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Nicky Morrison[1] & Nikodem Szumilo (2019) 'The drivers and implications of mega-mergers: Evidence from English not-for-profit housing organisations' ***Journal Housing and Built Environment*** DOI: 10.1007/s10901-019-09696-6

Abstract

Heightened economic uncertainty, reduced government expenditure and reliance on capital markets have had a profound impact on not-for-profit housing providers across the globe, forcing them to strategically pursue new business models to ensure their long-term survival. Whilst mergers are not new for the English not-for-profit housing sector, a number of mega-mergers have materialised among the largest housing associations, with these newly formed organisations predicted to become amongst the largest volume housing builders in England and largest housing associations in Europe. Drawing on business literature, this paper examines the policy and business drivers, alongside managers' motivations and strategic choices that have culminated towards this mega-merger activity. These processes are highly significant for contemporary housing policy, with the dominance of large-scale organisations marking a complete reversal from a position where not-for-profit housing providers used to be valued as small-scale, locally based community organisations. Whilst empirically this article focuses on English housing associations, the underlying drivers and strategic behaviours have considerable resonance elsewhere, as not-for-profit housing organisations across the globe face pressures to transform.

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1. Introduction

Not-for-profit housing organisations are classified as hybrid organisations, acting as neither market nor state actors (Mullins et al 2012). In most countries, their role is to fill the gap when the state or market provision is unable to provide for households in need (Manzi & Morrison 2017). Yet the business environment they operate in has become increasingly challenging (Morrison 2016a, 2018). Steep reductions in government spending coupled with regulatory demands for greater efficiency have driven not-for-profit housing providers to re-examine their business strategies and consider mergers with other organisations (Wainwright and Manville 2017). In this paper, our main research question is to examine what has motivated England's largest not-for-profit housing providers to merge at this point in time.

Consolidation of not-for-profit housing associations via mergers (voluntary amalgamation of two firms on roughly equal terms into one new legal entity) appears to be a common trend in several European countries. The English housing association (HA) sector has a long history of mergers, with a number of academics examining their rationale (see e.g. Van Bortel et al 2010, Mullins 2006, 2012, Pawson and Sosenko 2011). Similarly, the Dutch not-for-profit housing sector has also seen several large mergers over the last decade. Organisations have steadily increased in size and this trend not only heralded considerable criticism over the potential abuse of their monopoly position from policy makers and academics alike, but it brought about systemic failure across the sector, requiring state intervention (Nieboer & Gruis 2016, Veenstra et al 2016).

Whilst mergers among English HAs have not occurred at the same pace as between their Dutch counterparts, a number of mega-mergers among the largest HAs have resulted in the formation of super-sized entities on a scale never experienced before in England or elsewhere in the UK, with these HAs holding stock ranging from 55,000 homes to 125,000 homes (Cross 2017a). The latter organisation is also set to be one of the largest not-for-profit housing associations in Europe (Housing Europe 2017). This spate of HAs' mega-mergers has created considerable political and media interest in England (NHF 2015a; House of Lords 2016; Cross 2016a&b; Johnstone 2016; Evans 2017). Limited theorization and academic studies, however, exist to date, to aid our understanding of the external drivers and HAs' strategic choices that have culminated towards this contemporary merger activity.

The purpose of this paper is to fill this research gap by drawing on business theory of mergers as a way to understand what has motivated the largest English HAs to merge. Most of the business literature on the rationale for mergers centres on the private sector, which has a long tradition of analysing organisational strategies and managerial motivations. Yet, in the private sector, strategic choices are invariably conceived in a profit-making context with the emphasis on optimising financial performance within the marketplace and maximising shareholder returns. To assess the applicability of business literature explanations of organisational restructuring, the paper adopts a case study approach, focusing on three mega-mergers among England's largest HAs.

We explore the organisational motives for mergers of HAs' by verifying how some of the key arguments from the literature on mergers in private companies can explain the behaviour of HAs. We begin by analysing industry-wide trends (external to any one firm) that have been shown to lead to mergers (Gorton et al. 2009) and explore the topic further by looking into firm-specific drivers such as financial and operating efficiency gains (Maksimovic et al. 2011, Fee & Thomas 2004) and managerial motivations (Bliss & Rosen 2001). To this end, we closely examine our chosen case study organisations. What prompts these large-scale organisations to merge and the broader implications have considerable resonance elsewhere as not for profit housing providers across the globe face pressures to transform (Mullins 2012).[2]

In what follows, we start by reviewing the most popular explanations for mergers in the private sector in section 2. In section 3, we summarise the external pressures facing the English HA sector. In section 4 we outline the unique legal and organisational structure of this sector and specify our analytical framework and research methods. Section 5 outlines our findings, which are then discussed in section 6. Section 7 concludes with final remarks.

[2] In France, for example, although Paris Habitat HA (with 120,000 homes) remains dominant in the French subsidized rental market, smaller communal HAs are under pressure to merge, following the enactment of French National Assembly's ELAN law (Moody 2018). Although the sector is comparatively smaller in size in Australia and US (less than 5% of the total housing stock, respectively), similar pressures to pursue growth strategies are at play (see Pawson et al 2016; Bratt et al 2016).

2. Business cases for mergers

External drivers

A large body of international research exists on the business rationale for corporate mergers that primarily focuses on the private sector (see Weston et al 1998; Jovanovic and Rousseau 2001; Gaughan 2004, Angwin and Vaara 2005). Although it is still uncertain what exactly stimulates a merger, mergers often cluster in time so may correspond to phases of the business cycle, which affect their business strategies and decisions. The same behaviour may be induced by unexpected economic shocks or technological changes (Makri et al 2010). A change in the macroeconomic environment may also be driven by government policy or regulatory changes (Resti 1998) or political developments (Thelen 2009). For Gorton et al (2009) mergers are often seen as 'positioning acquisitions' in response to a regime shift so that businesses ensure long-term survival.

Organisational motivations

Making a business case for mergers is critical, as each firm needs to justify their decisions in terms of the positive synergy gains they expect to be created. International business literature on firm-specific drivers of mergers has a long history of focusing on two main motivations for this process. The first argument is based on the traditional assumption that by combining two entities it is possible to increase efficiency (Maksimovic & Phillips 2001). It is centred on different aspects of business productivity, including: financial (Lewellen 1971) operating efficiencies (Scherer 1988; Manne 1965). The second focuses on motivations of the key decision makers who are involved in the process (Morck et al 1990).

Financial and operational efficiencies

After a merger, in relation to strengthening financial efficiency, the focus is often on the cost of capital (the borrowing rate and return required by equity holders), which often can be reduced by merging (Gompers et al 2003). In the for-profit sector this is very often driven by changes to the debt to equity ratio (capital structure) and tax optimization (Lewellen 1971). With regards to operating efficiency, business operations can benefit from a wide range of synergy effects such as a cost reduction due to economies of scale (Lambrecht 2004), increasing market share (Mueller 1985) or accessing new technologies or markets (Maksimovic & Phillips 2001). Managerial productivity improvements may take different forms and vary from improving procedures to gaining intimate knowledge of a local market or product (Manne 1965). All theories of improving efficiency focus on gains that can be made by adding new skills, resources or new business opportunities to an existing portfolio. Their critical assumption is that these are institutional features that can be acquired by merging with another entity. Economically, it is also implied that developing them internally would be less efficient (Shleifer & Vishny1997).

Managerial benefits

While many executive managers argue that economic efficiency would be a natural consequence of mergers (Shi et al 2017), the empirical evidence on this topic does not appear to support this logic. In fact, Moeller et al (2004) find that mergers often result in a loss of shareholder value in the sample of organisations operating in developed countries while Gubbi et al (2010) confirm this for developing nations, which brings into question the real motives for this strategy. The literature on corporate governance argues that this may be attributable to the fact that the managers of merging companies may be trying to achieve their personal objectives rather than maximize the benefit to the company (Morck et al 1990).

For example, Bliss and Rosen (2001) show that Chief Executive (CEO) compensation is positively affected by size and increases after mergers. They also show that the form of compensation is related to the likelihood of merging with another entity. In fact, Morck et al (1990) present evidence that managerial objectives may drive acquisitions that reduce the value of the acquiring firm. Even if executives believe that they are acting in the best interest of their companies, evidence suggests they may not be able to always make rational decisions and are likely to be overconfident when merging with another corporation and overestimate the returns the deal can generate (Malmendier and Tate 2008).

This simplified business theory of mergers offers an analytical framework informative for not-for-profit housing sectors operating within specific countries and we apply it to the English HA sector. Prior to this analysis, the next section provides context to the changing operating environment that English HA sector faces.

3. External pressures facing the English HA sector

In the English context, HAs are legally independent hybrid organisations that are overseen by the UK Government's Regulator for Social Housing (previously the Homes and Community Agency (HCA)). In total, there are around 1,500 active English HAs (to date), with most having fewer than 250 homes. In comparison, 235 providers own or manage at least 1,000 social homes, representing more than 95% of the sector's stock (HCA 2018).[3]

Mullins (2006) identifies a number of key phases of development within the English HA sector: first, when associations saw an increase in market share from less than 5% of social housing in 1974 to 11% in 1988 (p. 8), with HAs well positioned to take advantage with the disenchantment with both private sector and local authority landlords (Manzi 2006). The second phase, following the Housing Act 1988, was a 'more dramatic' one of 'demunicipalisation and transformation' (Mullins, 2006, p.8). This period witnessed the sector becoming the main provider of new social housing through its ability to raise private finance, enabling HAs to develop substantial property portfolios. HAs also benefited from the government viewing them as a preferred partner to what were considered overly bureaucratic local authorities. This period, however, also saw the emergence of criticisms of a perceived 'accountability deficit' and the description of HAs as 'self-perpetuating oligarchies' began to gain currency (Davis and Spencer, 1995 cited in Manzi 2006).

A third phase from 1997 onwards saw rapid growth through formerly owned local authority stock transfer to HAs, mergers and group structures (Morrison 2013). In 2004, the UK government established the Gershon review to make recommendations regarding expenditure and efficiency across all public services. As Mullins (2010) notes, mergers in the HA sector became 'a common organisational response to the efficiency agenda' (p.45). In 2004/6, almost 80% of government funding was allocated to just 70 lead partner associations (Van Bortel et al 2010). For Pawson and Sosenko (2011), organisations therefore merged to secure public subsidy. They show that by 2010, this primarily policy driven dynamic led to twenty largest entities owning more than 30% of the sector's total stock (p.800).

[3] In March 2018, 2.8m social housing units were owned and/or managed by 235 English HAs, compared to five years previously whereby 336 HAs owned and/or managed 2.6m social housing units i.e. approximately a third fewer HAs are now operating in the sector, primarily as a result of mergers among one another. Moreover, the three mega-merged case study HAs own approximately 9% of the total stock (to date) (HCA 2013, 2018).

Pressures on the HA sector to be efficient were intensified following the Conservative majority victory in the 2015 General Election, with the Chancellor's first budget statement introducing proposals to extend the Right to Buy to HA tenants and to limit rent increases by 1% per annum over a four year period (HM Treasury 2015).[4] Whilst these policy changes were designed to contribute towards reducing the UK public spending deficit, they also significantly accentuated the levels of risk that HAs faced (Morrison 2016b, 2018). The sector also experienced an increased level of antagonism from the media and central government (Ebrahini 2015). The Spectator, a centre-right magazine, suggested that HAs were '*the true villains of the property crisis…combining public sector lethargy and private sector greed'* (Clark 2015), whilst Channel 4 news programme argued '*why are HAs failing to build enough homes?*' (Ebranini 2015). The then Prime Minister reinforced this hostility in the House of Commons:

> I think it's vital we reform HAs and make sure they are more efficient. Frankly they are part of a public sector that hasn't been through efficiencies, haven't improved their performance and I think its about time that they did (David Cameron, cited in the *Independent*, 18/9/15).

The Government's arguments around efficiency also generated a wider political debate over the scope and responsibility of the sector in tackling acute housing shortages, particularly in London and the South East (Manzi & Morrison 2017). At the same time, the UK Conservative government took radical steps in its Housing and Planning Act (2016) to deregulate the HA sector, allowing individual organisations to merge without formal government consent or wider public accountability (UK Parliament 2016).

4. Analytical framework

Figure 1 summarises the analytical framework designed for this paper, distinguishing between the different levels that trigger merger decisions and is based on the business literature. Whilst this literature outlines the industry-wide and firm-specific drivers as well as managerial motivations to merge, there are key features of the HA sector that make it distinct from those in the private sector (see Table 1). The external drivers for the sector to increase efficiency and housing output (as outlined in section 3), in effect, frame HAs' behaviour, intensifying the pressure on individual organisations to re-examine their strategies and

[4] Estimated saving of £4.3m to housing benefit bill by 1% rent reduction over five years (HM Treasury 2015).

consider mergers as a way to re-position themselves. The firm-specific drivers and managerial motivations specific to the sector are in turn considered below.

----Insert figure 1 and table 1 here----

Financial efficiency

The legal structure of English HAs has implications for financial efficiency. As not-for-profit making organizations, they do not have shares traded on the market. Although the public can apply for nominal £1 voting rights, they do not receive shareholder dividends so there is no incentive to coerce managers to undergo a merger (Van Bortel et al 2010). This invalidates many of the common private sector corporate finance arguments for mergers and acquisitions based on maximising stakeholder interests (De Boer et al 2007). Reduced state funding has led HAs to become more reliant on raising debt from the financial markets as a way to fund expansion in the sector (Wainwright and Manville 2017). In this context, HAs have a clear incentive to increase their borrowing which makes their cost of debt a critical financial concern. One advantage of growing in size by merging is obtaining access to capital markets (Tang et al 2016). Larger asset bases in effect allow HAs to optimise their balance sheets and borrow more, thus attracting further investment funds for future growth (AWICS 2013).

To attract investment from institutional funders, individual HAs require high ratings from credit rating agencies. Very high ratings ranging from Aa2 to A1 suggest that the UK government will provide extraordinary support to these organisations, in the unlikely event of a HA facing acute liquidity stress. This gives reassurance to lenders (Oxley et al 2015). The ratings also reflect that the HA's social housing assets act as collateral (Tang et al 2016). Despite the strong asset base and income security, there are risks to the lenders in investing in the sector, including volatility of property values and rental yields as well as political risks associated with changing policies (Wainwright and Manville 2017).

Historically, English HAs could obtain long-term finance comparatively cheaply from banks, as the UK government underwrote rental income through housing benefit. Under the UK government's welfare reforms, caps on maximum housing benefit available alongside 1% rent cuts per annum has meant that the reliability of steady rental income has been threatened. The sector's low-risk credit ratings are therefore likely to alter as a consequence (Oxley et al 2015). Financial efficiency benefits of mergers may therefore include accessing additional debt funding and lowering its cost.

Operating efficiency

The current value for money focus in regulation in England has resulted in HAs looking closely at economies of scale, including shared and integrated back-office functions and consequent projected cost savings (HNQ 2016). Yet, the HCA (2016a) found no statistical correlation between size of HA and efficiency in terms of unit costs (p.18). The Chartered Institute of Housing (2007) and the National Housing Federation (2015a) have also made similar points that operating ratios do not appear to suggest significant differences between HAs. Mergers cannot therefore be seen as an automatic route to more efficiency or better service delivery. Making the case that mergers improve operating efficiency is therefore less clear-cut.

Exploiting new business opportunities

Opportunities to increase operational productivity through acquiring new products, exploiting new business lines or operating technologies could potentially be achieved by merging with other HAs. One specific operational difference that makes mergers attractive lies in the spatial distribution of their stock portfolios and hence market share (i.e. proportion of the social housing market controlled by a particular organisation). Each HA has assets that are uniquely positioned and distributed geographically within regions as well as cities (HCA 2017). Since housing market conditions can vary significantly even within small areas, it appears that accessing a new geographical market and spatial diversification could be valid motivations for mergers, as it allows portfolio diversification. Mergers allow not only geographical diversification but also increases the HA's overall asset base and opportunities to expand their market sales and market rental portfolios. Given reduced government subsidies, the sector's reliance on cash receipts to cross-subsidise the delivery of affordable homes has increased (HCA 2018). Moreover the largest HAs are the forefront of this trend, with mergers providing the opportunity to share risks and combine professional expertise (Manzi & Morrison 2017). Yet there are trade offs in expanding geographical markets and exploiting new business opportunities, particularly if larger organisations loose their local presence (Hydle, 2015).

Managerial motivations

The government has set clear expectations for HAs to increase their development capacity and meet its housing target of 1 million new homes by 2020, and a half a million more by

2022 (HoC Library 2018). It remains clear, however, how such government pressure incentivises HAs' managers to act. At the same time, without shares traded on the market and having shareholders voting on major decisions, corporate governance is difficult and boards of directors lack a direct incentive to exercise control over CEOs (Balzarova et al 2004). This increases the power of managers and allows them to pursue their own goals. A number of managerial incentives for mergers and acquisitions are discussed in the literature. The most commonly stated is the possibility of the CEO's remuneration increasing along with the size of the organisation they manage (Grinstein & Hribar 2004).

There are publicly available data that larger English HAs pay their top managers more, which are reported in the sector's CEO annual salary survey, published in *Inside Housing* trading magazine (Barnes 2018). As merging with another HA increases the total pay of their bosses, it provides a financial incentive to go through this process. This, however, leads to another common managerial problem, which is protecting their power (Shen & Cannella 2002). In a merger one of the CEOs has to accept that some control is transferred to someone else. Wulf (2004) argues that in order to protect themselves against diluting control, managers are likely to engage in a "defensive" merger. This is a process of merging with a smaller company that allows retaining control but still increases overall size (Louis 2004).

Research methods

Academics examining the rationale for previous HA mergers have adopted a variety of research methods. Mullins (2006), for example, adopts an organisational approach to explain English HAs' mergers (up until 2004), whilst Van Bortel et al (2010) and Pawson & Sosensko (2011) discuss merger activity in the sector (up until 2010) from a more macro perspective. By employing an aggregate level of data analysis, these latter two studies, however, can only speculate on organisational motivations, with Van Bortel et (2010) concluding that, 'further work on the merger process seems critical' (p.372). For Czischke et al (2012), organisational studies are essential, as they capture individual HAs' responses to rapidly changing operating environments.

For the purposes of this research, six of the largest HAs that have undergone mergers (listed in table 2) were selected as case study organisations, as they represented mergers on a much larger scale than ever witnessed before in England (Cross 2016a&b). They also had occurred relatively close in time to each other thus decisions to merge are likely to have been driven by common external factors. As Gruis (2008) suggests, it is critical to restrict the selection to those operating in similar market conditions and exclude as much as possible the differences caused through factors related to changes in the organisational context.

----Insert table 2 here----

In-depth semi-structured interviews were conducted with the chosen HAs' senior executive teams and board members to validate the accuracy of each other's statements and to consider the extent to which a shared business culture existed in each of the selected organisations. The purpose was to determine the extent to which the prevailing external policy, regulatory and financial environment had influenced their merger decisions; the managerial and board of directors' reasoning behind the merger; and types of positive synergy benefits they expect to be achieved and the possible outcomes following these mergers.

Given that senior managers and board members would be expected to reaffirm the validity of mergers in an optimistic light and offer a biased outlook in relation to answering questions about the future, it was critical to crosscheck these interviews' self justificatory responses with independent expert opinions. Supplementary interviews were therefore conducted with the housing consultants that had directly advised on the three merger business cases. These additional interviews could therefore question the managerial claims of synergy gains from mergers.

The interview responses were further verified by analysing published and unpublished documentary evidence, including the case study HAs' annual reports, financial accounts, company press releases, HCA's Global Accounts and Statistical data returns and the professional housing press. This triangulation of data provides a means to evaluate the different respondents' arguments and therefore strengthens the veracity and reliability of the evidence collected (Yin 2013). Since the mergers are in their infancy (at the time of writing), it is not possible to accurately state whether any unintended consequences of mergers will come to fruition. However, the paper can bring to the fore broader tensions and possible socio-economic risks that may emerge.

5. Research findings

External drivers towards mega-mergers

Each of the large HAs justified their merger strategy on the grounds that they were responding to the political imperative to become more self-financing - a pressure that was intensified under the 2015 Conservative administration (UK Parliament 2016). At the same time, political and public hostility towards the HA sector suggesting that it is not efficient nor building enough housing to meet the government's targets has forced HAs to respond proactively. As one CEO argued:

> '*The sector is being challenged by the government to sweat its assets, claiming that we are not doing enough. The threat and sense of the mood at the moment is that we are seen as part of the problem – and we <u>want</u> to be seen as part of the solution'*

Although the sector has previously faced pressures to reform (Pawson & Sosenko 2011), the response to contemporary pressures has culminated in 2016/17 in the completion of three of the largest mergers ever witnessed in the English HA sector (Cross 2016a&b, Barratt 2017). As Tables 2 and 3 highlight Affinity Sutton and Circle have formed the newly branded Clarion Group, managing over 125,000 units across 128 local authorities (of which 8 and 11 are in central and inner London, respectively). London & Quadrant (L&Q) and East Thames Group have merged, managing over 90,000 units across 102 local authorities (of which 8 and 12 are in central and inner London, respectively) and remains branded as L&Q given the size of this entity. Family Mosaic and Peabody have merged, managing over 55,000 units across 51 local authorities (of which 8 and 12 are in central and inner London, respectively).

----Insert table 3 here----

In terms of the size of the merging entities, Circle is 35% bigger than Affinity Sutton, while Peabody is 28% bigger than Family Mosaic with respect to the social housing units managed. As these mergers are relatively similar in size, they can be considered a 'merger of equals' (Gorton et al 2009). In comparison, L&Q is seven times as large as East Thames so in this respect it is a different merger than the other two and is effectively an acquisition or a takeover 'defensive merger' (Louis 2004), as East Thames Group becomes a newly formed subsidiary of L&Q. After all mergers, the three new legal entities are therefore relatively similar in size. If it did not merge with East Thames, L&Q would no longer be one of the largest ones. Although not explicitly stated, it is likely that L&Q merged to retain a top position in the sector and maintain its strategic influence. As one of the CEOs stressed:

> '*We want to have influence as a player to push our position. The most important driver is the ability to deliver more homes and improve resources. The government won't talk to all of us. It is likely to focus on the larger top 5. And we* <u>*want*</u> *to be in that discussion'*.

The housing consultants advising on mergers verified this stance, with one noting that *'these ambitious, heavyweight associations are looking purposefully at how to maintain and improve their scale relative to others*'. Although it is too early to accurately determine whether the respective HAs' synergy gains have been achieved, Table 2 compares the different pairings prior to merger to gauge the potential benefits and drawbacks from merging. These observations were also verified in interview with the senior executives and board of directors in each organisation, and then crosschecked with the independent experts.

Financial efficiency

As a result of lower gearing and higher interest cover ratios, Affinity Sutton's credit rating was better than Circle's prior to the merger but downgraded post-merger to Circle's level (Cross 2016a). The same happened to L&Q after it merged with East Thames (Johnstone 2016). L&Q's strong credit rating in effect suffered from merging with East Thames. It also changed their level of gearing, as East Thames has a lot more debt in its corporate structure. Family Mosaic has also suffered a downgrade, while Peabody benefited from an upgrade (Apps 2017). Moreover, in each of the cases, the banks also used the mergers as an opportunity to re-price their existing loans at higher rates. As an independent expert confirmed, *'banks have lent cheaply over a long time to the sector and are using mergers as a way to correct their own past pricing errors'*.

Although the HAs bore these costs, the senior executives were confident that their ratings would be revised upwards and that the mergers provided opportunities to secure cheaper money from the capital markets at better rates. As one CEO explained:

> '*The future is the bond market. Until recently, lenders had a vanilla attitude giving the same rate to all HAs. But now that they are learning more about the sector they are likely to differentiate more and favour larger HAs. Although the credit rating*

often go down after merger, it will go up as we prove our strength and investors have confidence in us'

Testimony to the strengths of these mega-merged organisation was borne out by L&Q securing the largest own-named bond issuance (£0.5bn) in the HA sector (at the time of writing) with the L&Q financial director publicly announcing:

> The bond issuance allows us to progress our commitment to enabling the delivery over the next decade of 100,000 urgently needed new homes. (L&Q, 21 July, 2017)

By combining assets, these newly formed mega-mergers have been able to borrow more than previously. The senior executives and board members also argued that this in turn increased their capacity to build more. Whilst the independent experts agreed that these HAs had strong balance sheets and were '*clearly driven by a desire to do to their bit to tackle the housing crisis - as the government expects'* (interview), they tempered the HAs' claims, with a housing consultant contending that:

> '*there is always an element of HAs exaggerating the gains. Bullish statements from CEOs ought not to be the measure of validity of mergers and I have witnessed varying levels of belief by Chairs, CEOs and other executives in their aspirations for new housing supply'*.

Moreover, the independent experts maintained that merger business cases need to be relatively cautious, particularly as the Regulator's in-depth assessment will scrutinise the pledges made and focus on whether the HAs have delivered the new units promised in due course.

Operating efficiency

As Table 2 highlights, there are stark differences in operating efficiencies between Circle and Affinity Sutton, and L&Q and East Thames - measured both in terms of cost per unit of social housing as well as operating ratios. Whilst all of the HAs had been forced to make operating savings as a result of the government's 1% rent cut, the senior executives argued that the savings made per annum would become much greater now that they had merged. Moreover, the mergers had allowed them to employ more specialist staff and introduce leading IT digitalisation, enabling them to provide a 24/7 service delivery and achieve much greater economies of scale and back office savings. As one senior executive noted:

> '*with larger budgets, there is the potential to look at more innovative solutions. Larger organisations can consolidate offices and look at greater investment in technology to reduce costs. We have more options and can share risk'*.

The independent experts, however, tempered these claims, arguing that they were less convinced that the government's 1% rent cuts had driven these large HAs' need to merge, as they could have independently reconfigured their financial plans to cope with reduced rental income. As one housing consultant remarked, '*the merger business cases nearly always blend the efficiency savings, which were already set to be delivered, with others that the merger deal itself would drive'*. Another equally suggested that *'smart board members need to therefore challenge this conflation of gains'*.

As the business literature and previous not for profit housing studies suggest, mergers cannot be seen as an automatic route to more efficiency or better service delivery (Morck et al 1990; CIH 2007; HCA 2016a). As highlighted in table 3, these newly created super-sized organisations are now managing stock across a considerable number of local authorities, although still retaining a presence within inner London to varying degrees. Spreading overheads across a larger geographical area alongside streamlining governance structures will challenge the ability of these larger HAs to remain accountable to their existing tenants, which also runs counter to their philanthropic origins to serve the most vulnerable households living in London.[5] The HAs' senior executives acknowledged that this strategic course of action could potentially result in their organisation sacrificing local accountability to their existing tenants, with one remarking that *'we need to retain our visibility at the local level – and work hard at the local level'.* As their headquarters and operations become more distant from the communities they serve, there is a risk that these large HAs will compromise the needs of existing tenants, and affect the delivery of local services. This concern was born out in an independent investigation into L&Q's maintenance and repairs services on one of its London housing estates, describing the '*poor service', 'inadequate responses' and 'an inability… to act in the residents' best interests'* (Campbell Tickell 2019), with the CEO publically responding '*We at L&Q got it wrong and have let our residents down'* (Montague 2019).

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[5] Peabody Trust was founded in London in 1862, having bought land under a slum clearance scheme to build housing for the poor (Peabody 2019). In 1990, a Victorian entrepreneur bestowed his fortune to Affinity Sutton charitable trust to provide model dwelling housing for poor in London (Clarion 2019); and in 1963 Quadrant London housing Trust was formed to help vulnerable people in London, Essex and South East (L&Q 2019).

Exploiting new business opportunities

A key rationale to merge, expressed by the HAs' senior executives and board members, was the increased ability to extend their geographical reach and expand their commercial activities. As Table 2 highlights, Circle has three times as much surplus coming from non-social housing activities as Affinity Sutton, and L&Q twice the amount generated by East Thames. Each of the HAs had plans to increase the proportion of market sales within their development programmes. As government grant diminishes, the senior executives argued that the cash receipts generated from market sales were needed to cross subsidise the delivery of affordable housing. Despite the exposure to risks associated with wider housing market fluctuations, one suggested:

> '*It will play an increasingly important role in how new homes are funded. If you move away from a grant model you have to look at all sources of capital'.*

It is also striking that in all mergers, one HA has considerably more non-social housing rent generated than the other. The different respondents made it clear their ambition to increase exposure to this market. Although the different pairings were comparatively new to this market, they could now expand their market rental portfolio by merging. It also provided them with more options and ability to share risk, particularly if the HA became overexposed to market sales and house prices fell. They could *'flex the tenure'* (as one CEO remarked, in interview) and switch back into long-term holdings of market rental housing (see also Morrison 2016a).

The HAs' respondents all stressed that mergers also had allowed them to expand into new geographical locations. This was particularly the case for L&Q, which through merging with a considerably smaller organisation allowed it to extend its reach into East London and along the Thames Gateway corridor much more quickly and effectively than through internal growth. Family Mosaic similarly benefited from merging with Peabody that owns 103 acres developable land in Thamesmead, one of the largest development sites in London, to date. As one of the senior executives was keen to emphasise (in interview), *'our merger should result in the 20,000-unit scheme coming to fruition at a faster pace as we can combine our professional expertise and resources in regenerating this major urban extension site'*.

Mergers had also enabled them to compete for larger sites, whereas previously they had been individually looking at primarily smaller (50-300 unit) urban sites. They now could focus on sites that could deliver 1,000 units or more, and where there is less competition from other players (Savills 2017). Yet although the HA respondents argued that they are better placed to address the chronic housing shortages, the respondents confirmed that the share of affordable housing provision would be reduced in their future development programmes. As an independent expert argued:

> '*we must ask if it is the most effective way of delivering more to existing and future HA tenants. We need to make sure HAs are merging for the right reasons'*.

Managerial motivations

Managerial self-interest motives, with the CEO in particular acquiring private benefits are hard to prove in any industry (Shi et al 2017). As L&Q was the larger organisation, its CEO retained his power as the boss, whilst Family Mosaic CEO became the new boss of Peabody, following the previous CEO's retirement. Clarion Group appointed a new CEO following the retirement of Affinity Sutton's boss and Circle's CEO decision to leave the organisation (Barratt 2017). These CEOs' salaries have undoubtedly increased, reflecting the management of a larger organisation. Yet this sparked critical reactions in the media, with The Channel 4 *Dispatches* programme called 'Getting rich from the Housing Crisis' and *The Times* newspaper headline, 'Housing crisis: few social homes to rent but chiefs' pay hitting new high' (Brown 2018; Knowles 2019).[6]

Each of the CEOs interviewed were fully cognisant of the media portrayal of the sector and in particular the salaries that they were paid. As one of the CEOs remarked:

> '*I was interviewed by the board's nomination and remuneration committee, which sorted the final salary package. Of course it is not an open competition. We are all very aware of the damaging reputation once salaries are known. This may sound defensive, but CEOs are held to account to meet targets and quality of service delivery by our board, lenders and the government*.'

However, it is worth noting that CEO pay rises in the HA sector pale in comparison to private sector CEO salaries – which the Chartered Institute of Personnel Development reported had risen by 11% to nearly £4m on average in 2017/8. The average charity CEO salary is also well above most HA bosses (cited in Barnes 2018). Moreover, unlike the private sector that is invariably driven by short-term pressures to maximise shareholder value (Gorton et al 2009), the very nature of the not-for-profit housing sector business model

[6] Clarion's CEO total salary in 2016/17 was reported in *Inside Housing* to be 17.2% higher than his pre-merger total salary at Affinity Sutton (Barnes 2017)

is that they are focused on long-term investments and the stewardship of their social housing assets and local communities. As one senior executive remarked *'we are in this for the long haul.'*

Yet as the business literature suggests, whilst believing that they act in the best interest of their organisation, and for the case of the not-for-profit housing sector in the interests of society, overestimating the positive synergy benefits and underestimating any unintended consequences of mergers are common problems for all sectors (Malmendier and Tate 2008).

5. Discussion

Drawing on business literature of mergers and designing an analytical framework that distinguishes external drivers, internal efficiency arguments and managerial motives, this paper has shed light on the explanations for England's three large-scale HA mergers. The senior executives and board members' justifications centre on their need to respond to contemporary government pressures for greater organisational efficiency and to increase development output. Their rationale for mergers reflects those set out in the business literature, including allowing the organisations to improve operating efficiencies through economies of scale; ability to leverage greater debt finance; exploit new business opportunities; and extend into new geographical areas through mergers (Lambrecht 2004, Mueller 1985, Maksimovic & Phillips 2001). Whilst this explanation for mergers has been presented, the independent housing experts call into question the extent of the anticipated positive synergy gains. Furthermore, previous studies warn that the relationship between size and performance is not straightforward in any sector (Scherer 1988; Gorton et al 2009; Van Bortel et al 2010; HCA 2016).

Scale does not necessarily guarantee automatic efficiency gains or increased development capacity. As a housing consultant suggests,

> '*Business cases for mergers nearly always exaggerate the gains and one is rarely able to identify with objectivity whether the benefits will be realised now or say three years down the track*' (interview).

The managerial motives and senior executives' self-justificatory claims for merger are in effect hard to challenge. As an independent expert raised (in interview), '*the recent wave of*

HA mega-mergers has sparked the question: is bigger necessarily better?'

In contrast to private sector motivations for mergers, not-for-profit organisations do not exist to maximise the benefits to shareholders. They instead need to balance the interests of current and future tenants, *'with an eye to the wishes of central government'* (interview). Although the HAs' respondents argue that by merging they have greater capacity to build more and hence are well placed to address the housing shortages, there still remains a chronic shortage of social and genuinely affordable housing, particularly in London and the South East of England (Morrison and Burgess 2014; Savills 2017). This shortfall may also worsen as these large HAs' development programmes shift towards market sales and rental properties (Manzi & Morrison 2017). Furthermore, there remains a legitimate concern that these merged entities will become less locally accountable and their social purpose compromised, as they move away from their philanthropic, community roots (Campbell Tickell 2019).

7. Conclusions

The English not-for-profit housing sector shares common challenges and expectations as those witnessed internationally (Czischke et al 2012). Amidst pressures to be more efficient and deliver new housing, alongside steep reductions in government expenditure, the propensity for not-for-profit housing organisations to become more business orientated and gain access to the capital markets has increased in England, as elsewhere (Manzi and Morrison 2017). The degree of regulatory and financial independence that allows organisations to pursue merger strategies as a way to reposition themselves varies by country, with English HAs enjoying comparatively greater freedoms than many of their international counterparts (Czischke et al 2012, Housing Europe 2017). Although considerable variety of not-for-profit housing providers exists within and between countries, for Nieboer and Gruis (2016), examining strategies adopted by 'front runner' organisations provide salient lessons for others yet to develop business-orientated strategies.

By investigating England's largest HA mergers, this paper fills an important empirical gap in knowledge and also a theoretical one. Combining the body of literature on private and not-for-profit sector mergers not only strengthens our understanding of what has motivated such mega-mergers, it also offers a way to showcase why the sector is so distinct. Each of the case study HAs provided similar justifications for why they had merged. Moreover, the senior executives' explanations reflected the rationale given for mergers outlined in the for-profit sector literature, primarily centring on financial and operating efficiency arguments, although the expected positive synergy gains were challenged by the independent housing experts. Managerial motivations remain, however, harder to uncover, as they are for any sector. Yet it is also important to re-examine these central arguments presented in business literature in the context of a sector that faces competing accountabilities to the government, institutional lenders, existing tenants and local communities they serve, all of which place conflicting demands on individual organisations. On the one hand, there are pressures for larger and streamlined organisations with resources and influence to compete and operate efficiently. Yet on the other hand, an expectation remains for not-for-profit organisations to be driven by more than just an economic rationale but also to serve a social goal.

Mergers among England's largest HAs have resulted in large-scale entities never witnessed before (Wainwright and Manville 2017). A sector that, in the past, was mainly constituted of small, locally based organisations, has become dominated by large, national organisations (Cross 2016a). Yet mergers that are primarily business driven carry significant socio-economic risks, if commitment to a HA's social purpose is compromised. In line with the work of Hydle (2015), as not-for-profit organisations grow in size, they loose their local presence. The dominance of these large organisations, which are also concentrating on developing for owner occupier and private rental markets, have considerable implications for the wider legitimacy of HAs as independent socially aware agencies within England.

Moreover, these large-scale mergers among England's largest HAs are also comparable to that witnessed in the Dutch HA sector prior to state intervention (Nieboer and Gruis 2016). When Dutch HAs rapidly grew in scale via mergers, they were soon challenged by serious cases of mismanagement, with the state requiring them to return to their core social responsibilities, following the Dutch Parliamentary Inquiry in 2014 (Veenstra et al 2016). As English HAs merge and streamline their structures in the drive for scale and efficiency, they too are likely to become distant from their existing tenants and local communities they serve (Campbell Tickell 2019; Montague 2019).

It has been beyond the scope of this study to examine the longer-term consequences of different HAs' merger strategies, yet longitudinal post-merger evaluations are a critical avenue for future research. A greater number of not-for-profit housing organisations that have undergone mergers should also be examined across England and in different jurisdictions. Collaborative international research would generate wider discussions about how individual organisations balance competing demands and expectations, and how the not-for-profit housing sector as a whole is responding to the fundamental challenges of delivering affordable housing in contrasting settings.

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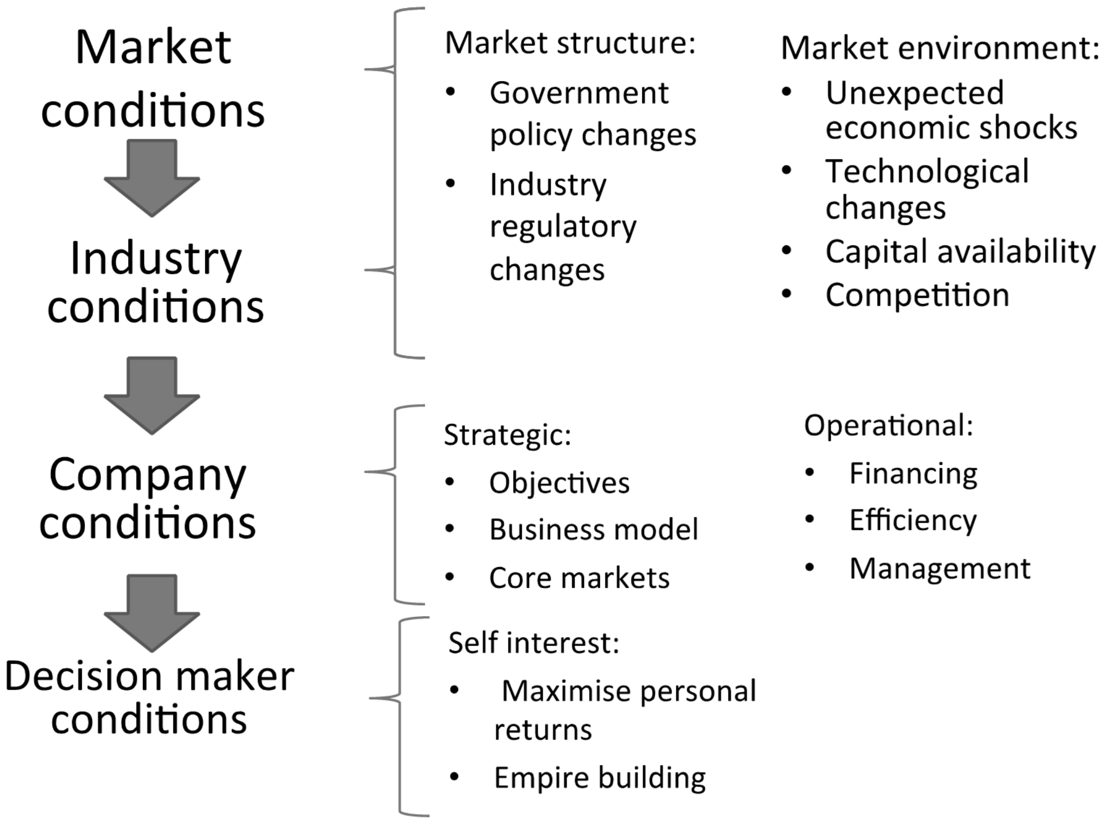
Figure 1: Analytical framework to examine conditions for corporate mergers



(source: Authors)

Table 1 Distinct features of the English not-for-profit housing association sector

	Not-for-profit housing associations	**For profit house builders**
Core activity	Providing affordable and social housing.	Housing development.
Business model	Based on social housing lettings but increasingly supported by commercial activities.	Built to sell and built to let developments.
Profit	Reinvested into core activities	Distributed to shareholders.
Financing	Government grants, retained profits and private and public loans.	Public equity and public and private debt.
Loan security	Government guaranteed rents and social housing assets.	Own assets.
Credit ratings	A (varies)	B (varies)
Regulation	Regulated by Regulator for Social Housing	Regulated as any other private entity.
Voting rights	Public can apply and have voting rights but does not receive shareholder dividends.	Shareholders have voting rights.
Corporate governance	Managers recruit board members.	Shareholders elect the board.
Tax optimisation	Taxable subsidiaries use gift aid to minimize tax at group level	Same as any other private entity.

(source: Authors)

Table 2: Data on the paired housing associations.

(source: compiled by authors from HCA 2016b, 2017, Barnes 2016/7; and HAs' financial accounts)

Size	Affinity Sutton	Circle	London & Quadrant	East Thames	Family Mosaic	Peabody Trust	England total
Total fixed assets	£2,939,629	£3,958,700	£7,747,254	£1,108,059	£2,364,306	£3,032,867	£143,223,847
Turnover	£386,423	£439,200	£719,788	£128,723	£265,640	£351,979	£19,979,660
Total properties held at end of period	£3,169,971	£3,905,400	£7,448,418	£1,049,272	£2,532,306	£2,857,266	£150,589,749
Closing social housing units managed	58,679	62,647	63,604	13,577	24,878	24,598	2744785
CEO compensation	£320,933	£239,109	£344,000	£155,000	£220,000	£223,060	
Operations							
Surplus for the period	£144,779	£85,800	£273,535	£28,036	£73,486	£122,118	£3,341,367
Headline Social Housing Costs per Unit	3.46	4.19	3.32	3.94	6.86	5.79	3.97
Operating Ratio	51%	64%	35%	59%	61%	42%	0%
Social housing Operating Ratio	57%	71%	51%	68%	76%	65%	68%
Financing							
Gearing ratio	40%	53%	27%	53%	30%	36%	45%
Interest cover ratio	3.71	1.95	5.07	2.05	5.11	4.35	
Credit rating pre/post merger (Moody's)	Aa3/A2	A2/A2	A1/A2	A3/A2	A1	A3	
Diversification							
Surplus from sale of fixed assets %	7.13%	26.69%	8.60%	54.70%	56.23%	4.56%	21.58%
Surplus from non-SH activity	7.71%	23.08%	20.58%	11.03%	23.89%	29.50%	15.30%
Surplus from non-SH prop. sale	5.28%	8.97%	6.28%	2.03%	72.74%	32.06%	12.02%
Non SH - Market rent - Surplus	£660	£8,000	£9,014	£0	£0	£2,989	£96,937
Growth							
Total properties added	£136,529	£80,000	£196,853	£20,684	£142,261	£111,653	£5,372,863
% asset growth	4.64%	2.02%	2.54%	1.87%	6.02%	3.68%	3.75%
Social properties Added	1,015	450	419	- 214	504	743	51,333

Table 3: Spatial concentration of the housing associations' assets

(source: compiled by authors from HCA 2016b)

	Affinity Sutton	Circle	London & Quadrant	East Thames	Family Mosaic	Peabody Trust
% in urban areas	89.07%	92.46%	90.03%	99.09%	98.23%	100.00%
no. of LAs covered	104	47	96	27	48	25
Central London LAs	7	8	8	2	8	8
Inner London LAs	8	11	12	2	12	12
After merging						
% in London	44.90%		84.94%		96.78%	
% in inner London	15.75%		36.51%		76.04%	
% in central London	11.38%		26.73%		52.22%	
% in urban areas	89.81%		91.38%		99.07%	
no. of LAs covered	128		102		51	
Central London LAs	8		8		8	
Inner London LAs	11		12		12	