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**Proximity and Power within Investment Relationships:
the case of the UK Private Equity industry**

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Abstract

The role of power in economic activity has been researched across the social sciences but there has been little engagement with the spatialities of power relations. This paper thus draws on a recent reinvigorated interest in power within economic geography to develop an approach for understanding how the spatiality of power relations in economic practices are constituted through different forms of proximity. It argues that proximity needs to be conceptualised as multi-dimensional including physical, cultural, virtual and organizational proximity between firms and actors. It further contends that the development of different forms of proximity shape the agency of empowered actors in industry clusters and regional economies. This general proposition is explored by presenting research into a case study: the UK-based private equity industry. The research focuses on the nature, role and development of different forms of proximity between private equity firms and the investee firms that are the subject of investments.

1) INTRODUCTION

Across the social sciences, there is a sizeable literature concerned with power in economic activity. Work within economics and business studies has engaged at length with, for example, the market power possessed by firms (Berry *et al* 1999; Perloff *et al* 2007), transactional power (Bowles *et al* 1998; 2006; Diez-Viall 2007) or the differentially empowered positions of economic actors produced by asymmetric access to information (e.g. Akerlof 1970; Stiglitz & Greenwald 1986; Stiglitz 2002). Yet approaches within these disciplinary traditions have not directly engaged with an issue increasingly highlighted by economic geographers: the geographical form of power (c.f. Allen 2003).

Economic geography has had a longstanding, if sporadic, interest in the question of power. During the 1970s, for example, economic geographical work concerned with the social relations of production (SRP) emerged as a radical critique of neoclassical industrial location theory (c.f. Massey 1973; 1979; Walker & Storper 1981), engaging with how uneven development arose from the complex interrelationships between social divisions of labour (c.f. Yeung 2005). However, during the 1980s economic geographers concern with power arguably waned as regulationist and institutional approaches came to the fore (c.f. Amin 1994; 1999). Yet over the last decade or so, the significance of power has become reinvigorated in debates within economic geography. In particular, work concerning the success or failure of firms, industries, clusters and regional economies (c.f. Boschma & Lambooy 2002; Bathelt 2002; Asheim *et al* 2006; Cooke & Lazaretti 2007). Within these discussions, the cultural economy approach to economic geography (Amin & Thrift 2004) has begun to re-engage with the ‘problem’ of understanding the geographies of power relations (Massey 1998; Allen 2004), as well as a wider economic geographical concern with its constitutive role in investment decisions (Clark & Hebb 2005; Clark *et al* 2006), knowledge management (Amin and Cohendet 2004), innovation (Faulconbridge, 2006), risk management (Babcock-Lumish 2004), corporate control (Taylor 1995; 2000) and corporate culture (Schoenberger, 1997). However a number of theorists continue

to argue that power as a form of (economic) practice remains ‘under-theorised’ (Taylor 2000; Allen 2003; Yeung 2005).

Central to this problem is the issue of the spatiality of power. Much of the existing geographical literature – in common with the literature in economics and business studies - tends to see power as ‘located’ in places (cities, regions) or possessed by entities (firms, institutions or clusters). Yet a relational economic geographic perspective - informed in particular by post-structuralist thinking in social science - calls into question the validity and usefulness of such an epistemological stance. Recently, economic geographers have shown how power can be better conceptualized as a relational effect at the scale of firms or industries (Yeung 2005), and how a focus on specific forms of economic practice mediated through face-to-face interaction (and other forms of proximity (Storper & Venables 2004; Jones 2007)) can provide significant insight into how power relations transcend geographical, institutional and organizational boundaries. This literature has thus started to engage with how the spatiality of power is manifest through networks of firms or individual economic actors (Sachetti & Sugden 2003; Faulconbridge 2006), as well as how power is constituted through translocal linkages (c.f. Bathelt 2002; Hess 2004).

This paper seeks to build on this developing literature by focusing on how the spatiality of power relations in economic practice are constituted through different forms of proximity. The goal is to conceptualise how the nature of proximity between firms, individuals and groups of actors mediates the practices of power enrolled in economic activity. In particular, we argue that different forms of proximity shape the nature and agency of empowered actors in the economy, and that to better understand how power relations affect economic outcomes in the contemporary world there is a need to more effectively engage with the specific spatial forms of power relationships. Furthermore, and contrary to the hegemonic conception of power in socio-economic thinking as a property held by or inherent in entities, markets or processes, we further contend that a framework which seeks to capture the spatial configuration of power *between* economic actors will produce greater insight into the dynamism of economic

success or failure. Conceiving power as a phenomenon constituted through relational spaces (c.f. Yeung 2005) can thus be useful in better understanding the complex relationships between industries, institutions and social relations that exist in the contemporary global economy.

These arguments are developed by presenting research into a specific case study industry in one region: private equity in the UK economy. This sector provides medium to long-term finance in return for an equity stake in potentially high growth unquoted companies, and (in the UK) it also provides funding to growing unquoted² companies. Private equity firms themselves usually operate by setting up funds or partnerships, often with a fixed time horizon, and sometimes with a particular target group of investors. The industry has been the subject of research across management studies and economic geography (Mason and Harrison 2000; Martin *et al* 2003; Babcock-Lumish 2006). Whilst much of this work has focused on numeric measurements of financial performance and the industry's trajectory of development (Morck *et al* 2003; DeClerq *et al* 2008), a growing literature has emerged around the social aspects of economic practices within the sector (Pruthi *et al* 2009). This also includes analysis of, for example, the role of trust (Hoang and Antoncic 2003; Duffner *et al* 2009), the importance of knowledge (Cohen and Levinthal 1990; Declerq & Dimov 2008), and most importantly for our purposes here the influence of spatial proximity on socio-economic behaviour (Thrift 1994; Sorenson and Stuart 2001; Christensen 2007).

Based on research into the nature of power, trust and knowledge in this UK industry, we develop three interrelated propositions about how the spatiality of power relations shapes economic outcomes within industry clusters or regional economies. First, we suggest that the development of proximity is a crucial factor in shaping the development of inter-firm power relationships. Proximity influences the capacity of actors to act, as well as representing a key medium through which to exercise power. Second, we contend that proximity needs to be conceptualized in multi-dimensional terms which include - but go beyond - the

² Typically privately owned companies whose shares are not traded on a public stock exchange.

concept of physical proximity as co-presence. In this sense, the spatial configuration of power relationships are constituted through multiple forms of proximity including, for example, cultural, virtual and organizational proximity between firms and actors. However, and third, whilst the nature of proximity through which power relations are mediated is multi-dimensional, we suggest that physical proximity in the form of face-to-face interaction corresponds to the most significant set of practices which are instrumental in fostering other forms of proximity.

The remainder of the paper is organized to elaborate these theoretical arguments concerning spatiality of power relations in economic activity through an analysis of our private equity case study. The next section begins by briefly outlining existing geographical approaches for conceptualizing the spatiality of power relations. The third section then sets out a series of arguments in depth as to how the spatial configuration of power relations within industry clusters or regional economies might be conceptualised, and proposes a theoretical framework for understanding how proximity is important in shaping power relations in economic practices. Thereafter, section four provides an overview of the UK private equity industry case-study before we present our research findings in the fifth section. We divide the discussion here around four major strands to the research findings concerned with the way in which different forms of proximity are intrinsically bound into the practices of power within private equity investment relationships. Finally, the sixth section draws together a number of conclusions about the wider implications of our findings for theoretical debates concerning the spatiality of power relations in business activity.

2) GEOGRAPHICAL APPROACHES TO POWER

At the broadest level, power can be taken simply to mean ‘the ability to achieve certain ends’. Johnston (2000) argues, in seeking to define it, that whilst ‘an absolute concept’, it is often used as a synonym for influence, and that it refers to a property of inter-personal or inter-group relations. Yet the issue of definition remains difficult. As with other generalized concepts like culture (Williams 2005), society (Geertz 1993) or globalization (Herod 2009), the geographical thinking

has grappled with the diverse specific conceptions of power in economic activity (c.f. Herod & Wright 2003). In this respect, three strands to wider geographical thinking about power inform our position.

First, there is a broadly relational typology for thinking about the spatiality of power. John Allen (1997; 2003) provides the key contribution in this respect. Drawing on classical sociology, he argues that there is a need to understand power as *an inscribed capacity*. This is power conceived as a possession which is held by an individual, a group or an organization and which is inherent to a certain position they occupy within a network. This concept of power is of ‘the potential to control, command or direct the actions of others which may or may not be exercised. However, when it is exercised, how and why is contingent on the particular circumstances. He also suggests power can be conceived as a resource which is equivalent to the power ‘to do’ something rather than the power ‘over’ people or things, and that it also needs to be understood as strategy, practice and technique.

Allen also makes extensive use of Lukes (1974: 16-29) who differentiates between ‘one’ ‘two’ and ‘three’ dimensional views of power. A one-dimensional view involves ‘a focus on behaviour in the making of decisions on issues over which there is an observable conflict of (subjective) interests, seen as express policy preferences, revealed by political participation’. His two-dimensional conception of power adds to this idea of power in decision-making, agenda-setting and the role of institutions and informal influence. Finally, three-dimensional power includes aspects of the first two dimensions but also sees power as shaping preferences via values and norms, and ideologies, and as being intrinsic in all forms of social interaction (c.f. Massey 1998).

This latter point draws on a second strand of post-modern and poststructuralist thought. Central to this is the work of Michel Foucault (1980) who contends that power is the central force between actors who dominate, on one side of the relationship, and actors who resist on the other. The core of Foucault’s view of power is that ‘power relations are both intentional and non-subjective’. This means that if ‘in fact they are intelligible’ then this is ‘not

because they are the effect of another instance that “explains” them’, but rather because they are ‘imbued, through and through, with calculation’. The implication is that there is no power that is exercised without a series of aims and objectives’ (Foucault 1984: 94 - 95). However, Foucaultian conceptions of power are not uncontroversial. McNay (1992) summarises much of the critique when she suggests that Foucault ‘tends to depict power as a centralised, monolithic force with an inexorable and repressive grip on its subjects’ (ibid.: 39).

Third, and related, Foucaultian conceptions of power have, furthermore, strongly influenced actor-network theories (ANT). ANT conceptualises power as an emergent property of an actor-network comprised of multiple associations between human and non-human ‘agents’. Latour (1997; 2005), in particular, has developed an ANT perspective which seeks to trace the multiple associations that produce the capacity to exercise power. ANT thus starts from the premise that ‘power and domination have to be produced, made up, composed’ (ibid.: 64), and that the notion of a social force (i.e. power in societal structures) needs to be replaced ‘either by short-lived interactions or by new associations’. For Latour, structuralist and modernist epistemologies see power in social structures and society, whereas power in fact needs to be seen as a consequence of the ceaseless renegotiation of relations. Geographical thinking has taken up the ANT challenge that explanations of power and domination thus need to shift away from structures, social laws or rules, and examine the relational practices of constantly renegotiated associations between actors that enable power to be enacted at any given moment.

3) POWER, PROXIMITY AND THE SPATIALITY OF ECONOMIC PRACTICES

Yeung (2005) argues that the so-called ‘relational turn’ in economic geography has a missing link: its conceptualisation of power practised through relationality. He argues that ‘we need not only unpack what power is in relational terms’, but also ‘to demonstrate how heterogeneous configurations of power relations (i.e.

relational geometries) can generate certain relational effects and spatial tendencies that account for concrete economic change' (ibid.: 43).

Building on Yeung, our argument is that relational conceptions of power need to engage with the *spatial configuration* of the different kinds of power relations that economic actors are constituted within (and between) national and regional economic spaces. The reason is based on the proposition that theorising the spatialities of the practices that constitute power relationships – manifest as specific power-geometries in a given industry cluster or region - are instrumental in shaping the ongoing success (or failure) of firms and industries. In the contemporary global economy, the specific power-geometries in which a given industry cluster is embedded are constituted through a complex array of both 'local' and 'place-based' but also (increasingly) 'trans-local' relations (c.f. Dicken & Malmberg 2001; Hess 2004). Our proposition is that a geographical approach that explicitly engages with the spatial form of the practices that constitute power relations in an industry cluster or regional economy can provide more effective insight into how power relationships shape firm and industry success or failure, as well as an important factor affecting economic competitiveness that is currently under-emphasised.

These arguments are based around three interrelated theoretical propositions that emerge from applying social scientific literature on power discussed above to recent strands of debate in the economic geographical literature. The first concerns relational conceptualisations of the nature and role of spatial proximity in economic practices in the contemporary global economy. A significant literature within economic geography has established the key significance of proximity to the success of both urban economies (Thrift 1994; Thrift & Leyshon 1987) as well as regions and clusters (Rychen & Zimmerman 2008) arguing that the degree of proximity between economic actors is a key factor influencing economic success and competitiveness in the global knowledge economy (Moodysson 2008). Whilst there is a longstanding literature on agglomeration, economic geographers have thus more recently sought to identify the relative significance of different kinds of proximity. Broadly, at least four

forms are argued to be important: the physical proximity of economic actors (individuals or groups) (Thrift 1994; 2000; Grosetti 2008; Hauge *et al* 2009); virtual proximity created by and mediated through information and communications technologies (Amin & Cohendet 2005; Maggio *et al* 2009); the degree of cultural proximity between economic actors (c.f. Gertler 2004); and finally the organizational proximity between firms and suppliers, collaborators and other stakeholder institutions (investor organizations, for example) (e.g. Lorentzen 2008; Sachetti 2009; Cooke & Ehret 2009). Our contention is that the spatial configuration of power relationships within a given industry cluster are constituted through all of these forms of proximity, and that developing a framework for mapping these spatialities provides new insight into how power relations affect economic outcomes (e.g. competitiveness, profitability, industry sustainability).

Second, and closely related, is a proposition that arises from the debate about the ongoing significance of face-to-face interaction in economic practice (Gertler 2003; Storper & Venables 2004; Jones 2007). This growing debate has focused on the function and role of face-to-face interaction facilitated by the physical proximity of individuals or groups of actors in the work practices of firms. It has firmly established that the co-presence of individuals or groups of individuals is crucial to the work process, management and operation of many industries, especially key sectors in financial and business services at the centre of the global knowledge economy (Beaverstock 2004; Faulconbridge 2008). Research has begun to examine how face-to-face interaction is achieved in an increasingly integrated global space economy, and also indicates that face-to-face interaction represents the most important form of proximity in the spatial configuration of power relationships within which firms and industries are embedded (Jones 2007; Faulconbridge 2008). We suggest that better theorisations of how face-to-face interactions constitute inter-firm power relations will provide more conceptual traction on understanding how power impacts on industry and cluster success or failure.

Third, both of the preceding propositions provide the basis for a further contention concerned with the degree to which power relationships can be usefully understood to be ‘embedded’ in territorially-defined regional economies. A substantial literature concerned with ‘embeddedness’ has sought to examine how economic activity is constituted in place through a complex array of different kinds of social, cultural and institutional contexts. In particular, an ongoing issue remains the spatial form of these different relations that industry clusters are constituted through, and the interaction of local-embeddedness with translocal linkage (c.f. Hess 2004; Jones 2008). Our suggestion is that power needs to be understood through a similar conceptual lens insofar as it is partially an emergent phenomenon derived from the embeddedness of firms in demarcated ‘local’ contexts, but equally in the contemporary era is constituted through translocal spaces that ‘perforate’ the regional, national economies or supranational scales (c.f. Amin 2002). The balance between these constitutive aspects of power in industry clusters thus needs to be a key object of enquiry in developing more effective theories of power in economic activity.

In conjunction with these specific propositions concerning the nature of power in industry clusters and regional economies, we want to propose four dimensions around which to conceptualise the *qualities* of power relationships that exhibit differential spatial forms. In the case of each dimension, we suggest that within industry clusters success or failure in attempts at exercising power by firms is mediated and heavily influenced by the nature of proximity, the capacity and practices of co-presence (face-to-face interaction) and the nature of the institutional and cultural context in which an industry is embedded.

The first is the *strength* of power relationships. This refers to the degree of power, both in terms of the capacity to influence and the exercise of that capacity through spatially-constituted practice within and between firms. Our suggestion is that the strength of power is shaped by spatialities of the relational networks (from an ANT perspective) that firms or other actors are enrolled within. Spatial configurations of relations are important in determining how strongly empowered actors are to act. Second, and related, is the *symmetry* of any

given power relationship within and between individuals, groups and firms. Rarely is power symmetrical and as a consequence asymmetrical power relations prevail within networks of business relations (Taylor 2000). For Taylor (1995), unequal power within business relationships has been ascribed to the control of resources with the most powerful business enterprises exercising influence over subservient business partners. We suggest, however, that the nature of power symmetries within an industry cluster is intrinsically spatial, and that conceptualising the nature of this spatiality and how power asymmetries develop will provide greater insight into its role in shaping economic outcomes.

Third, drawing on Allen and others, we suggest that the *type* of a power relationship needs to be theorised. As Allen and others have differentiated, there are multiple types of power spanning a range of types of social relationship and/or interaction. These include, for example, power as domination, as an enabler or as manipulation. However, Allen does not engage with how the spatiality of relationships or social interactions affects which type of power exists and / or is important. In the context of industry clusters or regions, we contend that the spatialities constitute different types of power which influence the nature of economic outcomes differently, and are likely to be prevalent to different degrees in various economic relationships.

Fourth, and finally, we propose that the *purpose* of power is also conceptualised. Again, and as Allen (2003) elaborates at some length, the practices of exercising power in (economic) activity are thus likely to cover a range of potentially very different purposes in their enactment. Again, however, we contend that the purpose to which power is deployed is constituted through and shaped by the spatial configuration of practices undertaken in a given industry cluster or region.

This multi-dimensional framework for theorising the spatial form of power practices in economic relations aims to represent a better approach for understanding how power relations affect economic success or failure at the level of firms and regions. Its goal is to develop a sophisticated epistemological basis for conceptualising the diverse and complex forms of power which are central to

business activity, and their equally complex relationship with firm or regional economic success or failure. In order to illustrate the use of such an approach, we now turn to empirical research into the spatiality of power practices within an industry cluster with a specific form of geographical and historical embeddedness - the UK-based private equity industry.

4) THE UK PRIVATE EQUITY INDUSTRY

The term ‘private equity’ refers to ‘medium to long-term finance provided in return for an equity stake in an unquoted company (BCVA 2004). It is used synonymously in the UK with the term ‘venture capital’, although in the US the latter refers only to investments in early stage and expanding companies (ibid.). Private equity firms usually operate by setting up funds or partnerships, often with a fixed time horizon, and sometimes with a particular target group of investors. In recent years, a large proportion of the growth in private equity funds is attributable to the attraction of this asset class to institutional investors who provide private equity capital in the hopes of achieving risk adjusted returns that exceed those possible in public equity markets (Cendrowski *et al* 2008). A single private equity firm will typically have several funds (Brander *et al* 2002) with 170 such firms in operation in the UK in 2004. (BCVA 2004). Typically these firms thus represent intermediaries insofar as the private equity funds have in the last decade or so increasingly become agents for institutional investors.

Obtaining private equity is very different from raising debt or a loan from a lender, such as a bank. Lenders have a legal right to interest on a loan and repayment of the capital, irrespective of success or failure. Private equity is invested in exchange for a stake in a company and as shareholders the investors’ returns are dependent on the growth and profitability of that business. The private equity firm is thus an equity business partner and is rewarded by the company’s success, generally achieving its principal return through realising capital gain

through an ‘exit’³ (BVCA 2004). Private equity firms usually look to retain their investment for between three and seven years or more, consisting often of three phases to activity: investment in companies; management and development of the investee during the holding period; and exit from the company via a sale (Morck *et al*, 2003). Private equity can thus be used by potential investees looking to start up, expand, buy into a business, or indeed buy out of a division of a parent company, turnaround or revitalise a company.

Historically, private equity emerged in the UK as an industry in the 1970s, but since the 1990s it has been one of the fastest growing ‘asset classes’ (BCVA 2004). Related to this, the business model used by successful private equity houses in the 1990s evolved, whereby traditional acknowledged deal making expertise was supplemented with additional ‘hands-on’ portfolio management skills, thus enabling private equity houses to more readily add value throughout the investment cycle by improving performance and investment out-turns (Sweeting and Wong 1997). This ‘management intervention’ approach increasingly rests on incentivising the investee management and in many cases a willingness to embark on fundamental value-adding rationalisation programmes. In this model, the skill of the investment executive, as a deal maker and how the investee management are motivated are seen to represent key drivers of returns (MBS-KPMG 2002). Over the last decade in the ‘up-cycle’ years leading into 2007-9 ‘credit crunch’ (Leaver 2009), UK private equity became more active in management ‘buy-out’ and ‘buy-in’ with a greater prevalence of large companies being the target of investments.

Academic research into the industry has emerged across the areas of corporate finance, economics, management science, sociology and latterly economic geography (Cohen and Levinthal, 1990; Gompers, 1995; Cable and Shane, 1997; Sweeting and Wong, 1997; Brander *et al*, 2002; Mason and Harrison, 2002; Babcock-Lumish 2005). However, the private equity market has

³ The term ‘exit’ or ‘divestment’ is generally used when a private equity firm sells its shareholding to another company (a ‘trade sale’), or to another private equity firm (a ‘secondary purchase’), floats the company on a stock market (where it may pass on the shares to its investors or sell its shares often after a holding period), or writes the investment off.

been fast moving and the literature has struggled to recognise emerging trends. We would emphasise two. The first has been the need for private equity firms to differentiate themselves in order to firstly attract capital, and furthermore, to recycle investment funds in a continual stream of business ventures and other opportunities. The second is the growing need for the ability of private equity firms to attract business opportunities and in particular talented management teams. Without this ability to attract quality managers and investment opportunities, private equity firms would fail to satisfy their investors through a lack of adequate investment returns. Since the 1990s UK private equity has thus become increasingly a ‘people business’ where mutual cooperation and trust, between investor and investee management team, is critical to success in this highly competitive corner of the corporate finance industry. In adapting to this change, research into private equity firms has thus become increasingly interested in the power dynamics of investment relationships (Meuleman *et al* 2009) and with the nature of social relationships between investee firms and the managers of their portfolio companies (e.g. Watson *et al* 2003).

5) PROXIMITY AND POWER IN PRIVATE EQUITY RELATIONSHIPS

The aim of the project overall was to understand the dynamics of the investor-investee relationships in the UK context and the resultant influence on investment performance, although we focus here on the specific issues of power, proximity and social relationships between individuals and groups. The research focuses on the two key actors involved in private equity business: namely, the private equity firms themselves and the investee management teams of private equity-backed companies in the UK. It is worth noting, however, that since much private equity act as intermediaries for institutional or other investors, the potential constitution of ‘agency’ is complex. Clearly the nature of relationships between the private equity firm and institutional investor has considerable scope influence the power dynamic between the former and investee firms. However, a detailed analysis of

the nature of the intermediary role played by private equity firms in such instances is beyond the scope of the current study.

Following Strauss and Corbin (1990), key aspects of data collection and sampling, interview transcription and data analysis, data coding and theory development were based on grounded theory techniques. The primary empirical data was collected through interviews with key individuals in UK private equity firms, investee managers and advisors to the industry. Overall thirty-three interviews were conducted between 2001 and 2005. The interviews were between 25 and 60 minutes in length and followed a semi-structured topic guide. The topics were refined on the basis of initial pilot interviews with key segments of the sample: industry employees, advisors and commentators. As key informants, the majority of the interviewees occupied mid- or senior-level positions within private equity firms with a smaller number of investee firm managers. The primary data was supported by selective secondary sources, including prominent industry-sponsored research into private equity firms and portfolio companies, trade and national press articles on the industry in the UK, and private equity industry publications.

The following discussion divides our analysis of the spatiality of power relations in the UK private equity industry around four key aspects of the investment process. Whilst our theoretical propositions apply to all of these aspects, we will argue that the different ‘dimensions’ to power relationships have varying significance between different aspects of private equity investment practice.

5.1 Proximity and Power Asymmetry in the Pre-Acquisition Phase

The ‘pre-acquisition’ phase of private equity investment practice is characterised by asymmetrical power relations (c.f. Clegg and Wilson 1991; Hardy & Clegg 1996), whereby the vendor firm and its management team have clear power over the private equity firm (and often the institutional investors it is acting as an intermediary for) derived from their greater knowledge of the business being sold.

Three key findings emerge in relation to how proximity mediates and shapes this power asymmetry.

First, the research suggests that the degree of proximity (in a variety of forms) between a private equity firm and an investee firm shapes the balance of power (the *strength* and *symmetry* of power) between the two prior to acquisition. This stems from the fact that whilst vital information about the company for sale is clearly essential to the investment appraisal decision, the private equity firms' power to extract this information from secondary sources is limited:

"[Pre-acquisition information is]...of poor quality and partial with decreasing ethics and information disclosure."

(Partner, Euro private equity firm #2)

"There is a growing tendency for management teams to keep back material facts during the due diligence – if something is discovered just prior to the deal being signed we walk away. But the danger is that you have got so far down the track and invested so much money that you just stick with it."

(Partner, Euro private equity firm #6)

Lack of knowledge about an investee firm combined with the scope for management to conceal disadvantageous information means that private equity firms occupy a relatively disempowered position with regard to information access and ownership ahead of acquiring a firm. The research suggests that private equity firms use physical proximity between employees (face-to-face interaction) as a strategic practice to address this problem:

"We might spend a year getting the deal done over which time we will spend many hours with management. This will involve a lot of business planning as well as structuring the deal. You really get to know management during this time on a personal as well as a

professional level. We form a small team and a strong relationship between us develops...”

(Investment Manager, UK private equity firm #1)

Nevertheless, respondents in private equity firms saw the relationship as predominantly an untrusting one from their position. The asymmetry of the power in favour of the vendor thus creates social relations that are overshadowed by what is seen by investor firms as unethical and dishonest behaviour by investee management teams:

“There is no sense of ethics or honesty. Non-disclosure and a lack of transparency is becoming a big issue just before deals are signed and closed...Due diligence [should be] based on non-transparency and the ‘nasties’ brought out upfront... we seek the same protections they do...”

(Partner, international private equity firm #4)

Many respondents stated that subjective evaluation techniques based around greater proximity between investor and investee firms are increasingly important in private equity investments because of a range of problems that occur in the pre-acquisition phase and the inadequacy of quantitative ‘due diligence’ practices carried out ‘at distance’ and without direct contact between employees.

Second, and following on, the research suggests that the nature of proximity that private equity firms are seeking to promulgate are multi-dimensional, involving both working practices and organizational culture. Respondents suggested that physical proximity (in the guise of face-to-face interaction) is crucial to generating these further forms of proximity. As is well established in the literature on face-to-face interaction in other knowledge intensive industries (Storper & Venables 2004; Faulconbridge 2008), it represents an important mode of rapid and rich information exchange:

“We try and get to know them during the deal formation. Of number one importance is personality - entrepreneurial attitude, vision, business growth are all key attributes – followed by experience.”

(Partner, international pharmaceutical private equity firm)

However, and furthermore, the research suggests that prolonged periods of physical proximity between employees on both sides of the deal are important in developing the degree of cultural proximity - in terms of working practices, values and in depth knowledge of the investee firm employees – that produces a successful acquisition:

“You have to be able to get on with each other because you are working frantically together to get the deal done. This can often mean working late into the night and having pizzas delivered to the office. It is not unusual to work all through the night when the deal is closing. This is a high pressure situation which requires there to be a good working relationship in place, otherwise we just couldn’t reach closure.”

(Investment Manager, UK private equity firm #1)

Face-to-face interaction thus enables the development of socio-cultural proximity between employee actors that empowers the private equity firm with a greater capacity to act in the pre-acquisition phase.

Third, in light of the role for physical co-presence in the deal-making process, the physical distance between the private equity firms (all of which were London-based) and the investee firms is significant. Where investee firms were located out of the south-east of England, the research suggests private equity firms used both employee travel and technology to facilitate proximity. For example, one respondent reported how a private equity firm had imposed the use of ICT to generate virtual proximity where the level of face-to-face interaction achieved at the European scale through business travel was felt to be insufficient:

“Our key operations are based here in Hemel Hempstead (England), while our owners are based in Oslo (Norway). The video-conferencing facility was introduced by [private equity firm] to enable management meetings to take place in-between our monthly board meetings without the need to travel. As we know the people, the technology is actually quite effective...”
[Not verbatim] (Company Secretary, UK manufacturing investee company)

Fourth, and finally with respect to the pre-acquisition phase, developing proximity to an investor firm is a key method by which private equity firms can assess the risk involved with an investment. Given the perceived inadequacy of secondary research practices for ‘due diligence’, the process of assessing risk in the pre-acquisition phase is becoming increasingly reliant on face-to-face interaction:

“Pre-acquisition usually involves working closely with the management team to build trust and also to conduct detailed due diligence on the business plan...this is important for us in assessing the risks we will encounter”

(Director, UK technology private equity firm #1)

“We try to use contracts to limit risk as much as possible – but there is still a gap. We try to get to know the management team through some socialising...”

(Analyst, UK technology private equity firm #3)

Nevertheless, the scope for these proximity strategies to assess risk remains within limits and the research suggests overall that it remained common for due diligence studies to assume ‘unethical’ behaviour by the vendor. One private equity firm Partner, for example, referred to three recent cases of ‘non-disclosure

of material facts by vendors' during the deal formation process. It is only after the deal has been completed – post-acquisition – that the veracity and quality of information available to investor firms about the risks involved improves. And this is to do with a significant shift in the balance of power post-acquisition, to which we now turn.

5.2 The role of increasing proximity in shifting the balance of power post-acquisition

The post-acquisition phase is characterised by a dramatic shift in the balance of power relations towards the private equity firm. There is also a shift in the *type* and *purpose* of power from a more manipulative form to one of domination. This is a consequence of the investor firm gaining power through ascribing himself with control over the resources available to the organisation (Clegg and Wilson 1991). In the UK private equity industry this is commonly structured into a fifty-one per-cent equity ownership of the investee firm:

“Equity participation by the investor has meant that management do not have as much control and correspondingly their equity package is reduced. However, this does vary depending on the influence of management over the balance of control.”

(Partner, Euro private equity dept., international professional services firm #1)

“...They (investee management) are not interested in giving away their power... VCs (venture capitalists) typically want a fifty-one per-cent plus stake in the business and a seat on the board in exchange for the equity...”

(Analyst, UK private equity firm #2)

Two key findings emerge from the research with respect to how this shifting balance of power is bound into issues of proximity. Firstly, the survey

suggests that the shift in the balance of power between investee and investor is *facilitated* through increasing proximity between investor and investee, and the effective *exercising of power* by private equity firms is reliant on co-presence and increasing face-to-face interaction:

“VCs (Venture Capital Firms) are much more hands-on now. They control the deals through a deliberate strategy of owning fifty-one per-cent of the equity. They are effectively running the companies with people in there, and planning ahead with things like management succession planning [Paraphrased].”

(CEO, Euro private equity firm #1)

The domination tactic described by this Partner was cited by other respondents. It relies on high levels of face-to-face interaction where the capacity of power is developed through continued and extensive knowledge gathering achieved by investor firm employees maintaining very frequent contact with investee company employees.

Second, respondents also suggested that the shift towards co-presence as a medium through which private equity firms exercise power as domination represents a recent innovation in the form of working practice within the UK industry:

“Previously, private equity firms responded too slowly...For example , it used to be that both management teams had a relationship and... the investee management team might say we are having a little blip at the moment but we are fixing the problem, and the private equity firm would have said okay. This is the mistake – a small problem now is actually a big problem. Now they are asking a lot more questions and getting into the detail. They get the non-execs (non-executive directors) involved. People (private equity firms) are responding more quickly now.”

(Partner, Euro private equity dept., international professional services firm #1)

The post-acquisition phase thus involves private equity firms developing socio-cultural and organizational proximity to the investor firm, with a clear implication of aligning working practices, values and cultures. Respondents in private equity firms placed great importance on this increased proximity as being key to the success of the investment. As one respondent explained, ‘getting one with people’ is the crux and something clearly mediated primarily through prolonged and repeated face-to-face interaction:

“...It is very much about relationships with management when it comes to selecting an equity partner...it’s all about chemistry - of how you get on with the people, because getting the deal done is about a tenth of the work. You are going to have to live with these people for the next two to five years and that is going to be an uphill struggle if the chemistry is not right.”

(Investment Manager, Euro bank and private equity firm #3)

However, the research suggests that achieving this kind of socio-cultural and organizational proximity between investor and investee firm is not always possible. We now therefore turn to examine the role of these forms of proximity in how private equity firms manage investee firms post-acquisition in more depth.

5.3 Socio-cultural proximity and the management of performance in the investment relationship

Despite the reversal and empowered position of private equity firms post-acquisition, the research suggests that the investor’s power bias needs to be and is used sparingly when portfolio companies fail to perform. The proximity strategies discussed thus far are used to increase the *capacity* of investor firms to exercise power, rather than necessarily being widely bound in to practices of exercising it.

However, we suggest that the development of socio-cultural and organizational proximity between investor and investee becomes increasingly important over time post-acquisition, and the degree to which these kinds of proximity develop strongly influences what kind of practices private equity firms take in order to manage the performance of the investee firm.

Three findings are important in relation to this argument. First, whilst trust was first created through an appraisal of an investee manager's 'track record', respondents in private equity firms suggested that the key attributes they sought in management were ones that could only be assessed through extended periods of face-to-face interaction and co-presence:

“The fund looks to back management teams that have demonstrated exceptional leadership, organisational and execution skills. In particular, management should have either an entrepreneurial track record or have experience in building new organisations within a larger company.”

(Analyst, UK technology private equity firm #3)

“We are looking for good managers with industry experience that are strategic thinkers. They also need to have an entrepreneurial appetite to take the business forward and expand it [paraphrased].”

(Vice President, Euro bank and private equity firm #1)

Second, private equity investors select investee firms in part based on their track record with the intention that they will replicate a high level of performance and business results in the new company. The private equity firm is looking to 'trust' the investee management to deliver superior performance. The consequence of this is that the whole area of management performance becomes subject to an ongoing process of scrutiny around the criteria identified above. The research indicates that this picture of ongoing performance is constructed through frequent and 'rich' co-presence, to the point that employees from the private equity firm and the investee firm are working very closely together:

“We become married to them during the investment and good working relationships are important.”

(Analyst, international technology private equity firm)

“We are very hands on with our portfolio companies and get involved in all industry issues as well as micro-management. We tend to meet with the management team at least once a week. We also need to get on with the management team.”

(Analyst, international technology private equity firm)

Where a high degree of socio-cultural and organizational proximity develops, as these respondents suggest, then the performance management is broadly consensual and the private equity firm – whilst building its capacity to wield power over the investee firm’s operation – exercises only limited day-to-day influence.

However, and third, the interviews also indicate that increasing socio-cultural and organisational proximity also presents a heightened degree of risk for the investee firms’ management. Greater proximity means that the investor firm has more accurate and extensive knowledge about the investee firms’ operations and the working practices of management. In contrast to an earlier period in this industry when this relationship was characterised by less proximity, we would argue there is thus an increased likelihood of the relationship becoming problematic. Respondents suggested if the performance of investee managers (as mediated through increasing socio-cultural proximity between investor and investee firms) becomes mis-aligned with investor’s expectations, then private equity firms have the capacity to wield power as *domination*.

One respondent described the variation in the dynamic of this relationship:

At the board meeting they give us an update, go through the figures and if they execute the plan then everything is fine. If something external was to happen or when things go wrong, then we talk to them more often. When things go wrong, depending on how much time you need to spend there with them; it can be every two hours or every two days. When that company does well and starts to do better we change tactics and you have to start to rely on them more and take it more easy.”

(Investment Manager, Euro bank and private equity firm #3)

Overall the research suggests that the tendency for private equity firm actors is to believe that their trust in the management has been contravened when investee management fail to deliver expected results. This failure of trust we suggest is a phenomenon strongly mediated through the nature of socio-cultural and organizational proximity that develops through the post-acquisition phase of the investment process. However, the research also suggests that the circumstances that lead to such an understanding of investee under-performance are complex, and whether this leads to the exercise of more significant forms of power as domination by private equity firms is bound into the dynamics of physical co-presence between actors. We therefore turn now to explore this final aspect of the interaction between power and proximity through the investment process in depth.

5.4 *The role of proximity in constructing investee ‘under-performance’*

According to Clegg and Wilson (1991), manager-employee theorisations of power/trust relations can be highly variegated from high trust/high discretion configurations down to the low trust/low discretion configuration which is conducive to a ‘vicious cycle of control’ (c.f. Clegg and Dunkerley, 1980). A parallel can be drawn between manager-employee and the investor-investee relationships we are considering in the private equity industry in that where there is trust and understanding there is discretion to permit management to run the business in the best interests of all stakeholders. However, the research suggests that once the investor firm perceives the management of the investee firm to be under-performing, then relationships correspond to a low trust/low discretion arena where private equity investors look to interfere as soon as possible. Our argument is that different forms of proximity are central to the work practices that lead to the development of perceived ‘under-performance’ (see also Watson *et al* 2003). Three major findings emerge from the research in this respect.

First, as time passes in the aftermath of acquisition, the nature of proximity between investor and investee firms is important in shaping how key actors in private equity firms understand the performance of the firm. As the discussion suggests, greater socio-cultural proximity between investor and investee is often a double-edged sword for the investee firm because the quality and depth of information available to investor employees on both firm and management team performance is greatly enhanced as ‘closeness’ develops:

“Investors used to rely on the management team to provide information to the investor team – they didn’t have anything else. Now they have a much better working relationship through part-time chairmen who are actually involved in the day-to-day.”

(Partner, Euro private equity dept., international professional services firm #1)

As one respondent highlighted, this enables private equity firms to form judgements about whether or not performance is meeting their expectations. Investor firms therefore seek to promote socio-cultural and organizational proximity because it empowers them to act in the event of ‘under-performance’:

“There is no doubt we should have intervened earlier. We kind of knew the investment wasn’t going well. But you put your faith in management. We are much more proactive now. We are much closer to management and the operations, and can spot and act on problems earlier” [not verbatim]

(Partner, Euro private equity firm #2)

This frequency and intensity of proximity-enabled monitoring by private equity firms, when there is concern over management performance, is partially explained in the results of a survey conducted by SJ Berwin in association with Mergermarket⁴ in 2002, where the private equity firms that were sampled identified the failure of the management team as the single most dominant factor why deals do not succeed. This research supports our findings with respect to the pervasiveness of investor firm nervousness around investee management team’s ability to perform. Combined with a lack of trust, monitoring activity intensity by private equity investors is swift and immense where there is concern over management.

Second, and therefore following on, in the event of deteriorating performance several investor firms reported that they would seek to intervene and exercise power as domination to rectify poor performance. This was characterised by a phase of heightened ‘hands-on’ co-presence and face-to-face interaction between their employees and the investee firm management:

⁴ SJ Berwin in association with Mergermarket, canvassed the opinions of 164 buyout professionals and 166 venture capitalists in August and September 2002 in the United Kingdom (buyout 51, VC 44), France (buyout 30, VC 42), Germany (buyout 47, VC 49), and Spain (buyout 36, VC 31). The questionnaires were completed by email, fax and telephone interview. Factors contributing to the failure of an otherwise sound investment: Failure of management – 69%; external shocks 17%; and flawed business model 14%.

“...typically we would have meetings with the Managing Director every two weeks...if the position changes, or times become a bit tough then that could increase to two or three times a week or even daily.”

(Investment Manager, UK private equity firm #1)

Respondent’s suggested that in the first stage of tackling perceived ‘under-performance’, the heightened degree of proximity between investor and investee firm was used to exercise what can be described as a manipulative form of power by influencing the practices of the investee management:

“You have to move extremely quickly if the company is starting to go downhill...also, it is really important to be seen as an equal shareholder with the management team – ‘this is our company’ – and work together in that fashion.”

(Director, UK technology private equity firm #1)

However, third and finally, it is clear that often under-performance results in the exercising of strong forms of domination - i.e. replacing one or more investee firm managers:

“The VC (venture capital firm) owned fifty-one per-cent of the company ... You have got to remember that this VC (venture capitalist) had the power to take over the company and boot everybody out. [Did they eventually do this?] Yes.”

(Operations Director, Euro technology investee company)

Again, the study suggests that any final decision about exercising such power is ultimately a product of the period of heightened face-to-face interaction during ‘under-performance’ which allows the investor firm to form a judgement about

whether the existing investee firm management is capable of achieving the desired performance. A primary example that recurred was that of the key role played by the Sales Director in an investee firm whose practices – the research suggests - are the object of detailed scrutiny through this process:

“Basically, they would keep the Sales Director if he met his target and get rid of him if there was non-performance. That’s how it works with a VC (venture capital firm).”

(Operations Director, Euro technology investee company)

“We tend to replace people such as the Sales Director, he’s important. Also the CEO, Chairman and CFO... Sometimes this doesn’t work and we’ll replace again immediately...”

(Analyst, UK technology private equity firm #3)

Overall, to a considerable extent, ‘under-performance’ is a subjective viewpoint based around expectations by the investor firm (and potentially institutional investors for whom the private equity firm is acting as an intermediary) rather than an absolute benchmark of profitability, growth or market metrics. In this respect, private equity firms are reliant on strategies of developing proximity in order to assess and actively construct an understanding of performance and under-performance.

6) CONCLUSION

Our key contention in this paper has been that much social scientific thinking has neglected the issue of the spatial configuration of power, often restricting its analysis to an epistemological framework that conceptualises power as ‘space-less’ and a property of actors, entities or processes. And whilst economic geographical thinking has recently renewed its interest in the spatiality of power relationships between economic entities, we have argued much more analysis of this issue is likely to produce a better and more effective understanding of how

the spatiality of power relationships shape economic outcomes in the contemporary global economy.

This proposition of course opens up a wide field of potential theorisation and research, and the specific concern of this paper has been one particular aspect of the spatial configuration of power in the economy: the nature and role of different forms of proximity in constituting power relationships between firms within a regional economy or cluster. In presenting research into the UK private equity industry, we examined a sector where power practices are a central and evident aspect of day-to-day business activity. Such a case study is therefore useful in illustrating the wider applicability of the arguments developed because of the explicit nature of these power practices in this industry. We end therefore with four broad conclusions which we contend have wider relevance for understanding the way in which different forms of proximity mediate the nature of power relations in industry clusters or regional economies.

First, the UK private equity case demonstrates the utility of seeking to conceptualise proximity between economic actors in regional economies or clusters, not only for better understanding how power relations influence that nature of economic development, but also more generally for providing an in-depth analysis of how social relations and intra or inter-actor contact networks which have been increasingly emphasized in recent thinking (Gertler 2004; Yeung 2005) are manifest spatially.

Second, and following on, this conception of space is of course more than simply a physical and territorial one, since the research presented in this paper also demonstrates how proximity needs to be conceptualized as multi-dimensional. The research suggests that economic practices within and beyond regional economies involve actors becoming ‘closer’ or ‘more distant’ over time in a variety of ways that are bound into firm and industry development. The dynamism of these different forms of proximity is also not accidental, but in fact quite often the product of deliberate strategic practices related to economic goals. The private equity firms considered here actively seek to develop proximity to their potential investees as a means of rich information gathering, assessing the

nominally intangible managerial skills of the investee firms' management and as a mechanism to calibrate their other quantitative assessment techniques of firm performance. Such a finding has many wider implications with respect to the capacity for using research into proximity as a lens for better understanding all kinds of economic practices within clusters – for example, the nature of innovation or learning (c.f. Surinach *et al* 2006; Maggio *et al* 2009).

Third, and in relation to the specific issue of power, the analysis in this paper opens up a series of questions and fruitful avenues for understanding both what kinds of power exist between economic actors in a space economy and how spatiality shapes the nature of that power both as capacity and when exercised. This we contend is an important and innovative direction for research into power in economic activity to take since most of the current social scientific literature seeks to examine power at a much wider resolution than at the level of individual economic actors (be they firms or even the key individuals within firms). Whilst analysis of power within markets or economic processes is undoubtedly worthwhile, we suggest that analysis of power relations at the inter- and intra-firm level can shed significant insight into economic success or failure but remains relatively unexplored.

Finally, whilst the nature and spatial configuration of the power relations examined in this paper's case study industry may be more pronounced than in other sectors or industry clusters, we would emphasise that the broader characteristics of private equity activity shares many similarities with other financial and business service industries. What we would argue is clear from the research findings is how significant the power of actors is to knowledge-intensive business service activity. Given the primacy that other business service sectors are argued to have in the global informational economy – notably in relation to regional economic success and /or wealth generation (Bryson *et al* 2006) -we therefore argue that economic geographical research concerned with business service clusters and agglomeration should direct much greater analysis to the role played by the interaction between power and proximity in producing specific economic outcomes for such clusters. As Allen (2010) points out, for example, in

the aftermath of the 2007-9 downturn, the future success or failure of financial services in London may be much more to do with the outcomes of specific power interactions between firms, institutions and other economic actors than with the operation of global markets or abstract processes of competition. We suggest that this paper has thus provided some basis for developing an economic geographical approach in such an industry cluster that can offer some theoretical traction to tackle such an issue.

[9214 words]

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