Business Networks, Economic Findings and Governance Structures

1. Introduction
2. Current Situation
3. New Economic Findings
4. Structure of Business Networks
5. System of Rules
6. Governance Instruments
7. Example of a Governance Structure
8. Findings

1. Introduction

Business networks are a popular form of cooperation in Europe especially for small and medium sized enterprises (SME). Business networks are also an interesting legal instrument for the sometimes neglected group of larger medium sized companies, whereas big companies often do not see the need to cooperate with partners in the framework of a business network. Even if they are willing to join a business network, anti-trust law prohibits most forms of participation that are interesting from an economic perspective for big firms.

Despite being a widely used instrument, business networks cannot yet be fully grasped from a legal perspective. One problem is that they have not been well defined yet, which is why our research group developed a legal definition. This new definition has not yet been accepted, so it is not clear yet which forms of cooperation will be called “business networks” and which activities will not fall under this category. We are especially in doubt whether a typical centralised franchising system should be integrated into the category of business networks. But what can be said for sure about business networks is that the forms of cooperation widely differ. They differ concerning their size, their organizational structure, their network purposes.

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1 This paper is part of a broader research project at the University of Siegen. We would like to thank Katja Aedtner and Marion Schultes from the University of Siegen, who worked with us on other papers concerning business networks. Furthermore, we are very thankful for the valuable discussion with Gunter Teubner (University of Frankfurt), Johannes Glückler and Ingmar Hammer (both University of Heidelberg).
2 SME are defined by the EU. The threshold to big companies is an annual turnover of not more than 50 million Euro, a balance sheet total of not more than 43 million Euro and a workforce of not more than 250.
3 In favour of the introduction of such a quantitative category in Germany KREBS, P./JUNG, S., “Große mittelständische Unternehmen - der zu Unrecht vernachlässigte Teil des Mittelstands”, DB, 2013, Editorial issue 51/52.
4 See SCHULTES, M., Unternehmensnetzwerke und das Kartellverbot des Art. 101 AEUV (forthcoming).
5 KREBS, P./AEDTNER, K./SCHULTES, M., “Company networks reloaded – putting a general functional approach to defining complex problems to the test”, forthcoming, D. concluding statements. Definition: „A company network is every legally voluntary connection based on an economic and legal network aim of a minimum of three legally independent companies which induce a network-specific demand for organisation. The network companies at least partially exchange their economic independence for the coordination of their economic activities by means of concerted practices, agreements or the foundation of a corporation in order to implement the network aim through the bundling of resources.”
and with regard to the projects conducted within the network. Even though there are so many different projects that can be carried out within business networks, a recent study shows that there is a tendency towards realising certain types of projects in the scope of business networks. Such a group of identical or at least very similar projects can be called an activity. Among others, popular activities are buying associations (syndicates), joint research projects, exchange of goods and exchange of experiences and knowledge.

But even though business networks are used for a wide range of activities, business networks are generally characterised by the need for a high degree of flexibility. The members attach great importance to flowing organisational structures, because activities as well as interests and members may change. Besides, the intensity and the number of projects worked on may also vary a lot.

This directly leads to one basic legal problem of business networks: Because of this need for flexibility a tendency towards a low degree of juridification within networks can be observed. The members tend to use soft governance instruments (in the following SGI) instead of hard governance instruments (in the following HGI). For many members of business networks trust seems to be more important than an intense protection by legal rules. But this basic attitude does not work well in all cases. If valuable assets are at risk, there is a need for protective rules. National laws in most countries do not provide specific rules for business networks. Only general rules can be applied. Because these general rules of the law are not always appropriate, there is a need for some form of self-regulation within a business network, especially for bigger and more complex networks which deal with valuable assets. This self-regulation is complicated due to the problem of multi-level-governance, especially in developed business networks. The fact that a multi-level-governance structure exists in developed business networks has been indicated by a recent study. These characteristics of business networks may explain the challenges to find appropriate legal solutions for dealing with those forms of cooperation.


13 SGI and HGI are discussed in more detail below.

14 This aspect is discussed in more detail below.

15 Even if some specific rules exist (like in Italy), these rules do not form a complex system of rules.


It is the aim of this paper to provide a general regime for internal governance structures of business networks. We will distinguish different levels. This will lead to a multi-level-governance structure. In the second part of this paper, we will have a closer look at the different “soft governance instruments” (“weiche privatautonome Regelungsinstrumente”) and “hard governance instruments” (“harte privatautonome Regelungsinstrumente”)\(^{18}\) which can be used for self-regulation within the business network.

2. Current Situation

So far, literature has classified business networks either as chain of contracts,\(^{19}\) as a corporation,\(^{20}\) as a net contract,\(^{21}\) as multilateral special agreements,\(^{22}\) as a contract group (“Vertragsverbund”),\(^{23}\) a multilateral synallagma\(^{24}\) or as a hybrid between, next to or beyond market and hierarchies;\(^{25}\) or contract and corporation respectively.\(^{26}\)

Many of those classifications are based on a rather holistic approach with regard to the organisational structure, because the network is analysed by looking at its framework.\(^{27}\) In this article we will concentrate on the internal structure of developed business networks. Hence, we open up the “black box” called business networks and try to draw legal conclusions from it. Our approach focuses on the activities inside the business network and on how the multitude of the single projects is governed. Especially in complex systems like developed business networks, a functioning governance structure is decisive.

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\(^{18}\) For a closer look at this new categories see 6.1.


\(^{22}\) BERWANGER, E., „Der Gesellschaftsvertrag eines virtuellen Unternehmens, Münster 2000, p. 28 f.

\(^{23}\) MÖSCHEL, W., „Dogmatische Strukturen des bargeldlosen Zahlungsverkehrs“, AcP186 (1986), 187 (211 ff.);


\(^{27}\) See SYDOW, J., „Strategische Netzwerke. - Evolution und Organisation“, Gabler, Wiesbaden, 2005, p. 103 ff.;


\(^{29}\) THORELLI, H., „Networks between Markets and Hierarchies“, Strategic Management Journal, 1986, 295 (295 ff.);


3. New Economic Findings

Johannes Glückler, a German economist from the University of Heidelberg, and his research team have recently conducted an interesting study on developed business networks. To our knowledge it is the first encompassing empirical study showing how business networks (in Germany) really work. Since Glückler is an economist, he focused on the economic aspects of business networks. In this paper, we use these economic findings as the basis for the legal regime that we try to develop in the following.

Glückler and his team measured and visualised the structure of the cooperating groups as well as the intensity of the involvement of the individual companies on the basis of a survey of all network companies. The most stunning findings of the study were firstly, that developed (big) business networks comprise of diverse projects, which could be assigned to different forms of activities and secondly, that the members do not join all the activities (and, of course, not all projects). Even if they join a specific activity, they may participate with differing intensity.

The first interesting consequence from a legal perspective is that companies which are members of a business network do not behave like shareholders of a company. They do not expect to gain their main advantage from the network as a whole. This does not mean that the members of business networks cannot receive a dividend from the network as a whole. But first and foremost, they want to profit from the projects they take part in. If profit (or loss) from the single project is what matters most to the members of the business network, the law applicable to these projects deserves a closer look.

Glückler and his team formed categories of similar projects, which correspond to the term “activity” used in this paper. We will explain this term in more depth later on. The study found that for each of these studied activities resources were combined with a specific type of cooperation by various network members. In the scope of the activity of linked production, for instance, companies offer unused production capacities. Network members who are in need of production capacities can then acquire them. In this way, two network companies combined their resources (production capacity and demand) by simply exchanging goods or services.

34 See 4.2.4.
In exploratory interviews with some of the participating companies, Prof. Glückler and his team discovered three primary categories of activities usually laying at the core of a business network as well as a secondary activity.

Primary activities in business networks were:

1. Linked production: Companies with unused production capacity could sell this over-capacity to another member of the business network.
2. Knowledge exchange: Usually various forms of knowledge exchange exist in business networks. Some are very informal (phone call) and some take a more formalised structure (data base). Kreanets also found that imitation is a crucial form of knowledge exchange in networks.
3. Project cooperation: In a project cooperation the network members work together in order to create something new e.g. a compilation of a quality management system or standard contracts.

The secondary activity was the management of the aforementioned primary activities. Most primary activities do not need a specific and costly management. But some primary activities can be so complex and expensive that a special management may be necessary or at least useful. This management activity gives network members the chance to take part in the organisation of the activity without being obliged to participate in the activity itself. To reduce the complexity we will focus on the primary activities in business networks. That is not only because of the scarcity of the secondary management activity, but also because they are not the core of the economic activity of business networks.

4. The Structure of Business Networks

4.1. Business Networks with a Simple Structure

In business networks, companies cooperate in order to achieve co-operative gains (“Kooperationsgewinn”). In general, a multitude of different co-operations can be found within networks. Every single co-operation is a “project” which is why the sum of all projects can be called “project level”.

In addition, there is always a “framework level”. The existence of the framework level can be deduced from the fact that companies organise themselves in order to cooperate. The participating companies normally do not want to cooperate in all forms of their business activities.

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41 For a deep analysis of chances and risks of business networks see SCHULTES, M., Unternehmensnetzwerke und das Kartellverbot des Art. 101 AEUV, forthcoming.
Therefore, a “network purpose (aim)” (“Netzzweck”) is needed, to describe the aim of the network.\textsuperscript{43}

To sum up, simple business networks comprise of at least two levels, the project level and the framework level.

\textbf{4.2. Business Networks with a Complex Structure}

The business networks described above show a very simple internal structure. But especially more developed and bigger business networks are characterized by a more complex governance structure. Possible levels in those networks are:

- Framework level
- Module level
- Activity level
- Project level
- Sub-Project level/Individual level

All levels can be the source of rules and the target of rules.

\textbf{4.2.1. Framework Level}

The framework encompasses the business network as a whole and usually provides some general and abstract rules for the whole network. From a scientific point of view, a framework is helpful for legal scholars, because it makes it easier to distinguish business networks from the market and other organizational forms like “groups of companies” (“Konzerne”).\textsuperscript{44}

The framework level is used to determine the network purpose. Most of the times, the network purpose is implicitly assumed and not explicitly stated. Furthermore, many business networks opt for a very general and broad network purpose such as technical improvement or improvement of the market position of its members.\textsuperscript{45}

In general, the framework level also serves as the “gatekeeper” to membership. Like the network purpose this function is sometimes only implicitly assumed without lying down further provisions. But especially bigger networks with a flowing membership structure will provide clear rules for becoming a member and leaving the network. It is common to use corporations


\textsuperscript{44} KREBS, P./AEDTNER, K./SCHULTES, M., „Company networks reloaded – putting a general functional approach to defining complex problems to the test”, forthcoming, C. II. 3. a.

\textsuperscript{45} See SCHULTES, M., Unternehmen und das Kartellverbot des Art. 101 AEUV, forthcoming.
as part of the framework (popular legal forms are companies with limited liability and associations). In these cases, those corporations are usually used to regulate the membership. It may be necessary to become a shareholder of the corporation in order to become a full member of the business network.

Besides structuring the membership of the business network, corporations on the framework level may also be important if “network goods” exist (network goods are goods that belong to the network). In this case, corporations may be an interesting legal instrument to manage network property. A corporation can also be used to collect money for the overall activities of the business network and to have funds ready to support (mostly) more complex and costly projects within the business network, which are expected to have a benefit for all or most network members.

Furthermore, a corporation on the framework level may serve to structure the decision making process within the business network. But we do not expect this tool to be frequently used, due to the distance between the framework level and the individual projects, the individualistic approach of network members to a project and the difficulties of the law of corporations to deal with such individual cases.

Leaving aside internal aspects, a corporation as part of the framework is a good tool to represent the network to third parties.

In theory, it would be possible to carry out all projects within the corporation. But company law was not designed to deal with shareholders only interested in some of the projects within the company. The fact that members participate in projects in different ways and to different extents and that they want to profit primarily from those projects they take part in and not from the company as a whole makes it difficult to grasp business networks only with the help of company law. Corporations are not flexible enough in this respect, which is why normally most of the projects within business networks are not carried out within the corporation used on the framework level, but outside the scope of the corporation.

Besides, corporation “network rules” or “rules of the game” can be observed on the framework level. They are not part of the corporation but part of the framework. Some possible areas of regulation are:

- Fiduciary duty
- Cooperative behaviour
- Membership fee
- Rules for network goods
- Conditions for membership
- Decision making process
- Organization of projects

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49 According to our understanding network goods belong to the business network.
However, the existence of a framework does not necessarily imply a high degree of juridification. A low degree of juridification is possible as well. In German law, the legal concept “Sonderverbindung” (special relationship) grants a low degree of juridification with only some basic duties. In Germany, fiduciary duties exist to some extent (§ 242 BGB “Treu und Glauben”) within the “Sonderverbindung.” To a certain degree the parties have the duty to care for each other. Furthermore, liability for pure economic loss (“reiner Vermögensschaden”) (§ 280 I, § 241 II BGB) exists. There is also a strict liability for vicarious agents (“Erfüllungsgehilfen”) (§ 278 BGB).

4.2.2. Project Level

Bilateral (two members involved) or multilateral projects (more than two members involved) are the economic core of business networks. The single/individual projects are meant to create an economic benefit for the members of the network. Business networks are generally designed for a multitude of projects. The research group “kreanets” found that, as a matter of principle, those projects are independent of each other. Different members work on different projects with fluctuating intensity.

In case of problems within a project, specific rules that have been established for this project are particularly suited to solve the attached legal questions. That is the reason why one has to start looking at the rules on project level for solving a legal dispute notwithstanding that rules on other levels may have an influence on the rules at this level as well.

Under German law a project within a business network is always juridified by contract law or law of quasi-contractual relations to some extent. Parties can choose between contracts, corporations and a specific German instrument, the accommodation relationship (“Gefäl-ligkeitsverhältnis”). Which tool is suitable for which situation on the project level, will be discussed in more depth in the following (6.3.).

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50 See KREBS, P., Sonderverbindung und außerdeliktische Schutzpflichten, Beck, München, 2000 et passim; the concept has been accepted as part of German Law (§ 241 II BGB) since 2002.
54 See KREBS, P./JUNG, S./AEDTNER, K./SCHULTES, M., „The modular system of network activities“, forthcoming, B. I.
57 KREBS, P./JUNG, S./AEDTNER, K./SCHULTES, M., „The modular system of network activities“, forthcoming, B.
59 For a closer look at these accommodation relationships see BORK, R., in: STAUDINGER, BGB, Sellier de Gruyter, Berlin, 2014, “Vorbemerkungen zu §§ 145–156”, par. 79 ff.; GRÜNEBERG, C. in: PALANDT,
4.2.3. Sub-Project Level/Individual Level

Especially with regard to big, multilateral projects sub-projects and individual arrangements are possible and perhaps in some cases recommendable. The sub-projects and individual arrangements are characterized by their auxiliary function for the project. The rules established on this level resemble provisions on the project level. But it has to be taken into consideration that the rules on the project level will influence the sub-projects and individual arrangements.

As this level has a pure auxiliary function for the project level and this paper tries to reduce complexity, sub-projects and individual arrangements will not be further assessed in this paper.

4.2.4. Activity Level

In business networks it is common to have many similar projects, e. g. exchange of goods. In those cases it may be advisable to establish comprehensive rules for those homogenous projects. This level is herein called activity level.

The homogeneity is not an abstract juridical one, but a natural, economic homogeneity. Also non-lawyers will perceive the similarity between the projects and therefore consider general rules for the homogenous projects. An example may help to illustrate the activity level:

In a given business network, members regularly exchange unused production capacity. Every individual contract, that means every single exchange of overcapacity, is a so called “project”. But if the business network establishes general provisions for all individual exchanges of overcapacity, those rules belong to the “activity level”.

On this level, framework contracts (“Rahmenverträge”) may be used. But also soft governance instruments may effectively govern activities and shape the behaviour of the participating members.

4.2.5. Module Level

From a legal point of view there could be another level between the activity level and the framework level. This level shall be called “module level”. This is the level the law maker would use for setting network specific rules. The framework level is too abstract and the possible activities (activity level) and projects (projects level) within business networks are too diverse to provide general legal solutions for all kinds of business networks. Hence, a category between these two levels is needed and may be used by the law maker in order to regulate


business networks. Modules are the sum of different activities according to the underlying business models. As business models are used as a basis, it follows that activities and projects belonging to the same module also possess the same basic chance and risk structure. The homogenous chance and risk structure may justify common rules for projects and activities within one module from a legal point of view.

Business networks will normally not provide rules on module level, because this level is too abstract and "artificial", especially if one takes the tendency to have a low degree of juridification within business networks into account. Only if the law maker introduced default rules on the basis of those modules, would business networks be inclined to adjust them to their specific needs.

As the module level is not relevant for the internal structure of business networks, this aspect is not going to be discussed any further in this paper.

5. System of Rules

As shown above, there are many different levels in business networks. This leads to multi-level governance problems that are very similar to the problems within European Company

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The complexity arises due to the fact that every level can be the source of provisions. Two questions follow from this fact:

- On which level do those rules apply?
- Which rules have the priority in case of a conflict?

Mandatory law and binding case law will not be considered in the following, because this paper focuses on how the internal structure of the business network can be shaped by network members. The situation may also be easily legally assessed as long as the network provides specific rules concerning the system of rules that shall apply within the network. But such an explicit system of rules is generally not provided by business networks, which is why it is important to examine the “default” system.

In this case two main principles have to be reconciled. On the one hand, the principle of hierarchy may have an influence on the solution. According to this principle the higher ranking rules prevail over the lower ranking rule. On the other hand, one has to take the principle of specialty into consideration according to which the more specific rule overrules the more general rule.

The conflict between hierarchy and specialty can be solved (like for framework contracts) as follows: Primacy of application is granted to the more specific rule as long as the more specific rule is compatible with the higher-ranking rule. A more specific rule is also compatible with the higher-ranking rule in case the later one is a default rule. The more specific rule has to be interpreted in line with the higher-ranking rule. Usually, more specific rules are set on a lower-ranking level than general rules, because the parties involved on a lower-level are often closer to the specific problems that arise. There are cases where this “principle of specialty” does not work, because none of two rules is more specific, but they nevertheless have an area of intersection. In Germany, this problem is well known from the constitution. The tool to solve the problem is called “praktische Konkordanz” (practical concordance).

In case the network does not clearly state on which level a rule shall apply, the rules set on one level apply to the same level and the lower level. If there are contradicting rules on the

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68 In German Law there are no binding precedents. But if a court wants to deviate from a Supreme Court Decision the decision should be properly justified. In German Methodology this is called “Begründungslast” (burden of justification) see Krebs, AcP 195(1995), 171 ff.

69 “Lex superior derogat legi inferiori.”


71 “Lex specialis derogat legi generali.”


73 See 4.2.4.

same level, the more specific provision overrules the more general rule. If none of the rules is more specific the concept of practical concordance (“praktische Konkordanz”) applies.

Within business networks, the provisions on the framework level are the highest ranking ones. Those rules can apply on the framework level itself or might be directed to the activity and project level.

The rules on the activity level are lower-ranking than provisions on the framework level, but generally overrule provisions on the project level in case of a conflict. The rules on the activity level shape the individual projects within the business network.

The project level is the lowest level of regulation in the business network, of the aforementioned levels.\(^{75}\)

The system of rules may be object of special rules itself, but in business networks which tend to low juridification this is not very probable. But if a network exists for quite a time, the network members will probably practice a kind of system. If they do practice a coherent system, this should be treated as if they have set a specific system of rules. This customary rule should be binding until practice has changed or a formal rule has been set.

A graph may help to illustrate the system of rules.

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6. Governance Instruments

6.1. Overview

So far, no empirical studies on the use of different governance instruments within business networks have been conducted. But as the study done by “kreanets” shows the needs of developed business networks,\(^{76}\) this paper tries to assess the main governance instruments with regard to their advantages and disadvantages. The suitability of the different tools depends on many different factors, but not all of them can be discussed for every single governance instrument in this article. It is the aim of the article to discuss the most important factors for the two basic types of rules, hard governance instruments and soft governance instruments.

“Hard governance instruments” (“harte privatautonome Regelungsinstrumente”) and “soft governance instruments” (“weiche privatautonome Regelungsinstrumente”) are not common juridical terms. We developed these terms following the terms “hard law” and “soft law”. “Hard law” is the classical law by the lawmaker, which has to be obeyed. Soft law has a weaker legal binding force and is sometimes not even developed by the lawmaker, but by another group or commission. Normally, those soft law rules receive some form of approval

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\(^{75}\) The sub-project level respectively the individual level (4.2.3.) is not assessed to reduce complexity.

by the lawmaker. But neither the term hard law nor soft law are used within the framework of freedom of contract (“Vertragsfreiheit”). Hence, in our opinion, those terms cannot be used as categories for the provisions inside business networks. Therefore, we introduce the terms hard governance instruments (HGI) and soft governance instruments (SGI) instead.

The term “soft governance instruments” refers -like soft law - to instruments which do not have legal binding force. In contrast, “hard governance instruments” - like hard law rules - possess legal binding force. Because of the relationship between hard law/soft law and hard governance instruments/soft governance instruments both types of categories will work in a very similar way.

As mostly, there is grey area between the two categories SGI and HGI. In the field of soft law and hard law this grey area is well known. The German Corporate Governance Codex (DCGK) may serve as an example for a grey area between hard law and soft law: The obligation to provide a governance statement is based on hard law (§ 161 AktG), but the “comply or explain” approach used by the DCGK is a soft governance approach. Companies do not have to be in line with the Codex, but if they do not want to, they are obliged to state and explain this. In case of an infringement to provide a proper governance statement, German law provides legal consequences, which fall in the category of hard law. If a “comply or explain” instrument is used inside business networks, it would be an example for this grey area. An even better example is a drafting task, because drafting tasks are a more appropriate tool for business networks. The task itself maybe obligatory and therefore belongs to the category of hard governance instrument, while at the same time, the drafting task guarantees full freedom of content, which rather indicates that it is a soft governance instrument.

Business networks do not have to opt for either HGI or SGI as a basis for the governance structure. Both types of regulation rather complement each other within business networks.

6.2. Soft governance instruments

Soft governance instruments only set incentives to comply with rules laid down. They do not compel the members of business networks to apply them. This characteristic makes them an interesting instrument for business networks. Business networks rely more on intrinsic motivation and guidance rather than on force. They need trust and cooperation to work smoothly and effectively. But trust and a good “working atmosphere” could be destroyed by the implementation and even more by the enforcement of HGI.

Besides influencing behaviour, soft law rules may help the network members to reduce costs e.g. by offering standardisation. Standard contract models for similar projects may help to reduce information and transaction costs.

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80 About drafting tasks inside law see Institut für Gesellschaftsrecht der Universität zu Köln, „Europäischer Corporate Governance-Rahmen“, NZG 2011, 975 (977).
In general, SGI can work in two different ways in business networks. They can have influence on the existence of rules (“if”). Soft governance instruments can set incentives for the network members to establish rules without interfering with the content/substance of the rules. But soft governance instruments can also be used to shape the content of provisions (“how”) within business networks.

**Standard soft governance instruments** that are considered in this paper are:

- Model contract
- Tool box (of model clauses for contracts)
- Drafting task
- Best practice
- Comply or explain
- Recommendation
- Code of conduct

A **model contract** contains all necessary rules you need for a specific type of contract and normally is developed specifically for this purpose. A model contract helps to reduce costs through standardisation. The aim of the model contract is to save time for developing a contract and to make it more probable that the contract is well designed and fair. There is no obligation to use a model contract, but if the model contract is well designed and fair, it can be expected to be used without or with little alterations. Therefore, model contracts are able to play an important role in the way projects are practiced. A very similar soft law category would be a model procedure.

A **tool box** (of model clauses for contracts) has the same aims as a model contract. It is usually not focused on a specific type of contract and can therefore be used in a broader context. The members may choose different clauses for their specific contracts. But in contrast to model contracts, they are still forced to develop at least some parts of their contract or have to decide at least which clauses they integrate and which ones are left out.

**Drafting tasks** are established to remind members of the network that in certain cases rules are needed or at least useful in order to minimise risks and to ensure fair dealings. Drafting tasks might be combined with a tool box or a model contract. A drafting task is on the borderline between a SGI and a HGI, especially if the drafting task also provides a default rule for cases in which the members did not deal with the subject. But still, the freedom of choosing how to fulfil the drafting task remains.

**Best practice** is not a concept limited to law. As a soft governance instrument it can be used to have some sort of model contract without the network having the expenses to develop one, or as a model for a legally relevant procedure. The problem with a best practice is that a practice which works for one occasion does not automatically have to work for another occasion. Because a practice is normally not systematically tested, one cannot be sure of a successful practice being a best practice. Nevertheless, this instrument might be interesting within business networks, because many business networks stress the importance of knowledge transfer. Especially in the field of contracts and procedures this might be an interesting tool.

**Comply or Explain** is a method widely used in soft law approaches for corporate government codices. Normally a standard setting board provides rules. The companies have to either comply with them or explain the deviation. This concept works because the information is available for the public, the shareholders and other stakeholders. Besides this mild form of public pressure, there always is the threat of the law maker setting a mandatory rule, if companies do not react to this soft approach. With regard to business networks the “comply or explain” method does not seem suitable. Not only is the concept too complicated and too burdensome, but also public control is missing though it is needed for putting pressure on companies to
comply. Only the other network members could exercise this control. The costs for drafting such a codex within a network will normally be too high, which is why the “comply or explain” method is not likely to be used a lot inside business networks. Finally, there is no real threat of a mandatory rule, because the members of the business network themselves establish the rules inside the network.

**Recommendations** are a very broad category. A model contract, a tool box and a best practice are all examples for recommendations in this broad meaning. In a more specific way a recommendation is an advice how to deal with a certain situation. A recommendation can be given well in advance and in a very general way, but there may also be recommendations with regard to very unique situations. As we are looking for rules within business networks we are looking for more general recommendations. What is special about recommendations is that you need an expert, who is able to give a valuable recommendation.

A **Code of Conduct** is a set of rules given by an entity as a signal to stakeholders or the general public and are supposed to influence the behaviour inside the system. There are associations which develop and recommend a code of conduct. A business network could develop a code of conduct. The use of a code of conduct is more likely if this business network works in the light of the public. “Rules of the game” are similar to codes of conduct. Even if the network does not seek public visibility, rules of the game may help to establish a certain “culture” inside the business network and to increase trust.

**6.3. Hard governance instruments**

German law offers parties within the freedom of contract (“Vertragsfreiheit”) three basic types of hard governance instruments which the parties can chose from:

- corporations
- contracts
- accommodation relations (“Gefälligkeitsverhältnisse”)

In addition there is the hard law in form of the civil code with default rules and mandatory rules.

**6.3.1. Corporation**

All legal company forms might be used to govern business networks or parts of business networks. As the study of Glückler shows, limited liability companies and associations are often used to structure developed business networks. Corporations are a good tool to organise systems with multilateral partners that have a need for a high degree of juridification. These characteristics make corporations a good tool for the framework level where all the members of the network interact. But as only some members take part in every project and the projects are the main source of gains (and losses) within the business network, the corporation is not a suitable tool for most of the projects. Furthermore, as mentioned above, the corporation is most of the times only one part of the framework of the business network. This effect can be

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82 Rules of the game can be structured either as HGI or SGI.
explained by the fast that only some aspects need a high degree of juridification while the members stress the importance of flexibility for other aspects.

Corporations are often used as the “gate” to membership, to structure the decision making process on framework level and to represent the network to third parties. Furthermore, it is a useful instrument to regulate the situation of “network goods”. Regulatory instruments within the corporations are particularly the articles of association and the ancillary agreements (”gesellschaftsrechtliche Nebenabreden”)

Besides, corporations may be used for “project co-operations”. As well as on the framework level project, co-operatives might require the coordination of a multitude of participants (two or more) and significant resources. In this case the participating members might feel the need for a higher degree of juridification. In contrast, a simple exchange of goods or knowledge usually does not require the use of a corporation to structure the exchange process.

Overall, it can be concluded that corporations might be a useful instrument on the framework level and, under specific circumstances, on the project level.

6.3.2. Contracts

First and foremost, contracts are a common instrument to regulate projects, especially bilateral projects. On the project level, contracts may be used in the same way asoutside the business network. With respect to the projects “kreanets” found within business networks, the exchange of unused capacity (linked production) would usually be governed by contracts. Multilateral contracts could be used for multilateral projects or to create rules of the game for all projects belonging to the same type of activity.

In contract relations general practices often evolve. We expect that this phenomenon regularly occurs within business networks.

In the US the discussion about relational contracts might provide some insights how contracts can be structured in an environment that fosters high level of trust between the network members.

6.3.3. Accommodation Relation

The accommodation relation is a specific German instrument in a way similar to an informal agreement or a gentlemen’s agreement. The parties involved have no obligation to perform, but once they have performed, they cannot claim their performance back. Even if the counterpart did not perform, the performance in return cannot be claimed back. Within such a relation, there are no primary legal obligations for either side, but there is a minor duty of care for the

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assets of the other part ("Schutzpflicht") and a basic duty of loyalty ("Treu und Glauben"). Such an accommodation relation for example, could be the right instrument for knowledge exchanges, where the one who gives the information normally hopes to receive needed information from the other side or a third party inside the business network later on.

### 6.4. Suitability of Governance Instruments

So far, this paper presented different HGI and SGI that might be used to structure business networks. But not all governance tools are suitable for all purposes. In the following, we are going to discuss in which situations which instruments or which combination of instruments fit best. But the members of the business network do not only have to choose between the different instruments, but also on which level they will set the rule and to which level those provisions should apply. The choice of the governance instrument and the implementation into the multi-level governance system are the two main challenges.

This paper is not able to give a final answer to those aspects. We rather want to provide a starting point for further discussions on governance instruments. In the following the different instruments will be qualitatively analysed as we have no sufficient empirical information on how business networks are structured.

#### 6.4.1. Functioning of business networks as a starting point

Governance instruments aim to support the functioning of business networks. Therefore, it is useful to examine aspects that are important for the functioning of networks.

In general, the functioning of business networks is based on a high level of mutual trust between the network members. Mutual trust is one aspect that might have an influence on the choice of governance instruments. Internal rules may help to establish or to increase the level of trust in business networks. But often provisions – especially hard law rules, but to a certain degree also soft law rules – may have the opposite effect. Especially overprotective rules could be perceived as a proof of distrust.

Furthermore, members are keen on keeping the structures of the network flexible in order to be able to quickly and easily adjust it to their needs. The need of flexibility suggests that in many cases HGI might not be suitable for the business network. SGI usually leave the members more flexibility, what makes them interesting tools for business networks.

In case HGI and SGI are used to structure the business network, it is important for the members that they are not too burdensome. First of all, setting the provision should not be too burdensome, because then members might prefer to leave this aspect unregulated. The possible gain from a regulation must be high in order to be willing to set complex rules. Those assumptions lead us to the conclusion that more complex tools like corporations, multilateral agreements and sophisticated soft governance instruments such as extensive model contracts are probably carefully used inside business networks due to their complexity.

Secondly, the application of the rule should not cause high costs. HGI as well as SGI might create high compliance costs. For example, drafting tasks, corporations or demanding con-
tracts might be burdensome. But in general, SGI have lower compliance costs than HGI, which is another argument for the use of SGI in business networks.

Mutual trust, flexibility and not too burdensome provision are very important for business networks. This will lead to the parties tending to look for a low degree of juridification. Therefore, the business members might prefer soft governance instruments or hard governance instruments with a low degree of juridification (as in accommodation relations).

One of the main advantages of business networks is their possibility to rationalise. Despite the tendency towards a low degree of juridification, the argument of rationalisation and standardisation may be a sound argument for a rule. Instruments that help standardisation are, for example, model contracts and framework contracts.

Legal certainty is an international concept. But within business networks, many aspects are not or hardly juridified. With regard to those aspects, legal certainty is not a main concern of the members. But even inside business networks effective and protective rules are needed for certain aspects. Especially the problem of free-riding and cheap-riding, as well as the management of valuable assets may create a need for rules that provide legal certainty. Litigation would destroy trust inside the business network. Hence, the preventive effect of legal certainty reduces litigation and helps to maintain a better atmosphere for co-operation within the business network.

To sum up, the functioning of business networks influences on the choice of governance instruments. The high level of trust inside business networks needed for co-operation, the need for flexibility, the avoidance of too burdensome rules, the aim for standardisation and the need for legal certainty in some specific areas characterise business networks and affect their governance structure. Those characteristics are the framework in which the choice of the governance instrument takes place.

6.4.2. Implementation of Rules into the Multi-Level-Governance System

Not all governance instruments are suitable on all levels. The rule setters have to decide on which level they want to establish the rule and on which level those provisions should apply. This question is highly complex due to three main governance levels inside business networks (framework, activity and project level). On top of it, one subject can be regulated by rules established on different levels. But not only the multi-level governance structure leads to complexity. The members have a broad choice of hard governance instruments and soft governance instruments. Which tool or which combination of instruments fits best depends on many different factors. Those factors in turn also depend on the levels. If the instrument should govern the individual project, the choice of instrument is influenced, among other things, by the exchange process, by the form of cooperation and by the used resources. If the governance instrument deals with organisational questions, the levels also play a roll, because the framework level is more abstract than the activity level. Besides the levels, the complexity of the organisation is decisive for the choice of the governance instrument.


On top of this, the characteristics of business networks outlined above set the framework for the governance structure that shall be created with the help of HGI and SGI.

The economic benefit for the network members is supposed to be created at the project level. Most rules within business networks are directed towards the project level. That means the provisions shall shape the individual projects. The rules applicable on the project level can be set on all levels. In general, the provisions established on the framework and the activity level that apply to the project level are abstract, because those levels are abstract levels and only complement the specific rules set on the project level.

In a first step, we will have a look at rules that are set on project level and shall apply to the individual projects. Soft governance instruments are generally not used in this context as they better fit on more abstract levels (the framework and the activity level). Therefore, parties of a project will normally choose between a contract, an accommodation relation and a corporation (partnerships) in order to structure the individual projects.

The choice of the instrument also depends on the characteristics of the project. Important features are the form of cooperation (non-transformative or transformative transaction), the type of exchange process (exchange of consideration, communisation, informal give and take) and the type of good involved in the transaction. There are no big differences to the choice of hard governance instruments outside a business network. This paper cannot provide an extensive analysis of all the different possibilities, just some general conclusions shall be drawn here to give an example. We will only focus on the different types of exchange processes, because we assume that this is one of the main factors for choosing the best governance instrument.

A simple exchange of goods between two parties (a buyer and a seller) is generally structured by a contract. If a project is based on the economic concept of "informal give and take", the parties normally do not need and do not want any formal rules. But under German law this is an accommodation relation. Within such a relation, there is no obligation to perform for either side (and no indemnification for non-performance), but there is a minor duty of care for the assets of the other part ("Schutzpflicht") and a basic duty of loyalty ("Treu und

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92 See literature mentioned in footnote 59.
93 Non-transformative transaction is to be understood as an exchange without a difference between the consideration performed and the consideration received. KREBS, P./JUNG, S./AEDTNER, K./SCHULTES, M., "The modular system of network activities", forthcoming, C. III. 2. a).
94 Transformative transaction is to be understood as a co-operation of members with the result that the individual performances and the originated goods no longer concur with the initial input, KREBS, P./JUNG, S./AEDTNER, K./SCHULTES, M., "The modular system of network activities", forthcoming, C. III. 2. b).
95 The exchange of considerations is based on the classic do ut des which is the traditional individual form of exchange. KREBS, P./JUNG, S./AEDTNER, K./SCHULTES, M., "The modular system of network activities", forthcoming, C. III.2.a) aa).
96 With regard to communisation two or more network participants combine their resources which can subsequently be gathered and used either individually or collectively. KREBS, P./JUNG, S./AEDTNER, K./SCHULTES, M., "The modular system of network activities", forthcoming, C. III.2.a) bb).
97 The informal give and take consists of two action forms, which are often combined, namely informal giving and informal taking. The defining criterion for the informal giving is the fact that initially a consideration is provided without claim to consideration in return. The informal giving could also be termed "generalised exchange". The consideration is not provided in the case of informal taking. Instead, the benefit recipient lawfully takes the consideration usually based on informal connivance. KREBS, P./JUNG, S./AEDTNER, K./SCHULTES, M., "The modular system of network activities", forthcoming, C. III.2. a) cc).
98 See I.
100 See especially 4.2.1. and 6.3.3.
Glauben”). The third category of exchange process is communisation, which could either work as corporation or as a contract based pooling.

SGI as well as HGI can be used on those levels to shape the projects. In case specific projects shall be shaped, rules might be set on the activity level in order to be “closer” to the projects they want to influence. But in many cases the parties to the individual projects might not want their “freedom of contract” (“Privatautonomie”) to be too much limited by abstract rules set on the activity level. Hence, SGI might provide an appropriate solution on activity level. They can leave the members freedom of contract while helping standardisation and shaping behaviour at least to some extent. In a second step, the network members have to decide which SGI (or HGI) they want to use. The choice of the instrument depends on the projects belonging to the activity. If the projects within this activity are usually regulated by contracts, model contracts and tool boxes may be particularly useful on the activity level as they might achieve standardisation. Standardisation can help members to reduce transaction costs without interfering too much.

The framework level is the level where rules applying to the whole network (not only the project level) are usually set. Many rules on the framework level deal with organisational questions and are not directly related to the different projects. In some cases abstract “rules of the game” may set a framework for projects. Those rules might be hard or soft provisions.

Besides provisions that affect projects (independent from the level they are set at), there often is a practical need within business networks to establish organisational rules.

We expect a mixture of HGI and SGI to deal with organisational questions. Most organisational rules are probably set on the framework level as they shall organise the whole business network. Therefore, rules dealing with membership (how to become a member of the business network, rules for leaving the network etc.) generally apply and will be set on the framework level whether the network members opt for HGI or SGI will depend on the economic activity and size of the network. The bigger the number of network members, and the higher the values of the assets within the network, the more likely HGI are to regulate the membership. The same argumentation can be used with regard to the decision making process. When many parties are involved, a popular hard governance instrument is the corporation (partnership). Many developed networks set up a corporation (partnership) or association to deal with those aspects. In this case, the articles of association and corporate ancillary agreements (“gesellschaftsrechtliche Nebenabreden”) will be used to structure the business network.

But HGI are often complemented by SGI on the framework level. Soft governance instruments could be used for setting the “rules of the game” for the interaction between network members. Codes of conduct outline responsibilities and proper practices within the business network. Those guidelines will most likely be set on the framework level and apply to all actions within the network (at the framework level, at the activity level and at the project level).

7. **Semi-fictional Example of a Governance Structure**

An example may illustrate how SGI and HGI may be used on the different levels within business networks.

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102 See 6.2.

103 See 6.2.

104 See 6.3.2.

105 The example is based on findings by kreanets. In order to illustrate the multi-level-governance structure, aspects of different existing business networks are combined in this example.
7.1. Framework

Dental technicians located in one region of Germany formed a business network, called “DenTech” with the purpose of technical improvement of the network members. The members decided to form a GmbH (German limited liability company) and used it on the framework level. The purpose of the company in the articles of association reflected the purpose of the business network. The membership structure was governed by rules on the framework level as well. The dental technicians agreed to use the GmbH as a “gate” to the business network. In order to become a member of “DenTech” it was necessary to become a shareholder of the company. In order to keep the business network running, the members transferred an annual membership fee to the GmbH. This money was used to finance among other things a project to develop a quality management system.

7.2. Projects

Technical improvement was a key for being competitive. Therefore, the members did not only pursue research and development within the business network, but they also invested in R&D in their own companies. Especially with regard to big research projects within one company, the demand for technical expertise sometimes peeked for a limited period of time. In those cases, the members arranged a “body leasing” inside the business network. One member “leased” a dental technician to another company for a limited period of time. Those projects were governed by individual contracts and were a very popular form of co-operation inside “DenTech”.

7.3. Activity

But soon fierce competition for those “body leasing” contracts arose and led to some unrest among the network members. In order to mitigate the competition inside the network, the dental technicians agreed on a minimum price at the activity level for all body leasing contracts. In order to give every member the chance to offer their free capacities, “DenTech” established a database and recommended its members to use it (soft approach). The database fostered an atmosphere of trust and cooperation by ensuring an unrestricted flow of information. Model contracts for body leasing contracts were developed after a while to help standardisation and reduction of transaction cost. At the same time, they were used as a “soft” approach to ensure “fair” contracts on the project level.

7.4. Conclusions

The example of “DenTech” shows that it is natural for business networks to use the framework, the activity and the project level for regulating co-operation inside the business network. Many business networks establish rules on the framework and the project level from the start. Provisions on the activity level are likely to develop during time. Only when the members feel a growing need for standardisation and guidance are they likely to provide more abstract rules on the activity level.

107 Comparable to the s.r.l. in Spain.
108 If those rules are compatible with anti-trust law is not part of this paper. See SCHULTES, M., Unternehmensnetzwerke und das Kartellverbot des Art. 101 AEUV, forthcoming.
110 In the study by Glückler no model-contracts were found.
8. Findings

- Business networks are a popular form of co-operation for companies, which justifies more in depth analysis from an economic as well as a legal perspective.\(^{111}\)
- The economic finding that there are many diverse projects and activities in developed (big) business networks has an influence on the legal perception of business networks.\(^{112}\)
- Developed business networks are characterized by a multi-level governance structure. In this paper we identified five different regulatory levels\(^{113}\)
  - Framework level
  - Module level\(^{114}\)
  - Activity level
  - Project level
  - Sub-project/Individual level
- All levels can be the source of rules as well as the target of rules.\(^{115}\)
- The system of rules is characterised by two principles, the principle of hierarchy and the principle of speciality.\(^{116}\)
- As the regulatory system of business networks can be very complex, there is a need for a “good governance structure” within the business network.
- Business networks are likely to opt for a mixture of soft governance instruments (SGI) and hard governance instruments (HGI).\(^{117}\) Those two terms were developed in this paper with regard to the well known terms “soft law” and “hard law”. But the latter only refers to rules of law and cannot be applied in a contractual situation, which is why the terms SGI and HGI were introduced.\(^{118}\)
- In our paper we assess different instruments with regard to their suitability within business networks.
- The suitability of the different tools depends on many factors. The functioning of business networks sets the conditions for the choice of the particular instrument. The high level of trust inside business networks needed for co-operation, the need for flexibility, the avoidance of too burdensome rules, the aim for standardisation and the need for legal certainty in some specific areas affect the governance structure of business networks.\(^{119}\)
- Other factors that influence the choice of governance instruments are:\(^{120}\)
  - Form of exchange
  - Good that is exchanged
  - Number of members involved
  - Level, where the rule is set
  - Target level
  - Characteristics of the used tool
- In general, SGI can be used to influence behaviour and reduce costs by standardisation.\(^{121}\) Interesting soft governance tools for business networks might be\(^{122}\)

\(^{111}\) Cf. Point 1.
\(^{112}\) Cf. Point 3.
\(^{113}\) Cf. Point 4.2.
\(^{114}\) For a closer look at this level see KREBS, P./JUNG, S./AEDTNER, K./SCHULTES, M., “The modular system of network activities”, forthcoming, C.
\(^{115}\) Cf. Point 5.
\(^{116}\) Cf. Point 5.
\(^{117}\) Cf. Point 6.1.
\(^{118}\) Cf. point 6.1.
\(^{119}\) Cf. Point 6.2.
\(^{120}\) Cf. Point 6.1.
\(^{121}\) Cf. Point 6.2.
- HGI used in business networks are
  o Contracts
  o Corporations/partnerships/associations
  o Accommodation relations

122 Cf. Point 6.3.
123 Cf. Point 6.4.