promises, selective disclosures of transactional information, and so on (Williamson, 1975).

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A dramatic example of opportunistic behaviors is found in the American distribution system of imported office machines. As testified in the Senate hearing for "Retail Dealers Agreement Act" (1981), numerous dealers went bankrupt due to foreign manufacturers' opportunistic behaviors in the 1970's. These behaviors included undue terminations of dealerships, false promises regarding the product and manufacturers' loans, and so on. As another interesting example, a leading Korean apparel company recently enlarged its dual distribution system without any prior coordination with its independent retailers; thus, these retailers had more difficulties in holding their customers.

Control of opportunistic behaviors in transactions is clearly an important issue that industry members should take into account in order to maintain the desirable performance of their industry systems.

Control of opportunistic behaviors basically takes the form of accusation by the injured party. Thus, when we refer to the paradigm of social control (e.g., Goffman 1971; Wood, 1974; Black, 1977), such control focuses on resolving disputes between parties accused of engaging in opportunistic behaviors and accusing parties damaged by these behaviors. Major issues in these disputes include proving that opportunistic behaviors and resulting damages have occurred, and the determination of compensation for these damages (e.g., Thibaut and Kelley, 1959; Adams, 1965). The dispute-resolution restores what has been disturbed in terms of the transactional goal by compensating for damages due to opportunistic behaviors. This restoration is the goal of controlling opportunistic behaviors. Hereafter, a dispute means that described above.

Researchers in channels of distribution have been not paid relatively much attention to dispute-resolution (i.e., control of opportunistic behaviors). Some ad hoc studies on dispute-resolution is found (e.g., Stern and Gorman, 1969; Brown 1979; Lambert et al., 1986), but little empirical and normative research, except Dant and Schul (1992), based upon sound theories has been conducted in marketing. Meanwhile, dispute-resolution has activated much research in other social sciences, including sociology, anthropology, and law.

No clear reason is found for why researchers in marketing are not much interested in dispute-resolution. Nevertheless, we may guess that a managerial consideration leads to this lack of research. That is, managers may want to avoid situations where opportunistic behaviors actually happen, and thus always aim to optimally prevent opportunistic behaviors; when this prevention is optimal, the occurrence of opportunistic behaviors may be negligible, and, thus, no significant dispute exists. Perhaps, motivated by this managerial consideration, researchers in marketing have placed the focus of their studies on the explanation of preventing opportunistic behaviors, hoping that the results of these studies will contribute to the development of effective and efficient techniques of such prevention. In fact, a significant volume of research on preventing opportunistic behaviors is found in marketing (e.g., Phillips, 1982; John 1984; Anderson, 1988; John and Weitz, 1989; Heide and John 1988; Heide 1992).

However, as our experience indicates, opportunistic behaviors are not eradicated, despite efforts to prevent these behaviors. It is inevitable that transaction parties, to some extent, behave in an opportunistic manner during the performance of transaction tasks. The reason for this inevitability may be that the optimal prevention is technically impossible or very expensive, or that parties who are predisposed to non-opportunism change their minds and engage in opportunistic behaviors during the performance of transaction tasks (e.g., Williamson, 1975; MacNeil, 1978; John, 1984; Warshaw, Crawford, and Tank, 1985). So long as opportunistic behaviors actually happen, dispute-resolution is necessary, because damages due to opportunistic behaviors must be recovered so that transactions may be duly continued or terminated. In this sense, dispute-resolution plays a key role in maintaining the desirable performance of transactions. Academic researchers in marketing should be more concerned with dispute-resolution and, thus, contribute to both the understanding of phenomena concerning dispute-resolution and the development of effective and efficient dispute-resolution techniques useful for transactions between marketers.

## **II. Objective and Scope**

The issue addressed above is that dispute-resolution is relatively ignored by researchers in marketing although it has significant impact on marketers' transactions. Considering this issue, we discuss a key phenomenon concerning dispute-resolution in this paper. This phenomenon concerns the choice of a dispute-resolution-mechanism. The reason for focusing on this phenomenon is that the effectiveness and efficiency of dispute-resolution significantly vary depending on the choice of a dispute-resolution-mechanism, and, thus, this choice should be seriously considered in the process of resolving disputes (e.g., Malinowski, 1926; Folger, 1977; Griffiths, 1984).

Specifically, we discuss in this paper the choice of a dispute-resolution-mechanism in terms of the efficiency of dispute-resolution. In this discussion, we argue that, given dispute environments, one dispute-resolution-mechanism is more likely to lead to disputes being resolved without much cost than other mechanisms because it better adapts to these environments than others; in this sense, it is more likely to be efficient than others; thus, disputing parties tend to choose it.

One consideration leads us to focus solely on the efficiency of dispute-resolution rather than on both its effectiveness and efficiency. This consideration concerns the point that, as an overview of the literature relating to dispute-resolution indicates (e.g., McIver, 1936; Schwartz, 1954; Macaulay, 1963; Kidder, 1979; Fitzgerald and Dickins, 1980; Lind et al., 1983), the effectiveness of dispute-resolution-mechanisms has been much more thoroughly researched than has their efficiency (here, "effectiveness" means that a dispute-resolution-mechanism leads to disputes being effectively resolved). Thus, we judge that research on efficiency is more necessary than research on effectiveness, and, accordingly, our discussion is focused on efficiency.

Our discussion on the choice of a dispute-resolution-mechanism could take various directions depending on how we characterize dispute-resolution-mechanisms and dispute environments. In this regard, these characterizations are very critical to what we discuss in this paper. Researchers of dispute-resolution in social sciences other than marketing indicate that the division of labor in resolving disputes is a powerful

construct that reflects a wide variety of characteristic phases of a dispute-resolution-mechanism (e.g., Black, 1976; Griffiths, 1984). Based upon these researchers' indications, we characterize a dispute-resolution-mechanism by referring to a conceptual continuum regarding this division of labor (hereafter, this continuum is termed "resolution-continuum").

As explained in more detail below, "division of labor" refers to the extent to which roles concerning dispute-resolution are delegated to a third party (or a group of third parties) who does not participate in economic transactions, but participates only in the process of dispute-resolution. For example, suppose two different dispute-resolution-mechanisms; in one mechanism, roles of proving the occurrence of opportunistic behaviors are delegated to a third party; and, in the other mechanism, not only roles of proving these behaviors have occurred, but also roles of determining compensations for damages due to these behaviors are delegated to a third party. More roles are delegated to a third party in the latter mechanism than in the former mechanism. Thus, the division of labor is greater in the latter mechanism than in the former mechanism. When a dispute-resolution-mechanism locates on one extreme of the resolution-continuum, no division of labor exists in this mechanism. When a dispute-resolution-mechanism locates on the other extreme, complete division of labor exists in this mechanism. Most dispute-resolution-mechanisms are expected to locate somewhere between these two extremes.

In order to characterize dispute environments on which the efficiency of a dispute-resolution-mechanism depends, we refer to Black's theory of law (1976). In his theory, Black identifies a wide variety of variables governing dispute environments, and systematically examines some dimensions underlying these variables. As a survey of the dispute-resolution literature indicates, researchers of dispute-resolution support Black's analysis of these dimensions (e.g., Deutsch, 1973; Dunlop, 1978). However, Black develops his theory in the context of disputes due to behaviors deviant from social norms such as law and custom. In this paper, we reconstruct his theory in the context of disputes due to opportunistic behaviors in economic transactions, and characterize the environments of these disputes.

In short, our discussion in this paper is developed in order to address a conceptual framework and derive a set of propositions from it. This conceptual framework explains that in given dispute environments, one dispute-resolution-mechanism is more likely to be efficient than other mechanisms on the continuum. We expect that the conceptual framework will be a sound bases for conducting empirical research on dispute-resolution in marketing.

### **III. Opportunistic Behavior**

The main objective of this paper is to understand the choice of a dispute-resolution-mechanism in terms of the efficiency of the dispute-resolution. This understanding may be promoted when we have a clear definition of opportunistic behaviors in economic transactions. This definition is provided in this section.

In an economic transaction, one party exchanges resources with another party, whatever these resources and the style of such exchange may be. In a sense, the resources a party gives are "price", whereas those he/she receives are "benefit." According to Hobbes's paradigm of society (e.g., MacIver, 1937), human nature leads a party to pursue an unfair price for the benefit. This pursuit causes society to be chaotic. In this chaos, parties struggle against each other to pay the lower price for the greater benefit. To save society from such chaos, social justice requires of a party that a fair price for the benefit be imposed on him/her. However, the imposition of social justice cannot completely suppress human nature. When human nature is not significantly suppressed, a party behaves so as to gain an unfair price for the benefit. This behavior is defined as "opportunistic behavior."

There are three characteristics of opportunistic behaviors. First, the pursuit of an unfair price for the benefit violates social justice. Thus, an opportunistic party is subject to accusation whatever the style of this accusation may be. Second, opportunistic behaviors are accompanied by a variety of vicious practices, such as deception, threat, and the like. These

practices are aimed at disguising the pursuit of an unfair price for the benefit. Third, a party's opportunistic behaviors damage the innocent counterpart in the transaction. There are basically two reasons for this damage. One is that the innocent party receives an unfair price for the benefit; the degree of damage reflects the difference between the fair and unfair prices. The other reason is that an opportunistic party's vicious practices (say, false promises and selective disclosures of transactional information) mislead the innocent counterpart's transaction activities; due to these misled activities, resources are wasted.

In addition, there are basically three categories of opportunistic behaviors. First, by vicious practices such as selective and distorted disclosures of transactional information, an opportunistic party induces the innocent counterpart to agree to transaction terms that make it possible for the opportunistic party to realize an unfair price for the benefit. Second, an opportunistic party agrees to transaction terms for a fair price for the benefit with the intention of breaking these terms in order to realize an unfair price for the benefit in future conduct. Third, an opportunistic party agrees to transaction terms for a fair price for the benefit, but changes his/her mind and breaks these terms to gain an unfair price for the benefit during the performance of transaction tasks.

The accusation of an opportunistic party and the claim for the damage due to opportunistic behaviors are socially legitimized because such behaviors deviate from social justice. However, an opportunistic party usually tries to avoid the accusation and negate the claim. Thus, friction between an opportunistic party and the innocent counterpart occurs and disputes between these parties develop.



#### **IV. Dispute-Resolution Mechanism**

Dispute-resolution-mechanisms are characterized here by the resolution-continuum. A dispute-resolution-mechanism locates somewhere on the resolution-continuum. This location represents the extent to which division of labor in the dispute-resolution exists in the

dispute-resolution-mechanism. In this section, we first describe the division of labor in the dispute-resolution. After this description, we explain, in detail, the resolution-continuum in terms of the dispute-resolution-mechanisms that we describe.

#### 4.1. Division of Labor in the Dispute-Resolution

Since Adam Smith wrote on the subject, a variety of competing definitions have been proposed for "division of labor" (e.g., Durkheim, 1964; Weber, 1947; Kemper, 1972). In this paper, we explain "division of labor in the dispute-resolution" (hereafter, this division is termed "DLDR") by referring to "role-differentiation" for two reasons. One is that role-differentiation captures the key aspects of division of labor and can be quantitatively operationalized without much difficulty: this quantifiability facilitates the empirical tests of theories concerning division of labor in the scientific paradigm (e.g., Kemper, 1972; Smith & Snow, 1976). The other reason is that role-differentiation fits the explanation of the DLDR particularly well (e.g., Schwartz, 1954; Abel, 1973; Black, 1976).

In the context of role-differentiation, the DLDR refers to the extent to which roles concerning dispute-resolution are delegated to a third party (or a group of third parties). A third party does not participate in economic transactions themselves, but participates only in the process of resolving disputes. The larger the extent of the delegation, the more DLDR. Also, the larger this extent, the more powerful the third party. "The more powerful" means that the dispute-resolution is more likely to depend on the third party's control. Griffiths (1984) criticizes this definition of the DLDR in that the DLDR may depend on, not only role-differentiation, but also third-party-specialization, which is not explicitly considered in our definition of the DLDR. However, this criticism may be negligible, as explained below.

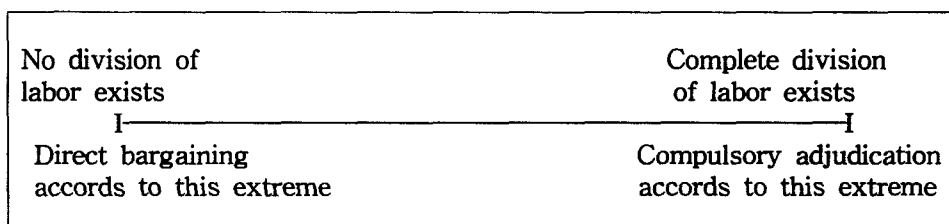
According to Griffiths (1984), third-party-specialization concerns the extent to which a third party is committed to the dispute-resolution. For example, let us consider Schwartz's study of dispute-resolution in the Israeli moshav and kvutza (1954). The moshav has a Judicial Committee to resolve disputes between its residents. If the Judicial Committee consists of lay



judges and juries who have impermanent and part-time role-occupancies on an ad hoc basis, it will be a less specialized third party intervening in the residents' disputes. On the other hand, if the Judicial Committee consists of professional judges and juries who have permanent and full-time role-occupancies, it will be a more specialized third party intervening in these disputes. Griffiths (1984) argues that, besides role-differentiation, third-party-specialization is another important factor that describes the DLDR. This argument may conceptually be reasonable to some degree. However, third-party-specialization depends significantly upon role-differentiation. That is, the more roles delegated to a third party, the more likely this party is to be specialized (Malinowski, 1926; Sander, 1982). Considering this dependency, we do not explicitly consider third-party-specialization in defining the DLDR. However, whenever necessary, we will discuss it.

## 4.2. Resolution-Mechanism

<Fig. 1>



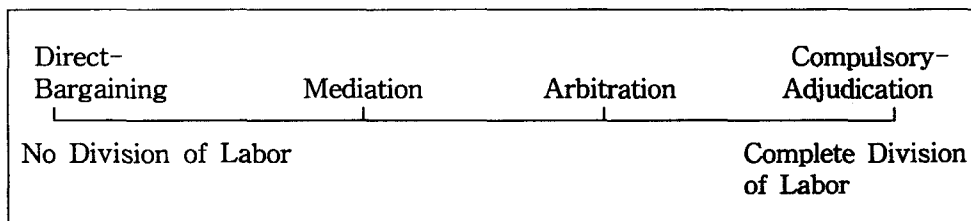
As Fig. 1 shows, the left extreme of the resolution-continuum stands for no DLDR. "No DLDR" means that no role concerning the dispute-resolution is delegated to a third party. In this case, disputing parties jointly participate in the process of resolving disputes while no third party intervenes in this process. Thus, a dispute-resolution-mechanism corresponding to this left extreme can be termed "direct-bargaining" (e.g., Thibaut & Walker, 1978).

The right extreme of the resolution-mechanism stands for complete DLDR. "Complete DLDR" means that all roles concerning the dispute-resolution are delegated to a third party. In this case, after disputing parties appeal to a third party, only the third party undertakes the task of

resolving disputes. Also, the third party is powerful enough that this party may fully control the whole process of dispute-resolution and may compel disputing parties to accept its resolution (e.g., Sheppard, 1985). When complete DLDR exists, a third party determines a resolution with full control of the resolution process, and disputing parties are obliged to accept this resolution with no possibility of discretionary action on this resolution. A dispute-resolution-mechanism corresponding to this right extreme can be termed "compulsory adjudication".

Thus, a dispute-resolution-mechanism closer to the right extreme than another mechanism involves more role-delegation of the dispute-resolution to a third party, while the third party is more powerful in that mechanism than in the mechanism farther to the left. "The more powerful" means that a third party has more control over the resolution and the resolution-process. Dispute-resolution-mechanisms frequently used in economic transactions can be characterized by the resolution-continuum as follows:

<Fig. 2>



In direct-bargaining, disputing parties jointly participate in the process of resolving their disputes and ultimately formulating a resolution, while no third party intervenes in this resolution-making-process. They resolve their disputes for themselves while they exercise power and compromise with each other (e.g., Schelling, 1960).

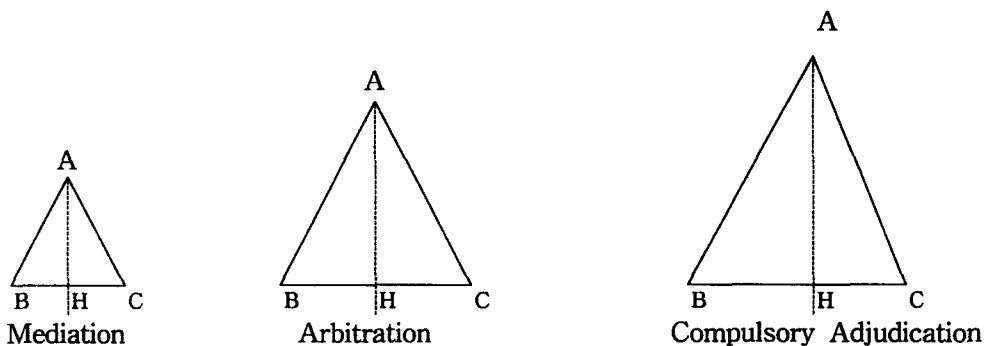
In mediation, a third party does not impose its resolution on disputing parties, but participates in the resolution-process in order to facilitate the dispute-resolution. The third party attempts to secure the dispute-resolution by persuading disputing parties either to continue their negotiations or to consider procedural or substantive recommendations that the third party may

make (e.g., Barkun, 1968; Stern & El-Ansary, 1977). This attempt, for example, exists when a third party clarifies facts and issues, and explores possible bases of agreement.

Arbitration and compulsory adjudication resemble mediation in that roles involving control of the resolution-making-process are delegated to a third party. The main difference between arbitration and compulsory adjudication consists in how far disputing parties can take discretionary actions on a resolution that a third party invents. More discretionary actions as such are permitted in arbitration than in compulsory adjudication.

In this paper, we define arbitration as existing when a third party is entitled to invent a resolution as well as control the resolution-making-process, but disputing parties are permitted to accept, reject, or modify this resolution to some extent (e.g., Black, 1976; Griffiths, 1984; Thibaut & Walker, 1975, 1978). On the other hand, a compulsory adjudication is defined as existing when a third party is entitled to invent a resolution as well as control the resolution-making-process, and disputing parties are obliged to accept this resolution as it is. The comparison among mediation, arbitration, and compulsory adjudication can be visually summarized as follows:

<Fig. 3>



- \* As BC increases, the division of labor becomes larger.
- As AH increases, the power of a third party becomes greater.

## V. Resolution Cost

Disputes are resolved when opportunistic behaviors and the corresponding damages are proved, and the compensations for these damages are ruled (e.g., Thibaut & Kelley, 1959; Homans, 1961; Adams, 1965; Deutsch, 1973). In this regard, there are basically two types of costs of the dispute-resolution. One is the cost of proving that opportunistic behaviors and the corresponding damages have occurred (hereafter, termed "evidencing cost"). The other is the cost of determining appropriate compensations for proven damages (hereafter, termed "ruling cost"). We term the sum of the evidencing and ruling costs "resolution cost."

The process of proving that opportunistic behaviors and the corresponding damages have occurred consists of two tasks: information search and communication (e.g., Thibaut & Kelley, 1959; LaTour et. al, 1976). Accordingly, the evidencing cost is defined as consisting of the information search cost and the communication cost. The information search cost is used to identify which behaviors are opportunistic and what the corresponding damages are. This cost depends on the idiosyncrasy of transactional behaviors.

This idiosyncrasy is defined as existing when a party behaves in terms of transactional tasks unique to him/her. There are two dimensions of this uniqueness. First, transactional tasks are specific to a particular economic transaction. When completely specific, these tasks are not needed and, thus, not found in any other economic transaction; in this case, the salvage value of assets involved in those tasks is zero (e.g., Williamson, 1975). Second, the technology of transactional tasks is a particular party's specialty, and, thus, the party enjoys a monopolistic position in terms of the technology. When the party's position is completely monopolistic, no other party can learn and use the technology; and only the monopolistic party can fully appreciate the technology and the performance of transactional tasks.

To promote the understanding of the idiosyncrasy of transactional behaviors, let us take two examples. First, suppose an economic transaction

between a consumer X and a grocery store Y; and X purchases a Coke from Y. In this economic transaction, Y's transactional tasks consist of selling the Coke in return for the price X pays to Y. Here, Y's tasks are not specific to the economic transaction, because many grocery stores including Y transact with many consumers including X for selling Cokes. The technology of tasks of selling Cokes is not Y's specialty to a significant degree because this technology is significantly easy to learn and apply. Thus, Y's transactional behaviors in the economic transaction are not significantly idiosyncratic.

Second, suppose an economic transaction between a company Z and the Pentagon; Z innovates a space weapon and sells it to the Pentagon. This weapon is so innovative and sophisticated that only Z can fully appreciate its attributes. Due to the consideration of national security, institutions other than the Pentagon are prohibited from purchasing the space weapon. Here, Z's tasks are specific to the economic transaction, because institutions other than the Pentagon cannot purchase the space weapon. The technology of tasks involved in selling the space weapon is Z's specialty, because the scientific knowledge used for the space weapon is difficult to learn and apply. Thus, Z's transactional behaviors in the economic transaction are idiosyncratic.

The information search cost is higher when transactional behaviors are idiosyncratic than when they are not (e.g., Ouchi, 1979, 1980). When idiosyncrasy does not exist, standardized criteria can be applied to judging transactional behaviors. Accordingly, these criteria can also be applied to identifying whether or not opportunistic behaviors and the corresponding damages occur. On the other hand, when idiosyncrasy exists, standardized criteria become inapplicable to judge transactional behaviors. In this case, criteria to judge transactional behaviors should be tailored to the nature of the idiosyncrasy (e.g., Ouchi, 1979). Accordingly, these "tailored" criteria should also be applied to identifying opportunistic behaviors and the corresponding damages.

More cost is associated with the application of tailored criteria than standardized criteria. In applying standardized criteria, a moderate level of operational cost occurs while little fixed cost occurs. Meanwhile, some

significant fixed cost occurs in the process of setting up and applying these tailored criteria. Operational cost is also higher in the application of tailored criteria than standardized criteria, since more adjustments are usually required in operationalizing the former criteria than the latter criteria. In sum, the more idiosyncratic transactional behaviors, the more information search cost.

The communication cost is that which occurs in presenting and receiving the proof of opportunistic behaviors and damages. This cost depends on the development of communication apparatuses between disputing parties and/or between disputing and third parties (e.g., Sander, 1982). These communication apparatuses include linguistic symbols and formats that contain the sought information, and social and institutional channels through which these symbols and formats are circulated among parties involved in disputes. The communication cost is higher when communication apparatuses are less developed than when they are more developed. When communication apparatuses are well developed, only a moderate level of cost occurs in operationalizing these apparatuses in order to communicate the sought information. When communication apparatuses are poorly developed, some significant fixed cost arises in building up these apparatuses while a certain level of cost also arises in operationalizing them in order to communicate the sought information. We may expect that that operational cost will be higher in operationalizing newly constructed communication apparatuses than in operationalizing those well developed for a long time. In sum, the better developed the communication apparatuses, the less information communication cost.

The ruling cost is that which occurs in determining the compensations for proven damages by processing the communicated information. This cost depends on whether disputes are constructive or destructive (e.g., Deutsch, 1973). Constructive disputes exist when disputing parties maintain their economic transactions after the dispute-resolution. Destructive disputes exist when those transactions are terminated after the dispute-resolution.

Constructive disputes are characterized by consideration of the future transactional relationship in determining the compensations for proven

damages (e.g., Stein, 1968). Such compensation is determined so as to cultivate the future transactional relationship rather than devastate it. Disputing parties usually realize this cultivation by distributing the compensations over the future transactional time span (e.g., Macaulay, 1963; Stewart, 1984). This distribution makes it possible for disputing parties to participate in a non-zero-sum-game at the very same time that disputes are resolved; thus, this non-zero-sum-game leads to a sound future transactional relationship.

On the other hand, the future transactional relationship is usually not a consideration in determining compensations for proven damages in destructive disputes. Rather, it is most important that the equity between proven damages and compensations should be completely realized at the very same time that disputes are resolved. In an extreme case, the principle of "an eye for an eye" is strictly applied to the determination of the compensations for proven damages. Thus, in destructive disputes, a zero-sum-game occurs where compensators and compensatees compete with each other only in order to be winners.

Generally, more futurity is considered in resolving constructive disputes than destructive disputes. The more futurity considered, the more ruling cost for two reasons. First, the more futurity, the more uncertainty. In order to overcome the greater uncertainty, more adjustment processes are needed. More resources such as time, money, and labor must be spent on the greater adjustment processes. Second, the more uncertainty, the more frequently activities concerning the compensations for proven damages are misconducted; thus, the more opportunity cost for this misconduct. The more constructive disputes, the more futurity involved in these disputes. The more futurity, the more ruling cost. In conclusion, the more constructive the dispute, the more the ruling cost.

To illustrate that the cost is higher in constructive disputes than in destructive disputes, suppose that Tom is a manufacturer and Mary is a distributor. A good business relationship between them has continued for some time. However, one day, Tom deceives Mary. She detects this deception and judges that her damage due to the deception amounts to

\$1,000,000. She is very angry and claims the compensation for this damage. Because he does not accept her claim, she sues. The court orders him to pay \$1,000,000 to her. His total assets amount to \$1,000,000, and, thus, he will go out of business if he pays \$1,000,000 immediately.

Here, we may suppose two cases. In the case of a destructive dispute, Mary appeals to the court for the immediate payment of \$1,000,000 because she wants to destroy Tom and finish the business relationship between them. The court orders him to make the immediate payment. He follows this order and goes out of business. In the case of a constructive dispute, Mary wants to continue the business relationship with Tom. She knows that if he makes the immediate payment, he will go out of business. Thus, Tom and Mary agree to a division of payment over the next 10 years. In the former case, no additional ruling cost occurs after the court's decision. However, in the latter case, some ruling cost occurs even after the court's decision; that is, a certain amount of resources must be spent in establishing the conditions and procedures of the divided payment in consideration of future events over the next 10 years. Thus, the total ruling cost is higher in the latter case than in the former case.

## **VI. Dispute Environments**

If resolution cost does not significantly exist - i.e., (1) no idiosyncrasy of transactional behaviors exists, (2) communication apparatuses are well developed, and (3) disputes are destructive - then a resolution-mechanism involving less DLDR will be more efficient than that involving more DLDR (e.g., Malinowski, 1926; Nader et. al, 1963). In this case, the involvement of a third party would only increase the resolution cost unnecessarily. If resolution cost exists to some significant extent, the efficiency of the resolution-mechanisms will vary depending on dispute environments. That is, given resolution cost, one resolution-mechanism involving less DLDR minimizes this cost either less or more than that involving more DLDR, depending on dispute environments. In this sense, the former is either less or more efficient than the latter, depending on dispute environments.



Dispute environments can be defined in a variety of ways. Here, we define these environments with reference to Black's theory of law (1976). In this theory, dispute environments are very systematically defined. Referring to Black's definition of dispute environments, we should consider one point. Black defines dispute environments in the context of social control. Considering this point, we refer to his definition in order to develop the definition used in this paper.

According to Black, dispute environments are basically governed by four factors: morphology, stratification, organization, and culture. However, morphology is merely the expression of culture. Stratification and organization are also tautological with each other in that organization is merely the structure reflecting stratification. Thus, as we interpret, Black actually describes dispute environments by two dimension: culture and stratification.

Culture is a system of knowledge, beliefs, and values that are shared by *Gemeinschaft* (community) members (e.g., Tönnies, 1971; Benedict, 1934; Mintz, 1982; Smircich, 1983). Culture fulfills some important functions. First, it conveys a sense of identity for social members (e.g., Deal & Kennedy, 1982). Second, it facilitates the generation of commitment to something larger than the self (e.g., Schall, 1981). Third, culture enhances social system stability (e.g., Louis, 1980). Lastly, culture serves as a sense-making device that can guide and shape behavior (e.g., Siehl & Martin, 1981). Due to these functions, culture determines the community relationship between social members. Simply speaking, the community relationship refers to the extent to which social members are integrated into one or more communities. The more culture shared by these members, the stronger the community relationship.

Stratification is a system of tangible and intangible assets "distinctive" to a *Gesellschaft* (association) setting; these assets are shared by members who pursue the realization of individual rationalized interests in that setting (e.g., Tönnies, 1887; McIver, 1936; Dahrendorf, 1959; Black, 1976; Stewart, 1984). For example, the microcomputer industry is a broadly defined *Gesellschaft* setting. Distinctive assets shared by members of this industry include the

technology of manufacturing and distributing microcomputer equipment and information on market trends. There is an important characteristic of such assets, namely, that distinctive assets shared by members of a Geselleshaft setting are, to some extent, difficult for members of another Geselleshaft setting to have access to; that is, there is some entry barrier in terms of such assets to the latter members; due to this barrier, some cost exists when the latter members obtain these assets.

It is very important to distinguish distinctive assets shared by members of a certain Geselleshaft setting G from unique assets that are owned by a particular member K of G, and, thus, make K's transactional behaviors idiosyncratic. Both members of G other than K and those of all the other Geselleshaft settings have some difficulty in obtaining assets unique to K; that is, there is some entry barrier in terms of these assets to both; thus, some cost occurs when both obtain these assets. However, members of G other than K may decrease this cost to a certain degree by virtue of distinctive assets shared by K and all the other members of G, whereas members of all the other Geselleshaft settings may not do so due to the lack of such distinctive assets.

In sum, we characterize dispute environments in economic transactions by two dimensions of culture and stratification. Culture refers to the extent to which disputing parties share one or more type of community life. As disputing parties share more culture, they have more affinity in terms of life style, knowledge, values, and behavioral rules. Stratification refers to the extent to which disputing parties share assets distinctive to the Geselleshaft setting where they conduct economic transactions and disputes between them are developed from these transaction.

## **VII. Efficiency of Resolution Mechanism**

As mentioned before, when resolution cost is little, a resolution-mechanism involving less DLDR is more efficient than one involving more DLDR, independent of dispute environments. When resolution cost is significantly high, the efficiency of the resolution-mechanism depends

on dispute environments governed by stratification and culture. This dependency is discussed in this section.

## 7.1. Stratification

### 7.1.1 Information search Cost

Information search cost is significantly high when transactional behaviors are so idiosyncratic that standardized criteria cannot be applied in identifying opportunistic behaviors and the resulting damages. In this case, certain other tailored criteria must be set up and applied to identify the opportunism and, thus, minimize search cost (e.g., Felstiner & Williams, 1978). There are two possible approaches to setting up and operationalizing tailored criteria. First, disputing parties can cooperate with each other, and jointly develop, set up, and operationalize tailored criteria (i.e., joint participation). Second, they can employ a third party who has some skill in setting up and operationalizing tailored criteria, and seek information with the aid of the third party. In considering the efficiency of the resolution-mechanism, the approach adopted is generally the less expensive one. For example, if the employment of the third party is less expensive in terms of money and time than joint participation, disputing parties will adopt the approach of employing a third party.

Joint participation is either less or more expensive than employment of a third party, depending on the amount of distinctive assets shared by disputing parties. When disputing parties share a greater amount of distinctive assets, they are more familiar with human and task factors of their economic transactions while stronger consensus exists in terms of processing these factors (e.g., Raiffa, 1982). The greater this familiarity, the more easily disputing parties can identify distinctive human and task factors that must be considered in setting up and operationalizing tailored criteria. The easier this identification, the fewer resources spent on the identification; in turn, the more efficient the identification. Also the stronger the consensus in terms of processing human and task factors, the less friction caused in jointly processing these factors and setting up and operationalizing tailored criteria. The less friction, the fewer resources spent on the joint work on

tailored criteria; thus, the more efficient this work.

On the other hand, the third party does not hold distinctive assets shared by disputing parties, because he/she has not participated in disputing parties' economic transactions. Moreover, the distinctive assets are not easily transferable to the third party (e.g., Stewart, 1984; Yngvesson, 1986). The distinctive assets can be transferred completely to the third party when he/she is completely assimilated to disputing parties and experiences all the history of disputing parties' economic transactions. These assimilations and experiences are usually impossible to some extent and very expensive. When a significant amount of distinctive assets is not transferred to the third party, he/she sets up and operationalizes tailored criteria with more difficulty than disputing parties. The third party's professional skill may contribute to minimizing the difficulty arising from the lack of distinctive assets. However, when the distinctive assets are significantly large, this contribution may be negligible. The more difficulty, the more resources spent on setting up and operationalizing tailored criteria. Thus, the employment of the third party becomes less efficient than joint participation when the distinctive assets are significantly large.

Even if a significant amount of the distinctive assets is transferred to the third party, employment of the third party may still be less efficient than joint participation. The third party may be as efficient as disputing parties only in terms of setting up and operationalizing tailored criteria. Nevertheless, much cost occurs in transferring the distinctive assets to the third party. The cost increase due to this transference cost may be offset to some extent by the cost decrease due to the third party's professional skill. However, this offset may be negligible when the transference cost is significantly large. In sum, a proposition is addressed as follows:

Proposition 1) as stratification is greater (i.e., the amount of distinctive assets shared by disputing parties is greater),  
 a dispute-resolution-mechanism involving less DLDR  
 minimizes the information search cost more than  
 one involving more DLDR.

### 7.1.2. Information Communication Cost

Information communication cost is significantly high when communication apparatuses between disputing parties are so poor that these parties cannot communicate sought information without much difficulty. In this case, disputing parties must develop communication apparatuses in order to minimize this high communication cost. There are basically two ways of developing communication apparatuses. First, disputing parties develop communication apparatuses by which they directly communicate sought information to each other (hereafter, these apparatuses are termed "direct communication apparatuses"). Second, each disputing party develops communication apparatuses by which he/she communicates sought information to a third party (hereafter, these apparatuses are termed "indirect communication apparatuses"). The third party mediates sought information between disputing parties.

Which alternative is less expensive depends on how much disputing parties share distinctive assets. When disputing parties share a certain amount of distinctive assets, they can apply these shared assets to the development of direct communication apparatuses (e.g., Cratsley, 1978). For example, if disputing parties already have some convenient communication channels for normal economic transactions, they can apply such channels to the development of direct communication apparatuses. Disputing parties do not spend resources in purchasing assets used for the development of direct communication apparatuses to the extent that they apply distinctive assets they share to this development. Thus, the cost of this development decreases when distinctive assets shared by disputing parties are applied to the development. The greater the amount of distinctive assets shared by disputing parties, the more of these assets can be applied to the development of direct communication apparatuses, and, thus, the less expensive this development.

On the other hand, distinctive assets shared by disputing parties basically cannot be applied to the development of indirect communication apparatuses. These assets cannot significantly contribute to minimizing the cost of developing indirect communication apparatuses. In this regard, as the amount

of distinctive amount assets shared by disputing parties is greater (i.e., stratification is greater), the development of direct communication apparatuses is less expensive (i.e., more efficient) than the development of indirect communication apparatuses. In turn, a proposition is addressed as follows:

Proposition 2) as stratification is greater, a dispute-resolution-mechanism involving less DLDR minimizes the communication cost more than one involving more DLDR.

### 7.1.3. Ruling Cost

When disputing parties' future transactional relationships are highly uncertain, the parties must eliminate the uncertainty to some significant extent by predicting factors governing these relationships. This prediction is based upon information about disputing parties' past and present transactional relationships. When this information is poor in terms of quality and quantity, many adjustment processes are necessary in order to make the prediction significantly accurate. Due to these processes, many resources are spent, and, thus, ruling cost is high.

Information about disputing parties' present and past transactional relationships constitutes an asset distinctive to these parties' transaction, an asset which these parties share (e.g., Posner, 1969). For example, such information concerns market trends and technology, which these parties must commonly know in order to conduct transactions. Thus, when stratification is greater, the information disputing parties share increases in terms of quality and quantity. When the shared information is significantly large, the volume of resources spent on the prediction of factors governing disputing parties' future transactional relationships is smaller when disputing parties jointly make the prediction than when a third party makes it. There are three reasons for this.

First, a third party is generally not familiar with the information shared by disputing parties, and, thus, must go through more adjustment processes than disputing parties in order to make the prediction significantly accurate (e.g., Goldberg, 1976). The more adjustment processes, the more resources

spent on the prediction. The third party's expertise may decrease this expenditure to some extent. However, this decrease may be negligible compared with the extent to which the lack of such information increases this expenditure. Second, when the third party learns the information disputing parties share, the volume of resources the third party spends on the prediction can be as small as that of the resources disputing parties jointly spend on it; however, learning the information is difficult because such information is distinctive to disputing parties' transactions (e.g., Bryer & Stewart, 1985). Due to this difficulty, a large volume of resources must be spent on the learning process. Third, even if the third party learns the information shared by disputing parties and makes the prediction without spending many resources, a significantly large volume of resources must be spent in employing the third party (e.g., McEwen & Maiman, 1982).

The fewer resources spent in predicting factors governing disputing parties' future transactional relationships, the lower the ruling cost. The lower the ruling cost of a resolution-mechanism, the more efficient it is. In this context, a proposition is addressed as follows:

Proposition 3) as stratification is greater (i.e., information on past and present transactional relationships), a dispute-resolution-mechanism involving less DLDR minimizes the ruling cost (i.e., resources spend in considering future transactional relationships) more than one involving more DLDR.

## 7.2. Culture

Shared culture enables one person to predict another person's attitude and behavior with certainty (e.g., Bilmes, 1976; Mintz, 1982; Schall, 1983). As shared culture decreases, the uncertainty of this prediction increases. For example, suppose the *Gemeinschaft* concerning race. A white person can predict another white person's attitude and behavior with more certainty than he/she can predict a black person's attitude and behavior. When little shared culture exists, the prediction of attitude and behavior is uncertain. In order to eliminate this uncertainty, many communication activities are necessary (e.g., Becker, 1982). Thus, the less shared culture, the more communication activities are necessary.

### 7.2.1. Information Search Cost

When transactional behaviors are significantly idiosyncratic, tailored criteria, rather than standardized criteria, must be set up and operationalized in identifying whether or not these behaviors are opportunistic. In order to set up and operationalize tailored criteria, a significant amount of adjustment is necessary. In these adjustment processes, one party predicts the other party's attitude and behavior. This prediction is a basis for a compromise between parties' differing attitudes and behaviors; such a compromise is necessary in order to crystallize tailored criteria.

When disputing parties share much culture, a significantly smaller volume of resources is spent on the prediction of attitude and behavior when this prediction is made by disputing parties than when it is made by a third party. There are two reasons for this. First, disputing parties make the prediction with high certainty by virtue of much shared culture, and, as a result, do not engage in many communication activities necessary to eliminate the uncertainty of the prediction. On the other hand, a third party who does not share the culture makes the prediction with high uncertainty, and, as a result, engages in many communication activities to eliminate this uncertainty. The third party's expertise may decrease these communication activities to some extent. However, this decrease may be negligible compared with the extent to which the communication activities are increased due to the lack of culture. The fewer the communication activities, the fewer resources spent them. Thus, a significant smaller amount of resources is spent on a prediction made by disputing parties than on one made by a third party. Second, even if a third party shares the culture of the disputing parties, fewer resources are spent on the prediction when it is made by disputing parties than when it is made by the third party. The amount of resources the third party spends on communication activities necessary to eliminate the uncertainty is as small as the amount of resources disputing parties spend. However, a significant amount of resources is spent on the employment of the third party.

The more resources spent on the prediction, the higher the information search cost. Thus, a proposition is addressed as follows:



Proposition 4) as disputing parties share more culture, a dispute-resolution-mechanism involving less DLDR minimizes the information search cost more than one involving more DLDR.

### 7.2.2. Information Communication Cost

Culture constitutes the basis for developing communication apparatuses (e.g., Cushman et. al, 1976; Fine, 1979; Baker, 1980). The more shared culture, the larger this basis. Thus, depending on culture, either fewer or more resources are spent on the development of communication apparatuses when disputing parties conduct this development than when a third party conducts it. When disputing parties share much culture, fewer resources are spent on the development of communication apparatuses when disputing parties conduct this development than when a third party conducts it. There are two reasons for this.

First, disputing parties do not spend a significantly large amount of resources in cultivating the bases for the development of communication apparatuses, whereas a third party who lacks the culture does spend a significantly large amount of resources in cultivating it. As a result, the third party spends more resources on the development of communication apparatuses than disputing parties. The third party's expertise may decrease the amount of resources needed for cultivating the basis to some extent. However, this decrease may be negligible compared with the extent to which the expenditure is increased due to the lack of shared culture. Second, when a third party also shares the culture, the amount of resources he/she spends on the development can be as small as that of resources disputing parties spend. However, a significant amount of resources is spent on the employment of the third party.

The more resources spent on the development of communication apparatuses, the higher the information communication cost. Thus, a proposition is addressed as follows:

Proposition 5) as disputing parties share more culture, a

dispute-resolution-mechanism involving less DLDR minimize  
the communication cost more than one involving more DLDR

### 7.2.3. Ruling Cost

In considering factors governing disputing parties' future transactional relationships, a significant amount of adjustment is necessary. In these adjustment processes, one party predicts the other party's attitude and behavior. This prediction is a basis for compromising between parties' differing attitudes and behaviors; such a compromise is necessary in order to appropriately consider the governing factors and distribute compensations for proven damages over future time periods. For the same reason described in the section on Information Search Cost, a proposition is addressed as follows:

Proposition 6) as disputing parties share more culture, a  
dispute-resolution-mechanism involving less DLDR minimizes  
the ruling cost more than one involving more DLDR.

## VIII. Epilogue

A huge volume of research on dispute-resolution has been conducted in a variety of social sciences. However, an overview of the current literature reveals two research gaps. First, it is hard to find a sound theory that explains the choice of a dispute-resolution-mechanism. Most research on this choice has been conducted in an ad hoc manner, motivated by fragmented issues. Second, it is also hard to find research on the costs of dispute-resolution. Even statistical records that provide state-of-the-art descriptions of the costs of dispute-resolution are hard to find. However, there is much evidence that indicates the importance of such costs to dispute-resolution (e.g., Senate Hearing S261-17, 1982; Sander, 1982). In addition to the lack of research on dispute-resolution in marketing, these two research gaps lead us to set forth the conceptual framework discussed in this paper.

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## **Abstract**

This paper is to develop a conceptual framework regarding the choice among dispute-resolution mechanisms in channels of distribution. These mechanisms are characterized by the division of labor in resolving disputes. The choice of the mechanism depends on dispute environments. These environments concern culture and stratification. Six propositions are addressed with respect to how the environments affect the choice of the mechanism.