Empire building? Analysing the drivers towards mega-mergers in the English housing association sector

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Abstract

Fundamental changes to the economic climate, government regulations and investment funding have had a profound impact on the operating environment for English housing associations, forcing them to pursue new business models in order to ensure their long-term survival. Whilst mergers are not new for the sector, a new wave of mega-mergers has materialised, with super-sized housing associations projected to become amongst the largest volume housing builders in the country. Scale, however, does not necessarily guarantee automatic efficiency gains or increased development output. Yet with size comes status and influence, strengthening the ability for organisations to shape their operating environment and take control of their future. Drawing on business theory, this paper examines the way in which wider policy and business drivers alongside managers' motivations and strategic choices have culminated towards this mega-merger activity. The paper suggests that this trend is not only changing organisational forms but also transforming the future direction of the sector.

1. Introduction

Not-for-profit housing organisations across the globe operate within an increasingly challenging operating environment, as they perform their core social mission of providing decent and affordable homes to those in greatest need (Morrison 2016a). Within the English housing association (HAs)[1] sector, major welfare reforms and reduced grant funding, coupled with regulatory demands for greater efficiency have driven HAs to re-examine their business strategies and consider mergers with other organisations in order to ensure their long term legitimacy and business survival (Manzi and Morrison 2017).

Mergers, defined as a voluntary amalgamation of two firms on roughly equal terms into one new legal entity, is a common business practice in both the private and not-for-profit sectors

[1] Since 1996, English not-for-profit housing organisations were termed Registered Social Landlords and subsequently Registered Providers, under the provisions of the Housing and Regeneration Act 2008. For the purposes of this paper, the generic term HAs will be used.

as a way to introduce major strategic changes to large organizations (Maksimovic & Phillips 2001). Mergers witnessed in the English HA sector have a long history, with a number of academics examining the rationale for previous waves of merger activity (see e.g. Bortel et al 2010, Mullins 2012, Pawson and Sosenko 2011). From an international comparative perspective, consolidation of the Dutch not-for-profit housing sector via mergers has also occurred over a long period. Organisations have steadily increased in size, with the largest at around 89,000 units. This trend has not only heralded considerable criticism over the potential abuse of their monopoly position from policy makers and academics alike, but it has brought about systemic failure across the sector, requiring state intervention (see e.g. Brown 2012; Van Bortel et al 2010; Veenstra et al 2016).

Although mergers amongst English HAs have not occurred at the same pace as between their Dutch counterparts, a new wave of mega-mergers has begun to materialise in England, with three newly formed legal entities holding stock ranging from 55,000 units to 125,000 units, with the latter (Clarion group) projected to become one of the largest volume housing builders in the country and association across Europe (Cross 2016a). Moreover, compared to their European counterparts, English HAs enjoy a relatively high degree of regulatory and financial independence, which facilitates merging into these super-sized entities, on a scale never experienced before in the country. The resulting increase in concentration of housing stock held by these largest organisations could have profound consequences that are difficult to foresee.

This wave of mega-mergers among the largest London-based housing associations have created considerable political and media interest (House of Lords 2016; Cross 2016a&b; Johnstone 2016). The issue, however, has been largely neglected by housing academics, to date. Limited theorization and academic studies also exist to aid our understanding of the wider policy and business drivers alongside HAs' strategic choices that have culminated towards contemporary merger activity (with the exception of Van Bortel et al 2010, Mullins 2012, Pawson and Sosenko 2011, focusing on previous merger waves).

The purpose of this article is therefore to fill this gap by analysing the common external drivers and contrasting managerial and strategic motivations that led to the three different mega-mergers of London's largest HAs. To do so, the paper draws on business theory of mergers as a way to understand what has motivated these large organisations to merge together. Most of the literature on the business rationale for mergers is drawn from the

private sector, which has a long tradition of analyzing organizational strategies and managerial motivations. Yet, in the private sector, strategic choices are invariably conceived in a profit-making context with the emphasis on optimizing financial performance within the marketplace and maximizing shareholder returns. This paper therefore fills not only an empirical gap in knowledge but also a theoretical one by combining the body of literature on private and not-for-profit sector mergers in order to strengthen our understanding of why this spate of mega-mergers has occurred in the English HA sector.

Finally, the paper concludes by considering the wider policy implications of this strategic direction, as English HAs become increasingly pressured to respond to powerful policy drivers to be more efficient and deliver the government's housing targets. The paper suggests that this wave of mergers is likely to be self-reinforcing, started by these large 'institutional entrepreneurs' (Garud et al 2007), however, others will not want to be left behind, leading to a potential institutional isomorphism over time.

2. Business theory of mergers

External drivers

A growing body of research has emerged focusing on the business rationale for corporate mergers that primarily focuses on the private sector (see Mitchell and Mulherin 1996, Weston et al 1998, Jovanovic and Rousseau 2001). Although each company is unique and mergers are always carefully planned in the context of entity-specific factors (Bris & Cabolis 2008), there are patterns that are common to all firms that can make mergers more likely. Some benefits of this process, such as economies of scale, are an advantage that is both easy to identify and implement which makes it likely to be pursued by all rational market participants (Lambrecht 2004). However, as the obvious opportunities are exploited, market-wide merger activity is likely to be lower (Avkiran 1999). In fact, it appears that over time mergers tend to come in waves and alternate between periods of heightened and low activity (Toxvaerd 2008). This suggests that certain macroeconomic events may make mergers more likely and that some operating environments may be more conducive to this activity.

Although it is still uncertain what exactly stimulates new waves of mergers, some interesting theories can be found in the literature. For example, throughout different phases of the business cycle firms may face different expectations of future growth, which may gradually affect their business strategies and decisions (Fauli-Oller 2000). The same behaviour may be

induced by unexpected economic shocks (Mitchell & Mulherin 1996) 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). In fact, Gorton et al (2009) demonstrate that shifts in regimes can explain why mergers tend to occur in waves. For Gorton et al (2009), mergers can be seen as 'positioning acquisitions' in response to a regime shift so that individual businesses ensure long-term legitimacy and survival. Regime changes can have different levels of influence and Mitchell and Mulherin (1996) show that clustering of merger activity is also likely to occur in individual industries. There is also a large body of financial literature that argues that changes in monetary (Schwartz 2002, Campello 2002, DeYoung et al 2009) and fiscal (Ghosh & Jain 2000) policy may be critical to this process and systematically affect the market. In addition, Rhodes-Kropf and Viswanathan (2004) show that changes in the financial market may also induce incentives for firms to merge.

Organisational motivations

For Thornton and Ocasio (2008), a capacity for agency within a given organisational field enables the mediation of the external operating environment. Focusing on the different strategies and actions at lower levels of analysis (i.e. within firms themselves) illuminates the way firms adapt their mode of operation to regime changes (Zuker 1987). Each organisation is infused with distinctive sets of ideological values, identities, and styles of leadership that shape and interpret their missions, strategies and logics of investment. For Garud et al (2007), certain organisations are in a stronger position to leverage resources and act as institutional entrepreneurs, taking the lead in repositioning themselves in their organisational field and, in doing so, transform it. There is a trade off, however, of waiting to see the best 'cultural fit' versus a pre-emptive move to not be left behind, effectively bringing about a 'race for firm size' (Gorton et al 2009). Making a business case for mergers is therefore critical and each firm needs to focus on the positive synergy gains to be made.

Efficiency benefits

Economic 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). The second focuses on motivations of the key decision makers who are involved in the process (Morck, Shleifer, and Vishny 1990). The efficiency argument centres on different aspects of business productivity, including: operating (Scherer 1988), managerial (Manne

1965) and financial (Lewellen 1971) efficiency. After a merger, 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). In finance, the focus is often on the cost of capital, 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 capital structure and tax optimization (Lewellen 1971). All theories of improving efficiency focus on gains that can be made by adding new skills, resources or markets to an existing portfolio. Their critical assumption is that those 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, 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 act in the best interest of their companies, evidence suggests they may not always be able to 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, Brown and Sarma 2007).

Although the business theory of mergers may appear general, it provides an analytical framework that can be applied to the English not-for-profit HA sector. Prior to this analysis,

the next section provides context to the changing operating environment that individual organisations face.

3. The operating environment of the English HA sector

Housing associations have long been described as 'curious entities' (Malpass, 2000, p.3) being classified as neither market nor state actors. Originally seen as the 'third arm' of housing policy their purpose was to 'fill in the gaps' where state or market provision was unable to provide effective supply (Manzi & Morrison 2017). In terms of their development, Mullins (2006) identifies a number of key phases of activity: 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 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 providers of new social housing through their ability to raise private finance, which in turn enabled them to develop substantial property portfolios (Walker 2000). As a result, the sector gained an increase in market share to 22% of the total stock. 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 followed in 1997, which saw rapid growth through formerly owned local authority stock transfer to HAs, mergers and group structures. A period of agglomeration was also witnessed through subsidy being concentrated on the 'best performing' associations. As Van Bortel et al (2010) suggests, regulatory intervention and a reduction in the number of investment partner associations receiving grant funding were the two key drivers of mergers. These changes involved substantial organisational restructuring with the sector slowly abandoning the idea that they constituted a coherent 'movement' and becoming increasingly entrepreneurial in approach.

Mullins (2010) recounts the efficiency drive in the wake of the Government's Gershon review in 2004, established to review operations across all public services and make recommendations regarding expenditure and efficiency. Mergers became 'a common organisational response to the efficiency agenda, initially resulting in tax and borrowing savings, with limited evidence of organisational savings. However gradually mergers and streamlining of groups generated clearer savings in central services and operating costs to meet tougher business case targets demanded by the Housing Corporation' (p.45). In 2004/6, almost 80% of government funding was allocated to just 70 lead partner associations (Mullins, 2010, p.11).

Following the 2010 General Election, the UK Coalition government continued to promote the sector as providing opportunity to advance their localism agenda, free from bureaucratic restrictions of local government (Manzi & Morrison 2017). However, pressures on the sector 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 housing association tenants and to limit HA rent increases by 1% per annum over a four year period (HM Treasury 2015).[2] Whilst these policy changes were designed to contribute towards eradicating the UK public sector deficit, at the same time they significantly accentuated the levels of risk that HAs face.

Not only have HAs faced pressures of grant reduction, rent restrictions and welfare reform, an increased level of antagonism from central government was reflected in media coverage of the lack of progress made by the sector in meeting the government's housing targets of one million new homes by 2020 (House of Lords 2016). An article in the *Spectator* magazine referred to HAs as 'the true villains of the property crisis' and described as 'combining public sector lethargy and private sector greed' (Clark, 2015). More damaging was an enquiry conducted by Channel 4 news (2015), presented under the headline 'why are housing associations failing to build enough homes?' The evidence presented in the Channel 4 news report (although highly contested) highlighted the way in which management costs have increased as more staff has been employed with above-inflation wage increases, particularly amongst Chief Executive salaries. The sector has thus been portrayed as highly inefficient, generating a wider political debate over scope and responsibility of sector in addressing housing needs (Manzi & Morrison 2017).

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

This argument around the efficiency of the sector was accompanied by a scarcely veiled threat that the government would be prepared to act if housing associations were reluctant to compromise – 'They can either work with us…or there can be a more confrontational relationship, but its not one we seek' (ibid.). The then Prime Minister reinforced this hostility in the House of Commons:

> I think it's vital we reform housing associations 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, response to Jeremy Corbyn, Prime Minister's Question Time quoted in the *Independent*, 18/9/15).

This latter response was highly significant in that the Prime Minister explicitly now saw HAs as inefficient public sector institutions. This view marked a stark contrast with earlier government statements that they were essentially private sector agencies (Manzi & Morrison 2017). As a consequence of this change in perception, the government reclassified spending by HAs as part of the public sector (calculated to incur around £60bn debt), leading to the sector becoming subsequently re-privatised (ONS 2017).

HAs therefore face a challenging policy environment. Whilst the English HA sector has a longstanding history of mergers (Bortel et al 2010, Mullins 2012, Pawson and Sosenko 2011), contemporary organisations face stark decisions about how to reposition themselves in response to the above pressures. These external drivers, in turn, frame organisations' behaviour, intensifying the pressure on HAs to re-examine their strategies and seriously consider mergers as a way to re-position themselves and gain positive synergy benefits.

Moreover, the institutional environment is also rapidly changing in England, with the UK Conservative government taking radical steps in its Housing and Planning Act (2016) to deregulate the HA sector and allow organisations to merge without formal government consent (NHF 2016).

4. Analytical framework

Figure 1 summarises the analytical framework used for this paper, distinguishing between the different levels that trigger merger decisions. This structure is based on the theory outlined in section 2 and allows a means to differentiate between factors that are specific to particular HAs and those that affect the whole sector. Although there are clear external regulatory and

policy changes witnessed that may drive firms to consider mergers, the strategic decision-making is ultimately taken at the managerial level within specific organisations. Moreover, whilst the literature on corporate mergers distinguishes the positive synergy gains to be made, many of the benefits are likely to be specific to the HA sector. As Table 1 highlights, not-for-profit HAs are distinct for a number reasons, thus many of the arguments presented above need to be re-examined in the context of the sector. The approach adopted by this study uses the structure represented in figure 1 and discusses its different levels in the context of the institutional characteristics of HAs and the sector.

Financial efficiency

The legal structure of housing associations has implications for financial efficiency. As non-profit making organizations they do not have shareholders. This invalidates many of the common corporate finance arguments for mergers and acquisitions based on maximising stakeholder interests (De Boer et al 2007). While the financial cost of "equity" (government grants) is low its availability since 1988 has been limited, thus raising debt from the financial markets has become an increasingly popular method of funding expansion in the HA 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. In fact, many HAs have increased their debt levels to a maximum level allowed by their lenders that limits their ability to access additional capital and fund further growth. One advantage of growing in size by merging is obtaining access to capital markets, which is less available to smaller housing associations (Tang et al 2016).

As the bond market is an increasingly popular source of funding in the sector (AWICS 2013), increasing overall size may reduce its cost (Arena 2011). As new developments in areas where land is expensive require large capital investments, small entities may not generate enough cash flow to be able to service the required debt. This results in an incentive to merge with entities that allow balance sheet optimization. Larger asset bases allow HAs to borrow more, thus attracting further investment funds for further growth (Wainwright and Manville 2017).

To attract investment from institutional funders, individual HAs require high ratings from credit rating agencies. Ratings ranging from Aa2 to A1 suggest that the UK government will provide extraordinary support to these organisations, in the unlikely event of the 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 if there is a default on the loan (Tang et al 2016). Despite the strong asset base and income security, there are risks to the lenders in investing in the sector, including capital risk on property value, rental yield risks and political risks associated with changing policies.

Historically, HAs could obtain long-term finance comparatively cheaply from banks as rental incomes were underwritten by the government in the form of 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 will therefore 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 efficiencies

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 government regulatory body, Homes and Communities Agency (HCA) overseeing the HA sector has found no statistical correlation between size of HA and efficiency in terms of unit costs (HCA 2016, p.18). The Chartered Institute of Housing (2007) and the National Housing Federation (2015) 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.

Opportunities to increase operational productivity through acquiring new products, business lines or operating technologies could potentially be achieved by merging with other HAs. One specific operational difference that makes mergers very attractive lies in the distribution of their stock portfolios and hence market share. Each HA has assets that are uniquely positioned and distributed geographically within regions as well as cities (Mullins 2010). Since housing market conditions can vary significantly even within small areas (Szumilo et al 2017), it appears that accessing a new geographical market and spatial diversification could be valid motivations for mergers. In light of the high costs of developing new housing in London, mergers may be a far cheaper method of not only geographical diversification but also increasing the overall asset base.

Managerial Incentives in HAs

Institutional objectives of HAs

Reducing the cost of capital allows increasing profits which is the goal of most private firms, however, it is difficult to show that non-profit making entities have the same objective (Jensen 2001). HAs have an incentive to grow their asset base and increase their development capacity in order to meet the government's expectations in relation to delivering its housing targets. Although inorganic growth may be the fastest way of expanding an entity, it does not create additional houses. However, larger HAs are likely to find it easier to build new houses, as discussed below.

Managerial objectives in HAs

While the institutional objectives of HAs are effectively set by the government it is less clear what incentivises their managers. Without shareholders, corporate governance is difficult and boards of directors lack a direct incentive to exercise control over CEOs. As board member vacancies are open to members of the public, it is also difficult to systematically assess their goals. 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 institution they manage (Grinstein & Hribar 2004).

Since there is some evidence that larger HAs pay their top managers more (Barnes 2016), merging with another HA may increase the total pay of their bosses, thus providing 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). On the other hand, many CEOs are reported to be 'empire builders' and strive to increase the size of the entity they manage even if they do not retain full control (Gaughan 2004).

5. Research methods

The research entailed in-depth case study analysis of the six London-based HAs undergoing mergers, namely London & Quadrant (L&Q) and East Thames; Family Mosaic and Peabody; and Affinity Sutton with Circle HAs. The selection process was therefore purposive (Yin, 2009), and thus provides a means to consider the different motivations behind the three mega-mergers. All the mergers are carefully examined in the context of the analytical framework presented above and supported with evidence from interviews with key decision makers and financial accounts of all analysed entities.

In-depth semi-structured interviews were conducted with the chosen HAs' senior executive teams. The purpose was to determine the extent to which prevailing external policy, regulatory and financial environment had influenced their merger decisions; the managerial reasoning behind the merger, and the ways in which chosen courses of action allowed organisations to ensure positive synergy benefits.

Given that senior managers would be expected to reaffirm their strategic direction in a positive light, it was critical to compare the interview responses with documentary evidence, including the HAs' annual reports, financial accounts, HCA Global Accounts, Statistical data returns and company press releases, to ascertain how far the claims could be verified or refuted by other forms of data (Manzi and Morrison 2017). The data has been collected specifically for the purpose of examining the claims made by senior executives and evaluating the arguments presented in section 4. Although no post-merger data is available table 2 shows the structure of each of the merging entities and allows the drawing of conclusions on the likelihood of certain factors playing a key role in merger decisions.

This form of analysis therefore makes use of a variety of spoken and written sources, in order to explain organisational strategic priorities and rationale for mergers (Morrison 2016a). Since the mergers are in their infancy (at the time of writing), it is not possible to evaluate the anticipated positive synergy benefits, however, the external drivers and managerial motivations to proceed with mergers can be investigated.

6. Research findings

External drivers towards mega-mergers

Each of large London-based 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 2015). 'I think we are at a genuine historical moment in post-war housing history' as one suggested. As this CEO explained 'what we are seeing today are the fruits of this new reality, which is a massive wave of consolidation within the sector'.

The impact of the rent reduction has been highly significant for a sector that has over time increasingly relied on a steady income stream. Projections have had to be radically altered which has hugely affected business plans. Combined with a withdrawal of government subsidy, organisations have been forced to rely on their own resources. At the same time, extensive political and public hostility towards the HA sector suggesting that they are not efficient nor building enough has forced HAs to proactively respond. 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'

This response culminated in 2016/7 in the completion of three of the largest mergers witnessed in the English HA sector, to date. Affinity Sutton and Circle formed the newly branded Clarion organisation, managing over 125,000 units across 176 local authorities; London & Quadrant (L&Q) and East Thames Group merged, managing over 90,000 units and remaining branded as L&Q given the size of this entity; and Family Mosaic and Peabody merged, managing over 55,000 units and operating under the name Peabody, given this brand's stronger 150 year-old historical roots. Combining annual turnover and total balance sheets assets through mergers was justified by all the CEOs as - 'enabling us to do more together than we could achieve alone' (interviews).

The three pairings have many differences but also many similarities that are useful in informing the potential synergy benefits of individual mergers. For example, Circle is 35% bigger than Affinity Sutton, while Peabody is 28% bigger than Family Mosaic in terms of the social housing units managed. Yet overall, in terms of size of the merging entities these two

mergers are similar and 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 'take over' (Gorton et al 2009), as East Thames Group becomes a newly formed subsidiary of L&Q. After all mergers, the three new legal entities will be relatively similar in size. If it did not merge with East Thames L&Q would no longer be the largest one. Although not explicitly stated, it is feasible that L&Q merged to retain the top position and maintain its strategic influence. As one of the CEOs in a newly formed mega-mergers noted in interview:

> '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 want to be in that discussion'.

Although it is too early to analyse if the respective HAs' business cases to merge will come to fruition, table 2 compares the different pairings prior to merger to gauge the potential synergy benefits. These observations were also verified in interview with the senior executives.

Financial efficiency

As a result of lower gearing and higher interest cover ratios, Affinity Sutton's credit rating is better than Circle's prior to the merger but downgraded after it to Circle's level (Cross 2016a). The same happened to L&Q after it merged with East Thames (Johnstone 2016). L&Q's very strong credit rating in effect suffered from merging with East Thames. It also changes their level of gearing, as East Thames has a lot more debt in their structure. It is likely that Family Mosaic will also suffer a downgrade, while Peabody benefit from an upgrade (Cross 2016b).

However, the CEOs stated in interview that although they took the risk of their credit ratings being downgraded, it was considered a balancing act as larger entitites provide 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 may go

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

Moreover, by having combined assets, these newly formed mega-mergers will be able to borrow more and hence build more, thus fulfilling government expectations. As a CEO argued:

> 'The end result will be a balance sheet with the capacity to increase development numbers from about 1000 homes p.a. between us to about 1400 homes minimum – a 40% increase. It beautifully illustrates the model – by bringing together two organisations that are doing their bit to meet housing need you can suddenly create massive more capacity (Interview).

Operating efficiency

As table 2 highlights, there are stark differences in operating efficiencies between Circle versus Affinity Sutton and L&Q versus East Thames - measured both in terms of cost per unit of social housing as well as operating ratios. This suggest potential for a synergy benefit if the less efficient entity can improve its operating performance. Whilst all the HAs had been forced to make operating savings as a result of the government's 1% rent cut, by 'cutting the fat in our organisation' as one CEO called it, once the mergers proceed the savings made per annum were predicted to be much greater.

Each of the CEOs argued that a key benefit to merging was the ability to introduce IT digitalisation, enabling them to provide a 24/7 service delivery and achieve much greater economies of scale and back office savings. As one CEO noted 'larger organisation are able to invest in the best IT systems as we have more options and can share risk'. The CEOs, however, acknowledged that this strategic course of action could potentially result in the organisation losing local accountability with its residents, with one remarking that 'we need to retain our visibility at the local level – and work hard at the local level'.

As discussed above, mergers, however, cannot be seen as an automatic route to more efficiency or better service delivery (CIH 2007; HCA 2016). Whilst the newly formed legal entities have restructuring plans in place to realise these operating benefits, organisational and cultural change, by necessity, takes time to embed.

Exploiting new business opportunities

A critical argument to merge, expressed by all the CEOs, was the increased ability to access new business 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. This indicates that there may be potential for synergy benefits of acquiring new business lines. It is also striking that in all mergers one HA has considerably more non-SH rent generated than the other. The different CEOs made it clear that their ambition to increase exposure to this market also provided a strong reason for merging. Although the different pairings were comparatively new to this market, they could now expand this portfolio by coming together. 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' and switch back into long-term holdings of market rental housing (see Morrison 2016a).

Another crucial synergy gain to each company was reaping the benefits of expanding their market share, particularly into new geographical areas. This was particularly the case for L&Q that is merging with a considerably smaller organisation primarily to extend its reach into East London and along the Thames Gateway corridor. Family Mosaic similarly benefits from merging with Peabody through its previous acquisition of 103 acres developable land in Thamesmead in 2014, which represents one of the largest development sites in London, to date. The mega-merger will result in the 20,000-unit scheme coming to fruition at a faster pace, as the two companies combine their professional expertise and resources in urban regeneration.

Managerial motives

Managerial self-interest motives, with CEO in particular acquiring private benefits are hard to prove in any industry (Shi et al 2017). At the same time, although HAs' CEO remunerations are recorded, many of the in-kind benefits go un-reported (Barnes 2016). There is also no comparable benchmark on what salaries should be as there is no shareholder accountability. Each of the CEOs interviewed were fully cognisant of the media portrayal of the sector and in particular the salaries that they were paid. Whilst it was clear that the decision to merge was taken by the CEO and Chair of the Board, after due diligence, special general meetings were held with their respective shareholders. Although having only a nominal £1 voting right in each case, these shareholders hold little power in the decision-making.

Moreover, the way in which power was controlled among the different HAs' CEOs on merger was equally resolved. As the larger organisation, L&Q's CEO retained his power as the boss, whilst Family Mosaic CEO becomes the new boss of Peabody, as the previous CEO retires. Affinity Sutton's CEO becomes the boss of Clarion Group, as the result of Circle's CEO decision to leave the organisation. These chief executive salaries will rise reflecting the management of a larger organisation, yet as one of the CEO's 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.'

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 is that they are focused on long-term investments and the stewardship of their social housing assets and local communities. The strategic decision to form mega-mergers as a way to stay relevant, meet government expectations, and be part of the solution to addressing UK's housing crisis, thus clearly underpinned managerial motivations. Yet as the business theory literature suggests, whilst believing that they act in the best interest of their organisation, and for the case of not-for-profit HA sector in the interests of society, overestimating the synergy benefits can be relatively common (Malmendier and Tate 2008).

7. Conclusions

For Thornton and Ocasio (2008), struggles to ensure legitimacy, control over market competition and respond to state rules and regulations inevitably shape business logics of behaviour and action. Consolidation through mergers in effect offers such an adaptive solution, allowing firms to reposition themselves through positive synergy gains. As Gorton et al (2009) suggest, mergers in effect become 'a defensive response to changing adverse circumstances', with entrepreneurial organisations strategically acquiring before they become the target of the acquirers or else there is less to pick from.

Within the English HA sector, debates about mergers have been longstanding (Mullins 2006). Writing over a decade and a half ago, Malpass (2000) argued that 'voluntary housing has changed, virtually out of recognition, transformed to a point where the voluntary element is

of symbolic relevance only' (p.272.). A sector, that mainly constituted of small, locally-based organisations, has become dominated by large, national institutions. Moreover, as tensions in the English HA sector mount through the removal of public subsidy, by changes to regulatory frameworks and an operating environment characterised by chronic uncertainty, this wave of mega-mergers marks a new chapter in the sector's history.

This paper has shed light on why this new breed of super-HAs has arisen in response to contemporary government pressures for greater efficiency and to increase development capacity. At the same time, managers are motivated by the opportunities to increase leverage, extend organisations' market reach, enter new business opportunities and improve operating efficiencies through economies of scale.

For Garud et al (2007), rather than conformity, these 'institutional entrepreneurs' that take the lead focus on ways to enhance their long run survival not only through restructuring organisational arrangements but also by challenging prevailing logics. With size comes status and influence, strengthening the ability for organisations to shape their operating environment and take control of their future (Gorton et al 2009). This new sub-group of large organisations, that are now directly comparable in scale to the FTSE 100 corporates, will potentially want greater freedom of action and less restrictive agreements that are similar to those put in place for large corporations (Cross 2016a). The ability to set their own rent increases if they increase development output could become a critical bargaining tool in future negotiations with the government.

Whilst the wider business and political environment has created a climate for the latest wave of mega-mergers, it has been beyond the scope of this study to examine the longer-term consequences, since each is in its relative infancy. Whether their business case for mergers comes to fruition is thus too early to tell. An important question, however, remains over the extent to which they achieve the positive synergy benefits expected and help towards meeting government housing targets.

As business theory and previous studies suggest, the relationship between size and performance is not straightforward in either the profit or not-for-profit sectors (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 anticipated. Instead costs will be incurred as these new legal entities undergo organisational change in order to realise scale-related benefits (CIH 2007).

HAs will continue to face competing sets of expectations. As Mullins (2006) contends, on the one hand, are pressures for larger and streamlined organisations with resources to survive in a highly competitive market. Yet on the other hand, an expectation remains for them to be local responsive organisations, in touch with communities, providing opportunities for residents to participate in decision making and supporting local community activities and social enterprises. Yet ultimately, local accountability may be sacrificed as organisations strive for scale in the name of efficiency and to maximise development output. Moreover, the drive to build more may be at the expense of creating a tenure mix, with genuinely affordable housing provision.

Through focusing on this critical juncture of mega-mergers, the paper also suggests that this trajectory of change will continue for the HA sector as a whole. Others will start to follow, resulting in institutional isomorphism, as they do not want to be left behind (Powell and DiMaggio 1991). Yet as HAs converge towards an increasingly market logic, a 'race for firm size' (Gorton et al 2009), and empire building, it is potentially at the expense of local accountability and the future of affordable housing provision in England's modern welfare state.

When Dutch HAs rapidly grew in scale, via mergers, they were soon challenged by serious cases of mismanagement and eventually the State intervened (Veenstra et al 2016). Given this context, the extent to which the English HA sector continues to pursue a growth strategy that is inexorably linked with a commercial logic, their distinctive social purpose and local accountability may therefore be in some jeopardy. An inability to deliver decent housing to those with least ability to pay and a lack of responsiveness to localised household needs, particularly to those most vulnerable, will in turn have wider implications for English urban policy (Manzi & Morrison 2017).

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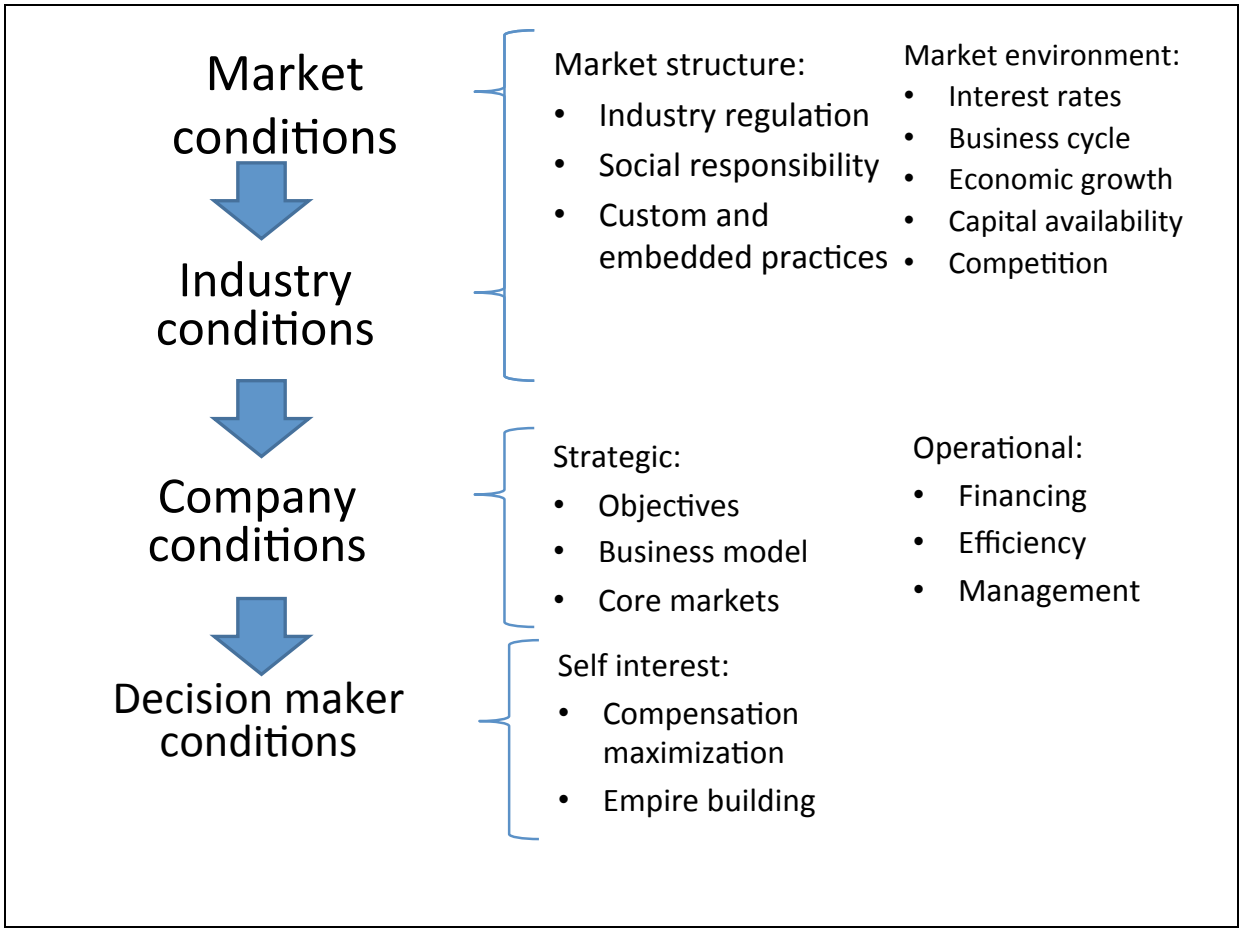
Figure 1: Analytical framework to examine conditions for corporate mergers



(source: Authors)

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

-	**Not-for-profit housing association***	**For profit house builder***
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	Three sources of finance: 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 Homes and Community agency	Regulated as any other private entity.
Voting rights	Public can apply and to have voting rights but does not receive dividends.	Shareholders have voting rights.
Corporate governance	Board members are recruited by shareholders and managers.	Shareholders elect the board.
Tax optimisation	Taxable subsidiaries use gift aid to minimize tax at group level	Same as any other private entity.

N.B * = represents a 'typical' entity in each sector

(source: Authors)

Size	Affinity Sutton	Circle	East Thames	London & Quadrant	Family Mosaic	Peabody Trust	England total
Total fixed assets	£2,939,629	£3,958,700	£1,108,059	£7,747,254	£2,364,306	£3,032,867	£143,223,847
Turnover	£386,423	£439,200	£128,723	£719,788	£265,640	£351,979	£19,979,660
Total properties held at end of period	£3,169,971	£3,905,400	£1,049,272	£7,448,418	£2,532,306	£2,857,266	£150,589,749
Closing social housing units managed	58,679	62,647	13,577	63,604	24,878	24,598	2744785
CEO compensation	£320,933	£239,109	£155,000	£355,105	£220,000	£223,060	
Operations							
Surplus for the period	£144,779	£85,800	£28,036	£273,535	£73,486	£122,118	£3,341,367
Headline Social Housing Costs per Unit	3.46	4.19	3.94	3.32	6.86	5.79	3.97
Operating Ratio	51%	64%	59%	35%	61%	42%	0%
Social housing Operating Ratio	57%	71%	68%	51%	76%	65%	68%
Financing							
Gearing ratio	40%	53%	53%	27%	30%	36%	45%
Interest cover ratio	3.71	1.95	2.05	5.07	5.11	4.35	
Credit rating pre/post merger (Moody's)	Aa3/A2	A2/A2	A3/A2	A1/A2	A1	A3	
Diversification							
Surplus from sale of fixed assets %	7.13%	26.69%	54.70%	8.60%	56.23%	4.56%	21.58%
Surplus from non-SH activity	7.71%	23.08%	11.03%	20.58%	23.89%	29.50%	15.30%
Surplus from non-SH prop. sale	5.28%	8.97%	2.03%	6.28%	72.74%	32.06%	12.02%
Non SH - Market rent - Surplus	£660	£8,000	£0	£9,014	£0	£2,989	£96,937
Growth							
Total properties added	£136,529	£80,000	£20,684	£196,853	£142,261	£111,653	£5,372,863
% asset growth	4.64%	2.02%	1.87%	2.54%	6.02%	3.68%	3.75%
Social properties added	1,015	450	- 214	419	504	743	51,333

Table 2: Data on the paired London-based Housing Associations

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