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Formation and Change of a Network in the Swedish Insurance Industry The Case of a Small Firm's Strategic Network

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Abstract

In recent years there has been great interest in strategic networks. These webs of organisations are usually defined as long-term arrangements between firms that are strategically led by one or more hub firms. The present paper examines the development of a strategic network in the Swedish insurance industry over an extended period of time. The case of the firm "Svedberg & Hübsch" illustrates how the organisation of insurance distribution has changed significantly through the initiative of two entrepreneurs setting up their own business. By establishing a tied agency and later transforming it to an independent brokerage company the former Skandia salespeople have introduced a new model for developing and selling insurance solutions. Central to the entrepreneurs' idea is their reliance on a well-developed network of suppliers and customers. However this network has undergone significant changes over time as Svedberg & Hübsch have met new challenges and developed their business further.

The paper poses some questions to existing theory problematising the strategic network concept. Considering a case with an SME's network the concept appears in a way that is different from much previous research. As the case shows a small firm may well develop a network with a strategic purpose. However, controlling the network and establishing a collective purpose becomes difficult due to power asymmetries. By applying a process perspective the idea of strategic networks as long-term purposeful arrangements is relativised. Considering, the importance of non-intentional strategy formation and networks' subjective character the strategic network notion appears as an ambiguous but still interesting concept.

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Formation and Change of a Network in the Swedish Insurance Industry

The Case of a Small Firm's Strategic Network

At least since the seminal piece “On Strategic Networks” by Juan Carlos Jarillo (1988) there has been great interest in these webs of organisations. The present research aims at illustrating the phenomenon by taking a look at one such network, namely the network around, Svedberg & Hübsch, a Swedish insurance broker that has been a forerunner in the re-structuring of insurance distribution in Sweden. First, the concepts of networks and in particular strategic networks will be introduced and discussed, reviewing relevant literature. Special emphasis is going to be put on the meaning of the strategy notion in this context. Secondly, theory will be compared to empirical findings on the network around Svedberg & Hübsch. As a conclusion, reflections on existing theory are going to be made and issues for further research on strategic networks will be outlined. The research is based on qualitative in-depth interviews with representatives from different actors in the network. The work is still in progress, but puts already up some interesting questions in connection with strategic networks. Since Svedberg & Hübsch is an SME, the research is going to reveal interesting power issues facing a small company networking with large firms. Hence, the purpose of this paper is to give a theoretical contribution to network research by trying to understand the formation and change of a strategic network around a small firm.

The Network Perspective

The network perspective has evolved due to critique of the old marketing paradigm that considers markets as areas of free exchange. There, actors act independently from each other and can easily switch exchange partners if they like. The firm's environment becomes faceless (Astley 1984:526) and competition is in focus when considering the relations to other actors. In contrast to this, the network view puts emphasis on

different forms of collaboration between actors. Economic behaviour is always embedded in social relations (Granovetter 1985), thus “no business is an island” (Håkansson and Snehota 1989:187). Actors link their activities to each other and exchange resources (Håkansson 1993). As a consequence of this, networks of interacting entities emerge and the setting of boundaries of an organisation becomes at least questionable since boundaries are frequently bridged with joint activities. Hence, the network perspective directs our attention towards what happens between firms rather than focusing on companies' internal organization. When the insurance business is concerned, this perspective implies that we do not look for rather anonymous actors exchanging insurance contracts for money. Instead, we try to understand how insurance solutions are produced in co-operation between different partners.

In recent years, a vast amount of research applying the network view has been produced. In the following section of the paper we will, after a brief introduction of the Svedberg & Hübsch case, take a look at some major topics in network literature that might offer helpful perspectives when analysing the case. In the review we will also identify questions that emanate from the theoretical debate. By confronting these questions with empirical data we are hopefully going to gain further insight in some central issues of the perspective, namely the concept of strategic networks, the formation of strategy in networks, power and trust in networks, and networks in relation to other governance modes.

Svedberg & Hübsch's network

During the past 20 years, the Swedish insurance industry and specifically its distribution system has undergone significant changes. While in the early 1980s insurance companies heavily relied on in-house sales forces, meanwhile tied agents

and independent brokers stand for an important share of insurance distribution. A major forerunner in this change process is “Svedberg & Hübsch”, a firm set up by two former salespeople of Skandia, Sweden’s largest insurance company, in 1986. Their initiative to start an own firm, by the founders called “entrepreneur company”, has found imitators in the industry and also lead to changes in Skandia’s own organization. Thus, Roger Svedberg and Arne Hübsch do not only label their own venture as an “entrepreneur company”. They also act entrepreneurially in a Schumpeterian sense (Schumpeter 1911/1997) since their initiative has led to a new organisation of the industry. Tied to Skandia alone, there are about 25 of these “entrepreneur companies”, standing for approximately 20% of Skandia’s total sales volume in Sweden and employing at least 60-70 people. The entrepreneurs have been so successful that in 1999 Skandia turned its entire remaining sales force with 500 employees into a large entrepreneur company, totally owned by the Skandia mother company. However, Svedberg and Hübsch go even one step further than being a tied agent distributing Skandia insurances. They are currently becoming independent insurance brokers selling insurance products from various suppliers. The development of Svedberg & Hübsch as well as the network of organisations around them reveals an interesting strategy process that will be subject to further examination in this paper.

Strategic networks

The strategic network concept will be central to the analysis of the Svedberg & Hübsch case. In literature, strategic networks constitute a specific kind of networks. Most authors see them as deliberately arranged around a hub firm, usually being the apex in a quasi-hierarchy. For instance Jarillo defines

“strategic networks as long-term purposeful arrangements among distinct but related for-profit organizations that allow those firms in them to gain or sustain competitive advantage vis-à-vis their competitors outside the network.”

Jarillo (1988:32)

Sydow (1992) takes a similar standpoint, drawing on Jarillo and stressing that “strategic

networks are distinct from other enterprise networks as they are strategically led by one or more focal enterprises” (p. 81, my translation). He also sees a relatively high degree of intent in the arrangement of strategic networks. Nevertheless, Sydow reminds us that any economic activity is a result of both planned and emergent behaviour. Considering the central role of hub firms in strategic networks, these companies will play the leading role in formulating strategy and directing relationships between network members.

Strategic networks in the financial services industry have been examined in earlier research (e.g. Sydow, Well and Windeler 1997; Sydow and Windeler 1998). However, in these pieces, the application of the strategic network concept has been unproblematic since hub firms directing the networks have been easy to identify. In the German insurance industry, that stands in focus in both papers, networks are often dominated vertically by insurers. Agents are reluctant to engage in horizontal networks, still some service providers like MLP-Finanzdienstleistungen may attain powerful positions as hubs in horizontal networks when independent advisors become economically dependent on them (Sydow and Windeler 1998). Looking at the Svedberg & Hübsch case it becomes thus crucial to see if there is any firm in the network that is able to obtain strategic leadership.

Strategy in networks

As we already can see in the literature on strategic networks, strategy is an ambiguous concept. One question that has been disputed concerns the intentionality of strategy. While many authors see strategy as a deliberate planning process, (e.g. Ansoff 1965) belief in the practical appropriateness of rationalistic planning approaches has been increasingly challenged (Lindblom 1959; Quinn 1978). To Mintzberg and Waters (1985) strategy is the outcome of both deliberate plans made up ex ante and patterns of action that emerge subsequently and are often only recognised in hindsight. Here again, we have to ask ourselves what we mean by strategy when talking about strategic networks. Mintzberg and Waters (p. 257) regard purely deliberate and purely emergent strategies “as two ends of a continuum along which real-world strategies lie”. What if the same is true for the formation of a network? Can there be different degrees of intent in such a process? Hope-

fully, this paper can give some hints to the formation and development of one strategic network, indicating to what degree intentional vis-à-vis emergent strategies were involved and what role the hub firm has played.

Power in networks

Cyert and March (1963/1992) as well as Pettigrew (1985) remind us that strategy formation takes place in the context of power and politics. Phenomena that become especially interesting in networks where power games occur between organisations (Oliver and Ebers 1998). In order to understand the changes in the network it is necessary to understand the different forces influencing its actors. Heide and John (1988) point out that in principal-agent relationships, agents may balance their dependence on principals by investing in their customer relationships. Hence, for insurance agents, networking might be an appropriate means to increase their independence vis-à-vis powerful insurers.

Looking at existing network literature, a concept that seems to be more commonly used than power is that of trust (e.g. Johanson and Mattsson 1987; Ring 1996). Networks are assumed to be characterised by mutual trust between actors in contrast to markets where competition is the dominant force. However, Axelsson (1992b), Powell (1990) and Thorelli (1986) point out that networks are not areas of trust alone, but rather comprise a combination of co-operation and competition, of trust and power.

The Svedberg & Hübsch case

Until 1986 Roger Svedberg in Stockholm and Arne Hübsch in Jönköping, a provincial capital in southern Sweden, were two members of Skandia's countrywide insurance salesforce. However, the two were not satisfied with their situation as employees in the large insurance company. They felt that there was a discrepancy between what Skandia's centralised sales organisation could offer and what customers actually needed. Moreover, Svedberg and Hübsch regarded their present job as little inspiring since their remuneration was not related to their success in the market. Hence, innovativeness, as far as it was possible at all to innovate, did not pay off financially. The two salesmen decided that becoming independent entrepreneurs was

the only way to change this situation. After negotiations with Skandia they signed a contract with their former employer, allowing them to set up their own business. Although they now had to take the full business risk, the new arrangement gave Svedberg and Hübsch new freedom in serving their customers:

"When we worked in a large sales organisation this [organisation] often says that here you have the ten products that have been created. Now it's your task to get them out in the market. We were not at all interested in that. We were interested in getting out the products our customers needed. As we had small and medium sized companies [as our customers] there were products in the line of products that we were not interested in at all. [...] As we started working in an own company we got the right to work exactly according to our own thoughts and ideas, doing what we thought the market needed. This has implied that some products that were created that were never used by us"

Arne Hübsch

The new business was called "Skandia Försäkringskonsult – Svedberg & Hübsch" (Skandia Insurance Consultant – Svedberg & Hübsch). As a tied agency, Svedberg & Hübsch exclusively sold Skandia's insurances. However, these could be supplemented with supporting products that were not available in Skandia's product range. Svedberg and Hübsch now ran their own company taking full risk concerning profits and losses. The idea of setting up an own business was to outweigh the limited amount of resources a small company controls by tying together customers, insurance suppliers and various other actors to an extensive network. On the supply side, insurance companies and asset management companies, such as Goldman Sachs, provided Svedberg & Hübsch with products that the entrepreneurs then combine to tailor-made insurance solutions for their customers. During the product development process, Svedberg and Hübsch drew upon their network of lawyers, tax experts, other insurance agents, suppliers, and customers to generate ideas, adjust them to market needs, and test them for feasibility. It quickly becomes obvious that the use of their extensive network was a cornerstone in Svedberg & Hübsch's strategy.

In order to keep the network up and running, it was important for the insurance agents to maintain a good bargaining position vis-à-vis their partners. This was primarily contingent upon the agents' portfolio of customers. An agent with a

large network of attractive customers naturally became more attractive for insurance providers, asset management companies and other actors to co-operate with. Hence, these partners would provide the agent in question with better service and more favourable business conditions.

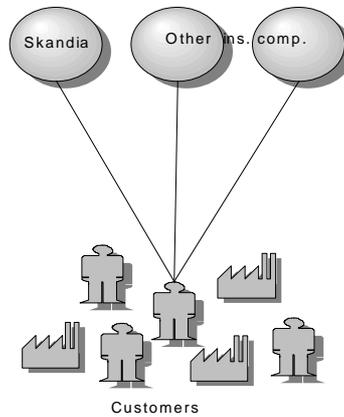


Figure 1. The situation before Roger Svedberg and Arne Hübsch started their own company. At that time Skandia sold insurances through an in-house sales force.

Start-up of the “entrepreneur company”

The step to leave Skandia’s organisation was initially not welcomed by everyone in Skandia’s organisation. However, attitudes at Skandia have shifted over time and between different organizational levels. At the start-up of the first entrepreneur company, especially middle managers at the mother company seemed to consider the coming into existence of the new organization as a threatening scenario. The way of distributing insurance products throughout the industry had, at least in Sweden, been to own the distribution channel in order to control how products were produced and how they reached the final customer. The giant sales organisations of the insurance companies enabled them to push out their products in the market. Now, the sales apparatus of Skandia suddenly started eroding. Middle managers on the corporate level perceived the initiative of Svedberg & Hübsch as illoyal and as a consequence the new companies initially did not get access to Skandia’s new products. For instance, in the asset management area newly developed product were only supplied to “loyal” sales-people who remained in house while the tied agents were put in some kind of quarantine.

This was a strong incentive for the independent entrepreneurs to go ahead in their striving for independence with even more determination. In order to make sure that they could provide their customers with asset management solutions they started establishing their own network of asset management companies, comprising well-known firms both in Sweden (e.g. Alfred Berg, Öhman) and abroad (Goldman Sachs, Bill Stearns). For instance Svedberg & Hübsch could offer portfolios, managed by these companies, that were adjusted to different risk levels the customer could be willing to take. Initially, Svedberg & Hübsch expected to arrive at an asset management volume of about 10 million SEK (1 USD = approx. 10.70 SEK). Now, together with a few other insurance agents, assets managed amount at several billion SEK.

While reactions among Skandia’s middle managers to Svedberg & Hübschs start-up were negative or even hostile, the attitude of Skandia’s top executive leadership was rather supportive from the beginning. Seen from a global perspective the phenomenon of legally independent agents being tied to insurance providers is nothing unusual. For instance in the US this way of organising insurance distribution has existed for a long time. Hence,

leading Skandia executives were familiar with the principle, not at least through acquisitions Skandia's life assurance business had made in countries where tied agents already were the most common distribution channel. Selling insurances through tied agents has several advantages for the provider. First of all, agents acting as independent businessmen, working for their own profit tended to sell more than in house salespeople. This was not very surprising since their possibility to increase their personal wealt through high sales offers a strong incentive. Secondly, Skandia reduced its

own risk taking by selling through tied agents since the insurance company had no obligation to support the agents in case business was running badly. A permanent in-house sales force on the contrary, had been much more difficult to cut down in times of economic depression. Hence, Svedberg & Hübsch eventually got support from Skandia's CEO Björn Wolrath and his successor Lars-Eric Petersson in their initiative to become tied agents and in managing their relationship with other parts of Skandia.

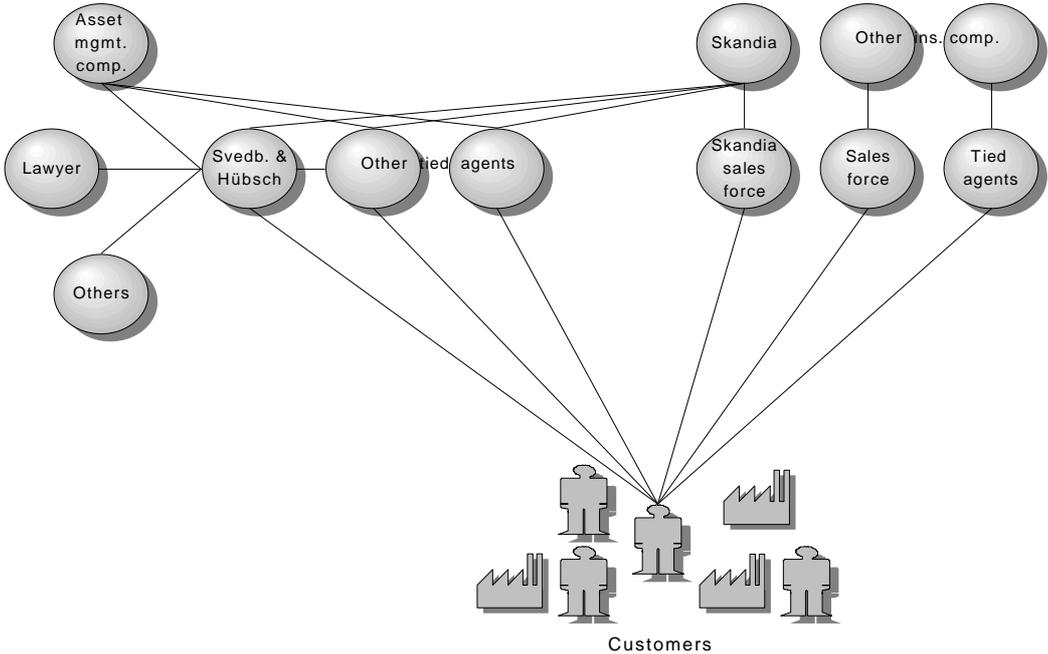


Figure 2. After the establishment of tied agents. Now multiple distribution channels for insurance products existed.

Re-organisation of the industry

Successively, the initiative taken by Svedberg & Hübsch was imitated by other salespeople within Skandia who set up their own tied agencies. Just recently, Skandia has outsourced its own salesforce, organising it in a separate company with 500 employees. However this large organisation differs from the other tied agents insofar that it is still totally owned by Skandia and employees have no ownership stakes at all. The mother company is now mainly a holding and product development company providing both the own sales company and the independently run agents

and brokers with products, information and other kinds of support. For the latter purpose a support unit called MSS (Marknadsstöd Spar, meaning Market Support Savings) has been established. In the meantime the reorganisation of insurance distribution has not been limited to Skandia. The other major Swedish insurance providers have set up networks of tied agents and brokers, outsourced their salesforces or taken other measures to change their way of reaching the final customer. It is interesting to keep in mind that this reorganisation originally was not initiated by the large insurance companies, but by two salespeople within Skandia who saw an opportunity

to become entrepreneurs and set up their own business.

Establishment of an independent brokerage company

However, the establishment of tied agencies and outsourced sales organisations has not been the final point in the process of reorganising insurance distribution. At Svedberg & Hübsch as well as at some other tied agents there has been continuing dissatisfaction how the tied agents are treated by Skandia’s central organisation. Having contracts with Skandia, that oblige the agents to sell exclusively Skandia products the discretion of agents in providing their customers with tailor made solutions is limited. Generally, the agents benefit little from being strongly tied to a single insurance company unless they are financially compensated for their loyalty. Hence, Svedberg & Hübsch, together with a group of all in all 35 tied Skandia agents have decided to become independent insurance brokers. Basically this implies that they become free to sell any insurance products they want. According to

Swedish legislation brokers are required not to source more than one third of their sales volume from one single supplier. That means that the former Skandia agents will have to reduce their sales of Skandia products rather dramatically. Since this is impossible in the short run they have obtained a temporary exemption from the legal requirement.

The organisational arrangement the new brokers have chosen for their operations is to form a joint brokerage company called Direct Försäkringsmäklarna AB (Direct Insurance Brokers Ltd.) The joint company is owned by the insurance brokers and is mainly planned too handle administrative tasks. Commissions for sold insurances are payed to the joint company and from there transferred to the insurance broker who has sold the insurance. Moreover, there are plans to let the joint company fulfil knowledge development tasks for the brokers. As the new arrangement is just about to be launched it remains to be seen how this way of organising the business is going to work practically.

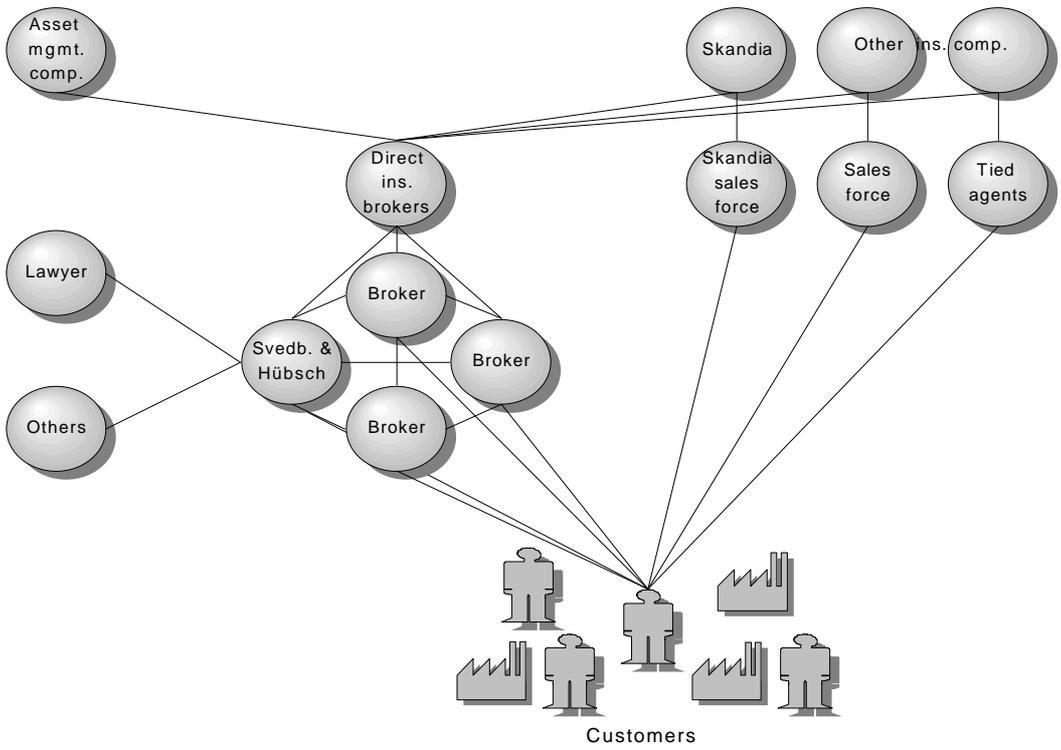


Figure 3. Svedberg & Hübsch’s network after becoming an insurance brokerage firm.

Theoretical implications

Empirically, the Svedberg & Hübsch case provides us with an interesting example of a network evolving and changing over time. By establishing a new way of selling insurances, drawing on a network of various actors, two entrepreneurs have not only developed their own business successfully, but also initiated a new way of organising insurance distribution in Sweden. However, beyond the empirical account the case also puts up questions to existing network theory.

Strategic Networks

The strategic network concept as defined by Jarillo (1988) is based on the assumption that such a network is purposefully arranged and strategically led by a hub firm. In literature the definition of the hub firm often seems to be rather unproblematic. The case examined in the present paper shows however that it is not self-evident what company acts as the hub firm. Networks are always theoretical conceptualisations of exchange relationships that exist in reality. Axelsson (1992a) regards networks as emergent in the minds of the actors. Thus networks are subjective descriptions by people who have chosen to see the world in network terms (New and Mitropoulos 1995). Adopting different points of view the exchange relationships in the case could be conceptualised as the strategic network of Svedberg & Hübsch, of Skandia, of an asset management company or of another actor. From each perspective one could argue that the organisation in question has arranged a network purposefully and maintains it proactively in order to pursue its corporate strategy. Following this line of argument a multitude of partially overlapping strategic networks would emerge.

Nevertheless, there are good reasons to adopt a perspective seeing Svedberg & Hübsch as the hub firm. It were the two entrepreneurs who initiated the reorganisation and took the most proactive stance to their network from the beginning. Hence, we have a situation where a relatively small company forms the hub of a network including large multinational companies. The power situation becomes different from that in often reported cases of large firms' networks, like that of Benetton (e.g. Sydow 1992), where the dominance of the hub firm is out of question. Where an SME has an important

role in network interactions we should thus rethink if a hub firm necessarily has to be the dominating leader in a quasi-hierarchic network or rather the nexus of a web of interactions between rather independent actors.

Strategy in networks

When a clear power asymmetry in favour of the hub firm is absent in a strategic network, this has consequences for the formation of strategy. No single firm can be assumed to be in charge of strategy development for the whole network. In Jarillo's (1988) work the stress on intentionality in the arrangement of a strategic network is rather strong, whereas other researchers (Sydow 1992; Sydow and Windeler 1998) have reminded us that even there strategy always arises as a combination of deliberate and emergent elements (Mintzberg and Waters 1985). In our case we see a network that was started deliberately. During its further development all actors take strategic actions, both deliberately and in a more unplanned, emergent manner. Svedberg & Hübsch as the hub firm can thus be said to operate in a field of force (cf. Melin 1989) where actors all the time undertake strategic measures that Svedberg & Hübsch must relate to. Examples are the cut-off from Skandia's new asset management products after Svedberg & Hübsch's establishment or the unwillingness of Skandia to pay their tied agents a financial premium for their loyalty. The first example led to the co-operation with asset management firms, the other one was a strong incentive to become independent brokers. Both actions were not initially planned. They rather emerged out of an unintended situation, but nevertheless they were in line with the entrepreneurs' main intent to run their business independently. Other factors influencing Svedberg & Hübsch exist on a societal level, for instance legal regulations for brokerage firms or changing consumer preferences. Likewise, strategy is influenced by internal organisational dynamics in the hub firm. An example could be the importance of the individual insurance consultants' personal networks that may imply that the firm loses business partners, i.e. parts of its network, if an employee leaves the firm. Strategy and network formation thus arise in a dynamic context that is partially unpredictable and where Jarillo's "long-term, purposeful arrangement" (Jarillo 1988:32) is constantly challenged by forces in and outside

the hub firm. The terms “long-term” and “purposeful” are still meaningful, but yet relativised as relationships within the network constantly change and the hub firm’s purpose in arranging the network stands in a contest with other actors’ purposes.

Power in networks

The competition between partially conflicting and changing purposes in a network again directs our attention to the trust and power issues. The tensions between the tied agents/brokers on the one and Skandia on the other side refute the romantic image of networks as harmonic areas of trust in a hostile environment. The kind of trust encountered in our case can be characterised by Ring’s (1996) fragile trust notion, meaning that trust is mainly based on rational calculations that the other party will behave in an acceptable way as far as specific business transactions are concerned. Concerning Svedberg & Hübsch, relationships to other network partners have been built up over years. However, the relationships are mainly based on what Svedberg & Hübsch can offer their suppliers. They are only attractive partners as long as they have a network of interesting customers to offer. If the customer base is good, Svedberg & Hübsch also have greater discretion for strategic actions as they can put more demands on insurance companies, asset management companies and other suppliers. This observation supports the view of Heide and John (1988) who see investments into customer relations as a means for agents to balance their principals’ power. Here again, it becomes clear that the hub firm’s strategy in a network evolves in a dynamic process. Although it makes its own strategic choices, its relation to other actors is not mainly characterised by the hub firm directing them, but rather by a constant process of bargaining and re-defining the mutual relationship.

The concept of a hub firm in strategic networks conjures up some idea of hierarchy as the hub firm can be thought to direct its own network to a certain extent. This would be in line with Thorelli (1986) and the earlier writings of Powell (1987) who see networks as an intermediate governance mode between markets and hierarchies. However, the question remains what degree of hierarchy exists in our case. The story of Svedberg & Hübsch began with two entrepreneurs leaving the hierarchy of Skandia,

building their own strategic network. In this network they have no dominant power position like that of the top executive in a hierarchy, nor does any other actor have. Nevertheless, Svedberg & Hübsch manage to arrange their network in a way that makes it the central feature of their strategy. Their success is not based on the ability to control specific network actors, but to combine actors that help them in providing their customers with the products they need. Consequently, we see a network with a clearly strategic function, but with less elements of hierarchy involved than often assumed for strategic networks.

Conclusions

Beyond exploring an exciting case of entrepreneurs reorganising insurance distribution in Sweden, this paper uses the case to discuss issues of network theory. Especially the concept of strategic networks is problematised. Can Svedberg & Hübsch’s network be labelled as a strategic network although there are good reasons to question their ability in directing the network? There is no doubt that Roger Svedberg and Arne Hübsch have arranged the network with a clear strategic purpose, namely being able to act as independent entrepreneurs and having the capability to provide their customers with optimal insurance solutions. Since the network is the central feature of Svedberg & Hübsch’s strategy the label “strategic” is justified. However, the network has characteristics that put into question some of the assumptions that underlie parts of the previous literature on strategic networks. These can be interesting to consider for future research. Especially, but not only, when strategic networks with an SME hub firm are concerned:

- **The degree of hierarchy.** Especially with an SME as the hub firm it is not evident that the hub can control other network members in a quasi-hierarchical manner as depicted by Sydow (1992). Co-ordination may rather occur through trust (cf. Jarillo 1988), even though a fragile form of trust that is based on rational calculations that both parties have an interest in successful co-operation. Examining strategic networks from a process perspective directs our attention towards the dynamics of strategy. This means

that even “long-term purposeful arrangements” are subject to change. A hub firm may be more or less easy to identify depending on the time of analysis and different firms’ role in a network will change over time.

- **The degree of collectivism.** Considering small hub firms the idea of the hub controlling a collective strategy becomes problematic. To some large actors the network around the small hub firm may be of little importance. Strategic networks should perhaps not be conceptualised as networks with a common strategy, but rather as networks with central importance to the hub firms strategy.
- **The degree of intentionality and planning.** Already Sydow (1992) has stressed the influence of emergent patterns for strategy formation in strategic networks. Small hub firms will have difficulties in controlling the actions of other network actors. Nevertheless, they have opportunities for strategic choice by selecting their partners and by renewing their strategy as opportunities arise. Strategy formation in strategic networks can therefore be regarded as a partly planned, partly emergent process that offers room for choice, but takes place in a field of force (c.f. Melin 1989) that comprises forces influencing the hub firm and its freedom of choice from both inside and outside.
- **The degree of subjectivity.** Networks do not exist as such. Rather they are theoretical conceptualisations of interactions between organisations and/or individuals. The strategic network that appears to the analyst depends on the choice of perspective. The Svedberg & Hübsch case shows that, especially with an SME playing an important role for interaction, it is not per se evident which actor should be considered being the hub firm. Defining another firm as the hub, a different network would have emerged.

These four issues emerging from the case should be considered in research on strategic networks.

Pursuing the questions they put forward the strategic network concepts appears as more ambiguous, but also as more challenging to researchers.

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