

# **Do network effects of mergers and acquisitions differ from those of strategic alliances?**

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## **Abstract**

When formerly independent firms merge or if one acquires the other (M&A) or form a strategic alliance (SA) that implies a change in governance form for these firms. Much has been written about both M&A and SA but less on how they differ from each other and even less about their network effects. In a markets-as-networks perspective, assuming that the market is characterized by “collective competition”, we discuss network processes impinging on a focal M&A and a focal SA respectively. We base our discussion on studies in the logistics and transportation industry, especially on two firms experiencing a failed SA and then an M&A. A previous study (reported in Hertz and Mattsson 2004) we concluded that over time, in an industry characterized by collective competition, M&As will be used to an increasing extent, rather than SAs as a way of coordinating interdependent activities and resources (proposition 12, *ibid.* p 50). The *purpose* of the paper is to discuss the validity of this proposition and to contribute to comparative analyses of SAs vs M&As using a dynamic network perspective on changes in governance structures.

Our findings suggest that the network effects are of similar nature to alliances as to M&As in short and medium term while there is a stabilisation for M&As in longer term and that over time M&As will be used rather than SA in an industry characterized by collective competition.

## Introduction

Mergers & Acquisitions (M&A)<sup>1</sup> and Strategic Alliances (SA) imply important changes in network structures and modes of governance in contemporary markets. Much has been written on each of them, especially relating to financial analyses and reorganisation for internal integration (for M&As) and to organizational aspects of cooperation between alliance partners (for SAs).

It has been suggested that contemporary markets are characterized by "collective competition" (Gomes-Casseres, 1996) rather than by competition between individual firms and that "waves" of both SAs and M&As are aspects of increasing need for inter-organizational cooperation in order to compete successfully.

For neither M&As nor SAs has much research focused on the wider network embeddedness of individual M&As and SAs in terms of their internal development and relationships to other actors such as customers, suppliers and competitors. Some exceptions are Anderson, Havila and Salmi (2001); Tunisini and Bocconcelli (2005); Hertz and Mattsson (2004).

Furthermore, we have not come across any study explicitly comparing network embeddedness effects between M&As and SAs. In the SA literature, and to a lesser extent in the M&A literature there is often some, but quite short, discussion of SA vs M&A (eg. Doz and Hamel 1998). Among differences mentioned are control of resources, resource synergies, financial commitment, risk, flexibility, availability, financial market considerations, but not network effects.

There are also a few studies comparing M&A and SA either as alternatives (Hagedoorn and Duysters 2002) or as development of an SA into an M&A (e.g. Hagedoorn and Sadowski 1999; Dyer, Kale and Singh, 2004) but these do not explicitly focus on network effects.

Dyer, Kale and Singh (2004) formulate five factors that affect the choice between an alliance and an M&A: types of synergies (modular, sequential, reciprocal), nature of resources (soft or hard), extent of redundant resources, degree of market uncertainty, and level of competition. We focus on the indirect network effects, linked to resources not controlled by the actors involved in the specific M&A and SA might negatively influence achievement of synergy.

Based on case studies in the international logistics and transportation industry, we found considerable network effects influencing SA development processes (Hertz and Mattsson 2004). One of our conclusions in that study was, that, due to network effects, "over time, in an industry characterized by collective competition, M&As will be used to an increasing extent, rather than SAs as a way of coordinating interdependent activities and resources" (proposition 12, *ibid.* p 50). A few years after the dissolution of the studied alliance, one of the earlier alliance partners acquired the other. Interviews after the acquisition suggest to us that somewhat similar network effects evolved and had to be handled also after the acquisition. This stimulated us to continue our analysis of network effects and compare M&As and SAs, with reference to the specific case and more in general, with reference to the reasoning behind the above mentioned proposition 12.

The *purpose* of the paper is thus to contribute to comparative analyses of SAs vs M&As using a dynamic network perspective on changes in governance structures and their network effects. The empirical case is taken from a specific type of industrial activities for which effective coordination of spatially dispersed resources performing logistics services is the "raison d'être". This delimits our ability to generalize the findings.

The disposition of the paper after the introduction is as follows.

Next we introduce the conceptual framework, a markets-as-networks perspective, that will help us to identify the processes that shall be compared, i.e. network effects of M&As compared to network effects of SAs .

Then, we present and discuss the type of network effects of SAs that we found in an earlier study (Hertz & Mattsson, 2004).

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<sup>1</sup> We here use mergers and acquisitions as similar governance changes even if we are aware that this misses some important distinctions between them.

After that, we discuss network processes of an M&A involving firms that alternatively could have formed a SA and are then ready to compare the two processes, and reach a conclusion.

## Conceptual framework<sup>2</sup>

The market is a governance form for coordination and development of economic exchange. In a markets-as-networks perspective transactions take place within exchange relationships between actors that carry out activities and control resources. Such relationships are dynamic and interdependent with other such relationships. Thus the market can be described as connectivity structures, i.e. how actors are directly and indirectly connected to each other, as counterparts in economic exchange and/or as competitors. Actors and exchange relationships are embedded in wider, dynamic network structures.

Market actors' positions in such networks describe how they are connected to other actors. Strategic actions are aimed at influencing own and other actors' network positions and by definition thereby are also aimed at influencing the connectivity pattern and the relationship content in the network. (Johanson and Mattsson 1992). Examples of strategic actions are market entry, mergers and acquisitions, development and breaking of exchange relationships with suppliers, customers and intermediaries, re-organisation of resources for interacting in exchange relationships, efforts to maintain endangered alliance partnerships. Strategic actions are both constrained and facilitated by the network structure and by strategic actions by others. Such restrictions and opportunities change over time due to network dynamics. Actors aim both to stabilize some aspects and to change some aspects of their relationships in the market. Strategic actions drive market *reconfiguration*, (interpreted as eg. globalisation, market convergence, number of sellers and buyers of specific products).

Thus, when two firms decide to merge or to form a strategic alliance, they commit strategic actions within a network context in which not only the connections between the directly involved firms are changed but also the connectivity structure in the wider network. Furthermore, the dyadic change might be aimed at, and/or result in, further changes in the network structure, in terms of both competitive and cooperative linkages. Strategic network changing actions can, and we believe usually do, cause multiple, sequential and interrelated strategic reactions by others in a market. Such interrelated strategic actions have been conceptualized as "domino effects" (Hertz 1998). The higher the perceived interdependence between relationships, the more important will the domino effects become.

We are here concerned with M&As and SAs that are aimed at *integrating resources* controlled by involved actors in order to become *more effective in exchanges with actors in the wider network*. The involved actors may at the outset *compete and/or cooperate, more or less intensively*. The resources that the actors bring may be *complementary and/or substitutes for each other*. In the former case coordination for higher productivity and/or for innovative activities is supposed to be more effective. In the latter case the idea is to increase effectiveness by reducing the combined resources. The actors may be *more or less close* (short or long distance) to each other in the wider network. The closer they are positioned, the higher is the interdependence between them at the outset, because they have likely more competitors, customers and suppliers in common, or potentially in common.

Even if aims of M&As and SAs can be interpreted as efforts to improve network positions, i.e. to achieve network effects that positively affects synergies between resources controlled by the actors involved, we have reasons to believe that network effects of a negative nature for the firms involved in an SA or an M&A may evolve as unintended effects during the M&A and SA processes.

Perceptions and interpretations of the network and network dynamics differ between actors, due to their network positions, experiences, cognitions, strategic intentions etc. Boundaries of what is perceived as the relevant market changes over time, e.g. due to internationalization, convergence between technologies, changes in institutional market rules.

## Network effects of a strategic alliance

### *The studied alliance*

The empirical study, on which we base our analysis concerns the strategic alliance between ASG and Danzas 1992-95 reported on in Hertz (1996) and Hertz and Mattsson (2004). The case represents efforts to reconfigure markets under conditions of collective competition. ASG and Danzas were among the biggest in the European freight-forwarding industry when the two competing firms entered

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<sup>2</sup> This section builds on Hertz and Mattsson (2004)

a strategic alliance. During this period the transportation industry was subject to a wave of SAs and M&As, preparing for or adapting to the regulatory changes within the EU. There was a “wave” of M&As and SAs in the industry during the 90s and the ASG-Danzas case is part of this wider network process.

ASG and Danzas, each with a world-wide network of representatives had experienced problems to keep their network of representatives intact, on the European continent and in Scandinavia respectively. Some representatives were acquired by competitors, some went bankrupt, and others perceived that ASG affiliated firms competed with them on the market, etc. Since both the representatives and the competitors were often themselves international companies, any change in ownership or affiliation frequently influenced ASG’s and Danzas’ situation in a problematic way in many countries.

The new alliance partners started in a coordinated way to restructure their networks of local representation. ASG broke relationships with some 20-30 of their agents outside of Scandinavia and sold out some subsidiaries. Danzas broke relationships with their representatives in Scandinavia. It soon showed that some network aspects made it difficult to effectively reconfigure the network.

First, some important ASG-customers stayed with local ASG-representative, perceiving that they offered better service or, and did not want to switch to the Danzas representative that within the alliance replaced them.

Second, it soon became evident that Danzas knowledge about Scandinavia was not sufficient for many customers and that the volumes to Scandinavia from the Continent were too small, given that some ASG customers stayed with the old representative, to match Scandinavian ASG customers’ demand for transports to the Continent.

Third, several ASG-subsiidiaries, after change in ownership, continued to take part in the transportation industry and also continued to interact with each other, and to some extent also with ASG in Sweden, thus preserving parts of the “old” ASG network of representatives.

ASG lost sales in Europe, major reasons perceived to be the network aspects mentioned above. In 1995 the alliance agreement was unilaterally broken by ASG. ASG planned and negotiated future cooperation with a new set of representatives. This involved integration of an independently run, but by ASG fully owned organization, ERT, into the ASG system, and repurchase of some of ASG’s “old” subsidiaries.

#### *Network effects*

Based on the above we briefly discuss the interdependence between network processes interacting with the focal alliance process. This makes the internal development of an alliance a complex process that involves important and difficult strategic actions by the alliance and its members. It has been showed to be complex and time consuming process in a study of another SA in the same industry (Ludvigsen (2001).

We have distinguished five types of interdependent network processes that interact with the internal development of the focal alliance:

- the customers’ network processes in general,
- the processes relating customers and the focal firm,
- the concurrently existing competing alliance processes,
- the focal firm’s process aimed at dissolving the focal alliance,
- the focal firm’s process aimed at developing a new alliance or joining another existing alliance.

The ability of an individual firm or the alliance, as a collective actor, to control the internal alliance development is quite limited due to reconfiguration processes, the outcome of which, to an important extent are controlled by others.

First, *the customers’ network processes in general* affect alliance processes. Customers develop their “supply chain networks”, under conditions of collective competition, thus coordinating geographically dispersed activities (both internal and those of their suppliers and customers) for higher effectiveness. This puts demands on suppliers of logistical services. Customers’ internal and external restructuring, sometimes initiated by M&As, influence relationships with freight forwarders and thereby also the latter’s alliance processes.

Second, *the processes relating customers and the focal firm* are interdependent with the focal alliance process. The focal firm’s provision of services, in some locations, involves representatives emanating

from the alliance partner's organization, as co-producers. Some customers will not accept the reconfiguration of the network of representatives, some may stay as customers to the former representatives. Alliance partners are likely to bring new customers to the focal firm but there is also a risk of losing customers due to the reconfiguration of the networks of representatives. Even if customers switch suppliers of logistics services rather frequently prior relationships to the focal firm are important.

Third, *the competing alliance processes* influence the focal alliance due to competition for customers and for alliance membership. Formation and break-up of international alliances (and international M&As) is part of market reconfiguration, thus affecting also a focal alliance. New members in a focal alliance may have switched from another alliance and a member leaving the focal alliance may join another alliance or establish a new one. The competing alliances thus influence the over-all network structure. As the number of SAs (and M&As) in the market increases, there are fewer firms left who are not already members of another SA or parts of large M&As. Reconfiguration of competing alliances influences the opportunities for strategic action by the focal firm. Firms' alliance switching behaviour is one important aspect of reconfiguration processes.

Fourth, *the focal firm's process aimed at dissolving its relationships with partners in a focal alliance*, influences the focal alliance's reconfiguration. Reasons for dissolution may be due to changes in the connectivity structure as discussed above and to dissatisfaction with the performance of the alliance. If one of the member's preparations to leave become known to, or anticipated by, the partners that will influence e.g. timing of exit and implementation of plans for further integration within the alliance. Under conditions of collective competition, it is not a viable alternative to exit one alliance without relying on other existing cooperative relationships and/or developing new ones, such as joining another alliance or initiating an M&A process. The resources of the exiting firm has to be replaced to maintain the service provision by the alliance (or by the remaining partner in a dyadic alliance). The dissolution process might be extended over time and prepared in parallel to the on-going development of the focal alliance as well as to the development of new alliance relationships.

Fifth, *the focal firm's process aimed at developing a new or joining another existing alliance* will influence the focal alliance (or the remaining partner) because the leaving member will likely join a competing alliance or develop a new constellation of relationships. The focal alliance's opportunities for finding new representatives will be influenced by whom its leaving member will team up with. Switching costs apply, not only for the leaving member but also for the focal alliance.

Issues to be discussed are how potential new partners fit the desired structure from the focal firm's point of view and what reconfigurations are needed? A new partner might e.g. already be involved in another alliance which it need to exit before it can join a new one. A new partner's network of representatives might include competitors to the focal firm's representatives. The higher the ability of individual firms, SAs and M&As to invest in "greenfield" resources to increase capacity at specific locations, rather than relate to already existing resources controlled by others in those locations, the less the problems due to network connectivity will be.

#### *Combination of processes*

If customers generally demand more integrated, spatially more diversified transport services, if the focal firm has important such customer relationships and if competing alliances strive to fulfil such demands, then there is a pressure on the focal alliance to organise for more effective integration within the focal alliance. If a focal firm finds that the present alliance cannot effectively do that, there is a pressure to develop a new alliance or to join another alliance. This will make it more likely that the firm must break some or all existing alliance relationships. Time constraints may force the focal firm to prepare for a break-up of its existing alliance by preparing for a new alliance concurrently with on-going internal alliance processes.

Since all the actors in a network might commit strategic actions, network effects are quite complicated to understand. A single strategic action does not necessarily succeed in altering the connectivity structure, since this is obviously dependent on the strategic actions and re-actions of others as well. However, a larger strategic change might cause a large restructuring on the market due to actions and reactions, "domino effects" (Hertz, 1998).

We shall now discuss if and how our analysis might differ if the actors involved had initiated an M&A rather than an SA.

## Network effects of an M&A

### *Continuation of the studied case*

In 1999 Danzas, then owned by Deutsche Post, acquired ASG, later DHL and in 2002 merged ASG/Danzas into DHL. Deutsche Post has, during the last decade, acquired some of the larger firms in the in logistics and transportation industry among which we find Nedloyd, Danzas, DHL. Thus reconfiguration has continued also after the initial M&A involving ASG and Danzas. Our information about the M&A period has been gathered from three interviews with involved executives. Our analysis is therefore based more on our own interpretations and conceptual analyses than on empirical data. We use the term focal M&A instead of focal alliance and keep focal firm to indicate the formerly independent firm that became part of the focal M&A, in our case ASG. We use the same types of processes as for the SA.

### *Network effects*

*Internal development of the focal M&A.* Basically the same type of restructuring and increased coordination of the resources controlled by the merged firms takes place with the same aims. Closing down, merging or selling subsidiaries, and even changing relations to independent representatives, may be somewhat quicker and according to a plan that can be implemented using hierarchical power. The continuing such reconfiguration process, due to the consecutive M&As in a short period of time, complicates the process. It is easier to control that organizational units, owned by each firm before the M&A, do not continue as competitors, even if that control is far from complete. Personnel with important relationships to customers may move to competitors. Independent representatives that are replaced will likely develop links to competitors.

*The customers' network processes in general* affect M&A processes in a similar way as for SAs, putting demands on suppliers to provide more globally integrated and customer specific logistical services. Reorganization of the customers' negotiations with suppliers, also due to M&A processes among customers may change the spatial distribution of customer-supplier contacts, eg. towards more centralization. In an M&A such adaptation might be easier than in an SA.

*The processes relating customers and the focal firm.* The focal firm's provision of services involves resources emanating from the M&A partner's organization, as co-producers, while resources that before the M&A belonged to the focal firm and to its pre M&A partners may or may not be available. Some customers will not accept the reconfiguration of the resources. Some may stay as customers to the former representatives or still active parts earlier belonging to the focal firm. M&A partners are likely to bring new customers to the focal firm but there is also a risk of losing customers. The "general customers' network processes" are also relevant as aspects of the specific customer relationships.

*The concurrently existing competing alliance and M&A processes.* The focal M&A is affected by these processes due to competition for customers and for any further development of the M&A by inclusion of more firms. An "initial" focal M&A might be preceded by membership for one or both firms in the same or different SAs, by both or one being the result of a prior M&A, or by both being independent firms. (We have assumed, in this paper that they were competitors, unless they were partners in the same alliance.) The formation of the focal M&A, and its further development, is driven by opportunities and restrictions to reconfigure the market under the conditions of collective competition. If M&As are perceived as more effective governance forms than SAs then there is a pressure towards M&As and there is a tendency for SAs to be replaced by M&As. As the number of alliances and M&As in the market increase, there are fewer firms left who are not already members of another alliance or part of M&As, and thus fewer opportunities to reorganize without disrupting SA memberships, change SAs into M&As, or merging several M&As. "Greenfield investments", as pointed about in the section on SAs might relax some of restrictions due to network connectivity.

*The focal firm's process aimed at dissolving the focal M&A.* Once the focal M&A has been initiated, the ability to dissolve it, is limited and depending on its influence over strategic actions by the focal M&A to divest some of its resources.

*The focal firm's process aimed at developing new cooperative partnerships within SA or M&A.* Given that the focal M&A has been initiated any additions to this M&A is a matter for strategic actions by

M&A central management, over which the focal firm might have more or less influence. Issues to be discussed also in the M&A case, which deals more with growth than with substituting some SA resources with other SA resources, are how potential new partners fit the desired structure from the focal M&As point of view and what reconfigurations, and to that related switching costs, are needed.

#### *Combining the processes*

We ended the SA analysis by showing how all the processes might impinge upon each other. A major difference in the M&A case is that the focal firm, as we have defined it, cannot withdraw from the M&A or search new partners other than as part of the strategic actions at the M&A level. However, the basic reasoning as concerns interaction between the focal process, the general customer processes, the customer- focal firm relationship processes and the competing SA/M&A processes are similar.

### **Comparison between the SAs and M&As**

In this section we summarize (from section 4) and develop further our comparative analysis of findings in sections 3 and 4.

As regards the *internal development* of an SA compared to an M&A we find the same basic purposes to increase effectiveness by restructuring and coordinating resources. The process might be quicker in an M&A due to financial and managerial control and the risk less that resources considered redundant will develop into competitors. The latter cannot be totally avoided however because key personnel with customer contacts may move and independent representatives link up with competitors also in the M&A case. The complexity of the internal process is augmented in the M&A case when consecutively more firms are added to the original M&A, since also those firms might have spatially dispersed resources to be reconfigured. The same is true if an original SA adds more partners.

*The customers' network processes in general* affect M&A processes in a similar way as for SAs, putting demands on suppliers to provide more globally integrated and customer specific logistical services. Reorganization of the customers' negotiations with suppliers, also due to M&A processes among customers, under conditions of collective competition, may change the spatial distribution of customer-supplier contacts, eg. towards more centralization. In an M&A such adaptation will likely be easier to achieve than in an SA.

*The processes relating customers and the focal firm* will be affected similarly in the SA and MA case as regards the risk that some customer will be negative to switch business away from the resources made redundant during the internal SA or M&A process to the SA partner or the new M&A constellation.

*The competing SA and M&A processes.* Under conditions of collective competition reconfiguration of alliances and M&As in the wider network is a continuous process that strongly affects focal SAs as well as M&As. If M&As are perceived as more effective governance forms than SAs, then there is a pressure towards M&As and there is a tendency for SAs to be replaced by M&As. As the number of alliances and M&As in the market increase, there are fewer firms left who are not already members of another alliance or part of M&As, and thus fewer opportunities to reorganize without disrupting SA memberships, change SAs into M&As, or merging several M&As.

*The focal firm's process aimed at dissolving its relationships with partners.* In this dimension there are obviously important difference between the two governance forms. Once the focal M&A has been initiated the ability to dissolve it is limited and depending on the focal firm's influence over strategic actions by central management in the M&A to divest some of its resources.

*The focal firm's process aimed at developing new cooperative partnerships.* Also here any additions to the M&A is a matter for strategic actions by M&A central management, over which the focal firm might have more or less influence. Issues to be discussed also in the M&A case, which deals more with growth than with substituting some SA resources with other SA resources, are how potential new partners fit the desired structure from the focal M&As point of view and what reconfigurations, and to that related switching costs, are needed.

In Hertz & Mattsson (2004) we proposed that, as regards strategic alliances:

- Network effects of a specific strategic action are not only related to connections between the actors directly involved but also to connections to other actors such as suppliers, customers, competitors to the firms directly involved in the change. There is a multitude of indirect cooperative and competitive connections, mediated through the network. *We propose this to be valid also for an M&A.*
- Network effects can be seen as aspects of the network conditions under which the focal SA originally was established. SAs serve to more or less reconfigure the market. *We propose this to be valid also for an M&A.*
- The stabilisation of an alliance is affected, positively or negatively, by processes of reconfiguration processes in a wider network. *We propose that an M&A can be more easily stabilized than an SA due to managerial and financial control of internal resources.* However, reconfiguration including external resources is under quite limited control also in the M&A case and might jeopardize stabilization also of an M&A.
- Reconfiguration processes, that disturb stabilization, incur switching costs for SA partners, for their customers and customers customers. *We argue that this is valid also in the M&A case not only during the initial phases, but later due to continuing changes in the M&A resource constellation, (investments in further M&As, divestments of some resources etc.)*

Our preliminary findings thus suggest that network effects are of a similar nature in SA and in M&A processes, at least in the short and possibly in the medium term. If customers are positively connected to a firm or resource unit in the firm that are excluded due to dissolved relationship or sold off during the reorganization process, then the alliance partners or acquired resource units loose customers.

Further, this might also lead to imbalance and ineffectiveness in the use of the new resource constellation. Concurrent competing alliances and/or M&A processes on the market may disturb the stability of a focal alliance as well as that of an M&A since excluded partners might be acquired, join an existing or develop a new alliance. This will have effects and give opportunities to development of competitors in both SA and M&A in a similar way.

The main difference in network effects will be expected to be visible in longer term when the initial negative influence on the stability and effectiveness of the strategic alliance might challenge its very existence or at least cause major re-evaluations and strategy changes. In the case of an M&A such a break-up or re-evaluation might not be possible or at least much more difficult to pursue since the total re-organisation has changed the whole structure of the merged organisations. It is not really possible to "turn back". Some destabilizing network effects may also be easier controlled in an M&A, especially as concerns physical resources (not management resources) owned by a common ownership rather than by the individual partners. If such stability, or lack of flexibility, is generally effective or not is difficult to say and worth further inquiries by academic research. In the specific case the M&A could not avoid some of the negative network effects that did hurt the alliance, at least not in the short and medium term. However, after a period 3-5 years there is a certain stabilization of its customer and representative connections on the market.

*We conclude that the validity of the proposition 12 referred to in the Introduction is strengthened by our analysis in this paper. Over time M&As rather than SAs, will be used to an increasing extent, as a governance form for coordinating interdependent resources in an industry characterized by collective competition.*

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