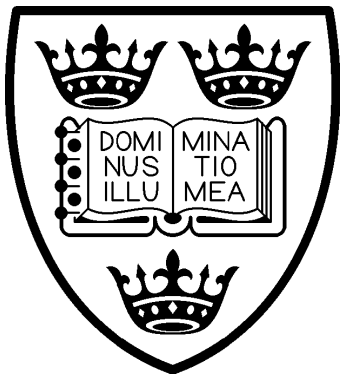


UNIVERSITY OF OXFORD

Discussion Papers in Economic and Social History

Number 86, January 2011

'THE PARADOX OF SUCCESS': THE EFFECT OF GROWTH, COMPETITION AND MANAGERIAL SELF-INTEREST ON BUILDING SOCIETY RISK-TAKING AND MARKET STRUCTURE, C.1880–1939

Luke Samy

'THE PARADOX OF SUCCESS': THE EFFECT OF GROWTH, COMPETITION AND MANAGERIAL SELF-INTEREST ON BUILDING SOCIETY RISK-TAKING AND MARKET STRUCTURE C.1880-1939

Luke Samy

Winton Institute for Monetary History
and
Nuffield College
University of Oxford

<luke.samy@nuffield.ox.ac.uk>

Abstract

Some scholars have posited that mutual banks have fewer incentives to engage in excessive risk-taking than joint-stock banks because of the unique structure of property rights in the mutual firm. This paper uses their theory as a framework to explain the divergent risk-taking behavior of building societies between the pre-war and the inter-war periods, and between large and small societies in the latter period. It is argued in this paper that the low risk-taking behaviour predicted of mutual financial institutions like building societies can only be expected of small, regional societies which were less exposed to competition than their larger, city-based counterparts which competed more aggressively for investor funds and mortgage business. In the inter-war period, increased competition between societies led to levels of risk-taking hitherto unseen in the movement, leading to calls by the movement's leaders to consolidate the sector into the hands of a few large societies. This process of consolidation promised to benefit members and to improve the overall efficiency of societies in the movement. The actual experience however shows that these promises were largely unmet. Rather, it is shown that the only beneficiaries of firm growth were building society managers, who were able to extract higher pay from empire building.

I. Introduction: Theory and History

There is a strand of literature on the theory of the firm which posits that mutual banks make for more stable financial institutions than joint-stock banks. Two papers in particular[1] argue that the structure of property rights in a mutual bank incentivises its managers to restrict themselves to low-risk investments, thereby producing an inherently more stable organisation than their joint-stock counterpart, which faces more pressure to invest in riskier projects in order to deliver higher returns to its shareholders. This paper uses these theories as a framework for analysing the risk-taking behaviour of building societies between 1880 and 1939, and revises them to better capture the nature and the evolution of building society behaviour during the period.

According to Rasmusen, the inability of owners to control managerial decisions, and the non-distribution constraint on profits, are two key differences which distinguish mutual banks from stock-based banks. In a mutual bank, the structure of voting rights, in allowing only one vote per member irrespective of capital contribution, precludes the concentration of ownership by members and thereby frees managers from the threat of outside control. This freedom from stakeholder interference is further reinforced by the non-distribution constraint on profits, which means that firms have no residual claimants and thus no competition between patrons for the profits generated by the firm. As a consequence, owners have weak incentives to monitor managers and to pressure them to be more efficient, giving greater latitude to managers to choose their preferred portfolio of investments. In a joint-stock bank however, stockholders are residual claimants, and so have incentives to ensure that managers minimise costs and maximise returns. If stockholders are unsatisfied with the performance of managers, they can combine to pressure management to run the bank more efficiently. Even where ownership is diffuse, the threat to managers of being disciplined by owners still exists, as any individual owner (or a coalition of owners) can concentrate ownership by buying enough shares from other shareholders in order to make disciplining profitable to himself (themselves). As a result, the threat of being ousted by owners forces managers to be more responsive to their preferences.

The implications for firm behaviour which result from this were spelled out by O'Hara. Because the manager of a mutual bank is undiversified in his earnings capacity (being as he is a full-time employee of the bank),[2] his lifetime flow of income is dependent on the success of the firm's investments and he will therefore be averse to firm-specific risk. As a consequence, he is more inclined to shore up the stability of the firm by investing in safe, low-yielding investments and by building up a large capital reserve to reduce the chances of bankruptcy. The fact that owners are not residual claimants in the mutual means that they will be indifferent to this policy.

---

[1] O'Hara, 'Property rights and financial firm'; Rasmusen, 'Mutual banks and Stock Banks'.

[2] As full-time employees of the firm, and usually middle-class in status, managers derive their income only through their employment by the mutual.

The manager is free to operate the firm without the threat of being dismissed by owners who are dissatisfied with the earnings performance of the society, which in turn reinforces his tendency to choose safer portfolios of investments. This tendency constitutes the very basis for the mutual's safety and hence its popularity among rational but uninformed investors, who are unwilling or unable to monitor managers to ensure that their capital is not put at undue risk.[3] In this way, Rasmusen defines a mutual bank as:

> a **self-reinforcing contract** [emphasis added] in which managers provide low-risk banking services to rational but ill-informed savers who are risk averse and unprotected by deposit insurance.[4]

The historical record of building societies in England however provides a more nuanced picture of the risk-taking propensity of financial mutuals. To wit, two distinct lending regimes can be seen between the pre-war and inter-war periods, as well as between large and small societies[5] within the movement. In the pre-war period, building societies behaved in a predominantly prudent manner, rarely lending more than 75 to 80 per cent of the purchase price of the properties mortgaged to them, and in most cases restricting their lending to within close proximity of their head offices. The predominantly relational nature of their lending – owing to their relatively small size and localised presence – meant that they had good information about their borrowers, and were able to employ non-contractual means (peer pressure, local business connections etc.) to ensure repayment. As a consequence, default rates were low,[6] and the exposure of the societies to capital losses on their mortgage assets was minimal.

In the 1930s however, the lending behaviour of societies within the movement diverged dramatically. Table 1 shows the contrast in the lending behaviour of a selected number of building societies in operation between the two periods, based on

---

[3] Rasmusen, 'Mutual banks and stock banks,' p.398.

[4] Ibid, p.396.

[5] 'Large' building societies were those identified as large by the Chief Registrar of Friendly Societies in his *Annual Reports.* This was on the basis of the size of the mortgage assets of a society. For example, societies with mortgage assets of more than £300,000 were considered 'large' in 1900, and the threshold gradually rose over time to the level of £1.5 million by 1937. Building societies classified as 'small' for the sake of subsequent analysis and discussion were those with less than 1 per cent market share, but which were located in remote, low populated areas (i.e. towns with less than 100,000 inhabitants in 1900). 'Medium' building societies were those societies that were not classified by the Chief Registrar as large, but which were headquartered in major towns (i.e. towns with more than 100,000 inhabitants in 1900) and were thus in direct competition with large building societies. Because of this latter criterion, some medium-sized societies were in fact smaller in size than some of the 'small' building societies in the sample.

[6] The average annual rate of loan defaults in the movement, as reported in the Annual Reports of the Chief Registrar of Friendly Societies, fluctuated between 4 and 8 per cent between 1900 and 1914 (Source: Chief Registrar of Friendly Societies (RFS), *Annual reports*, various issues). These official figures were higher than the average default rates of 33 building societies (large and small throughout England) whose annual returns to the Chief Registrar were analysed for the purposes of this paper. These varied between 0.8 to 3 per cent between 1900 and 1914. The average rates however belie the large variation in the defaults experience of individual societies, with some having few or no defaults at all.

mortgage data derived from the minute books and mortgage registers of the societies included in the table. In the pre-war period, few of the loans made by building societies exceeded the prudential threshold of 75 to 80 per cent loan-to-value, the exceptions being the London Grosvenor (LGBS) and Newcastle Portland (NPBS) building societies, two small societies whose median LVRs were above the prudential threshold. In these two cases, the higher LVRs are not reflective of their stronger risk-taking tendencies, but of the greater level of trust between the societies and their borrowers. Indeed, it was not uncommon for small societies - which tended to have better information about their borrowers – to lend at higher LVRs to their most trustworthy customers. The same interpretation however cannot be applied to the increased risk-taking by large building societies in the 1930s. The average LVR on loans made by these societies – viz. the Co-operative Permanent Building Society (CPBS, London), Northern Counties Permanent Building Society (NCPBS, Newcastle-upon-Tyne), Eastern Counties Building Society (ECBS, Ipswich) and Ipswich & Suffolk Building Society (IFLS) – rose to around 90 per cent, with a larger proportion of loans being made at even higher LVRs than before. This was symptomatic of the well-documented 'lending frenzy' of the 1930s, where the larger building societies competed vigorously for business by lowering their prudential standards in order to expand the market for their mortgages.[7] In stark contrast, the smaller societies displayed little change in their risk-taking behaviour, if anything becoming more cautious during the inter-war period. The nature of risk-taking by the larger societies however was not limited to lending at higher LVRs. The repayment period of loans was extended in order to reduce the monthly outlay on loans, and societies ran down their reserves and financed more of their loans with debt in order to achieve higher growth rates.[8] Moreover, the sheer expansion in the size of the large societies also meant that they had weaker social ties with their borrowers, further raising the risks of adverse selection and moral hazard. In the end, the poorer informational capital they had, combined with the higher levels of risk-taking on their loans, culminated in the massive spike in arrears and repossessions which many of these societies experienced at the onset of the Second World War,[9] sparking fears among government officials about the solvency of societies with assets exceeding £1,000,000.[10]

---

[7] A detailed analysis of the lending practices of large building societies during the lending frenzy can be found in Speight, 'Building society behaviour,' pp.189-239.

[8] On aggregate, the ratio of non-mortgage assets to total assets fell from 14 per cent in 1920 to 6 per cent by 1939. Leverage - the ratio of debt (deposits plus loans from banks) to total liabilities - also increased slightly during the 1930s from 22.3 per cent to 25.3 per cent (*Source*: RFS, *Annual reports*, various issues).

[9] Many large and medium building societies experienced an unprecedented spike in the number of loans that fell into default after War broke out in 1939. In many cases, this was in stark contrast to a record of little to no arrears or repossession for the previous two decades. In 1942, all of the large societies in our sample had a large number of loans in arrears, such as the Burnley with 47 arrears, the Co-operative Permanent with 277, the Huddersfield with 53, the Leeds Permanent with 267, the National with 376, and the Westbourne Park with 696 loans in arrears.[9] These numbers may have been low compared to the total number of mortgages held by these societies, but they expose the poor quality of loans made in the 1930s.

[10] Speight, 'Building society behaviour;' Cleary, *The Building Society Movement*.

Table 1: LVRs on loans by selected building societies Pre-war vs. 1930s

	Pre-War (1880-1913)			1930s (1930-1939)		
Society	**Median LVR (%)**	**% of loans with LVR > 0.90 (%)**	**% of loans with LVR > 0.95 (%)**	**Median LVR (%)**	**% of loans with LVR > 0.90 (%)**	**% of loans with LVR > 0.95 (%)**
CPBS	80.0	8.2	4.0	91.0	53.8	18.3
NCPBS	81.1	4.3	2.1	89.0	20.9	1.0
ECBS	79.5	15.2	6.5	n/a	n/a	n/a
IFLS	n/a	n/a	n/a	90.0	49.4	27.8
LGBS	85.1	36.5	26.9	81.8	20.8	12.6
NPBS	87.3	28.5	4.06	75.0	8.4	1.7

Note: Unabbreviated names of the societies and other details about the case studies such as the number of loans entered for each society are provided in Table A1.1 in Appendix 1. *Sources*: Minute books and mortgage registers of selected societies.

The spike in defaults after the outbreak of War in 1939 exposed an even more insidious aspect of the lending frenzy: lending to sub-prime borrowers. Table 2 shows the average ratio of debt outstanding on loans to the original loan amount, as well as the proportion of loans whose outstanding debt was greater than the original loan amount for a group of large, medium and small societies. The figures are based on information taken from the annual returns of 33 building societies spread throughout England between 1896 and 1945. The *Building Societies Act* of 1894 required building societies to furnish lists of all loans which were in arrears for three months or more, as well as all properties that had been repossessed and that had remained in possession of the society for 12 months or more, as an additional schedule to the main financial reports that had to be submitted annually to the Chief Registrar of Friendly Societies. The schedules required the disclosure of detailed information for each distressed loan, such as the original loan amount, purchase price, debt outstanding on the loans, loan date and date of repossession, number of months in arrears and so on. As such, they provide an invaluable source of information to assess the riskiness of the loan terms made to borrowers that would eventually default, and to investigate the severity of the defaults which occurred. Table 2 clearly shows an increase in the proportion of borrowers who were simply unable to repay their loans in the 1930s, as represented by the large rise in the proportion of defaulting loans whose outstanding debt levels were greater than the original loans amounts. The median ratio was one for large and medium-sized societies, with nearly half of the defaulting loans given to people who were clearly unable to repay them. These were much higher levels than

those seen in the pre-war period. Most the defaults came from the annual reports in 1940 and 1941, and the average age of these loans was between to 4 to 5 years, suggesting that many of the loans made in the 1930s were to sub-prime borrowers that were being kept on the books in order to conceal the bad quality of loans being made. The differential behaviour of large and small building societies is again borne out in the table, which shows that the small societies were far less reckless in their lending. Indeed, the bad debt experience of small societies was much less serious than those of their larger counterparts. Every one of the seven building societies which had no arrears or repossessions in the 1940s in our sample of 33 societies were small and located in regional areas, viz. the Warwick & Warwickshire Permanent, the Barnstaple Permanent Mutual Benefit, the Cambridgeshire Permanent Benefit, the Grantham Permanent Benefit, the Saddleworth Permanent Benefit, the Saffron Walden & Essex Mechanics Permanent Benefit and the Swindon Permanent building societies.

Table 2: Ratio of debt owing to original loan amount on distressed loans: Pre-war vs. Housing Boom

Society	Pre-War		Housing Boom (1932-1938)	
	Debt Outstanding : Loan Amount	**% of loans with Debt : Loan Amount > 100%**	**Debt Outstanding : Loan Amount**	**% of loans with Debt : Loan Amount > 100%**
All (33)	0.76	15.5	1.01	44.7
Large (14)	0.76	13.1	1.02	42.5
Medium (9)	0.77	16.3	1.00	58.2
Small (10)	0.83	26.1	0.89	25.0

Note: Of the 33 societies represented in the table, 14 were classified as 'large,' 9 were classified as 'medium,' and 10 were 'small.' *Source*: Annual reports, various societies (see Appendix 1).

The divergent behaviour of the large societies from the low-risk behavioural equilibrium predicted by O'Hara and Rasmusen's models of mutual bank behaviour highlights the sensitivity of their predictions to the underlying assumptions of their models. Indeed, it is argued in this chapter that the divergence in firm behaviour can be attributed to the violation of all but the first of these assumptions in the case of the large building societies in the inter-war period, when such societies effectively became more like joint-stock banks than mutual firms. To wit, in what follows, it is argued (1) that the non-distribution constraint on profits was circumvented by the increase in competition in the building society market, as it gave investors the ability to easily punish building societies offering lower returns than rival societies in the same area, and thereby force societies to offer higher returns to members; (2) that

managers were in practice able to influence the level of their pay through empire building, giving them a direct incentive to pursue a high-growth strategy that compounded the competitive pressures forcing managers to liberalise loan terms and take on more risk in the inter-war years; (3) that the professionalization of the managerial class meant that building society managers were employable in other financial institutions, and thus that their future earnings capacity was not purely tied to the fortunes of the society or the building society sector more generally; and (4) that the growing practice of amalgamations effectively meant that the value of building societies could be realised and exchanged, and more importantly, expropriated by managers of both the acquiring and the acquired societies who determined the distribution of the reserve assets of the acquired society. Altogether, these various developments changed the incentive structure for risk-taking by managers in the inter-war period, and with it the subsequent behaviour of the larger firms in the movement. These are discussed in turn.

II. Revising the O'Hara-Rasmusen Theory: The role of competition and the changing face of the building society investor

Three particular aspects of the English context are important to explaining the divergent behaviour of building societies in England compared to those in the United States in the inter-war period, namely: (1) the role of increased competition on managerial incentives to take on risk; (2) the role of the changing socioeconomic profile of building society investors on the objective functions of building societies during the period; and (3) the ability of directors to influence their emoluments. Each of these aspects constitute violations in the key assumptions behind O'Hara and Rasmusen's models of firm behaviour. The models themselves were designed to represent the particular context of mutual banks in the United States, which before financial deregulation in the 1980s was a sector of highly localised institutions subject to strict legislative restrictions on branching, expansion and managerial pay.[11] As a consequence, in this highly segmented market, mutual banks in the US traditionally faced much less competition from other mutual banks, or even other financial institutions in the particular market niche they served. Their purely local character meant that their members were mostly composed of local townspeople, and indeed, according to Rasmusen, the mutual banks were favoured precisely by those 'rational but ill-informed savers' who were 'unable or unwilling to monitor the [asset] portfolio' of the firm. Their mutuals were attractive to them because of the inherently 'stronger incentives [for managers] to choose a safe portfolio," and indeed in practice, mutual managers were more prudent than their joint-stock counterparts.[12]

The market conditions and regulatory environment in which the building societies in England operated on the other hand were different. While the building societies of the pre-war period were much like their counterparts in the US, i.e. predominantly small and localised, they were not prevented by law from expanding geographically. Indeed, by the middle of the inter-war period, all of the large building societies had a nationwide network of branches and agencies. As a result, expansion brought the building societies into direct competition with each other as well as with other financial institutions, forcing them to act in a way contrary to the conservative behaviour expected of them in O'Hara and Rasmusen's theory. Indeed, it is posited here that it is only under the conditions of a segmented, localised market of small societies that the prediction of low risk-taking by mutual managers is more likely to be validated. Such conditions characterised England in the pre-war period when market concentration and competition were low, and even in remote areas in the inter-war period that continued to have only a single building society serving the needs of the local market. For societies located in larger and competitive markets however, competition necessitated greater risk-taking and a change to the way in which the

[11] Many states prohibited branching of banking institutions until financial deregulation in the early 1990s. Regulation Q prevented interstate branching of federal banks in jurisdictions where bank branching was not permitted. Such regulations were designed to limit the expansion of banks geographically.

[12] Rasmusen, *Mutual banks and stock banks*, p.396.

societies did business. These observations give rise to our modified theory: that large building societies in major housing markets abandoned their mutual behaviour and behaved more like commercial banks, being more prepared to invest in riskier assets than small societies that remained isolated from competition in more remote housing markets. In the middle were small-to-medium societies (hereafter referred to as 'medium' societies), which being located in competitive housing markets were forced to match the loan terms offered by their larger rivals. These predictions are borne out by the historical record.

There is in fact a large body of theoretical and empirical literature which suggests that competition between financial institutions increases the likelihood of financial crises. For example, Smith contends that competition for deposits among banks generates inherent 'instability' in the banking system, even when other factors such as uncertainty about portfolio returns, withdrawal demand by depositors and the absence of a 'lender of last resort' are considered. Indeed, the belief that competition for deposits by banks would lead to undesirable banking practices was once widely shared by regulators in the US and elsewhere, and underpinned the tight regulatory regimes imposed on banks for most of the twentieth century.[13] Keeley has argued that the removal of such regulatory measures, such as branching and market entry restrictions in the US banking sector, played a large role in the savings and loans crisis of the 1980s, as it "reduced bankers' incentives to act prudently with regard to risk-taking."[14]

Even within the movement, some contemporaries were aware of the dangers that the untrammeled expansion of the larger societies might pose to the prudential standards and the spirit of fair play and solidarity within the movement. Writing in the *Building Societies Gazette* (*BSG*) in 1930, one contemporary lamented the effects of competition:

> [Competition] is causing some anxiety to those who are jealous for the good name and traditions of building societies. It would appear that an almost unseemly craving for big favours has developed, and in the effort to become the most gigantic society, little thought is given to the old courtesies, an "esprit de corps" which in by-gone days existed between one society and another. At one time, it would have been considered very bad form to have opened a branch office or agency in a town where a local society was already operating, but in these days, when some societies possess vast funds which must be placed out, every possible avenue is exploited without regard to any existing institution in the area chosen for development. The state of things is naturally arousing much antagonism and is not doing the movement any good, in fact, it seems likely to bring considerable harm.[15]

---

[13] Smith, 'Private information, deposit interest rates and the "stability" of the banking system,' p.291.

[14] Keeley, 'Deposit insurance, risk and market power in banking,' p.1183.

[15] *BSG*, 'Competition' (June, 1930), p.431.

The reason why the O'Hara-Rasmusen model breaks down in a competitive setting is that managers cannot be concerned with simply providing a stable return to members. In the segmented building society market of the US, managers did not compete so much with other financial institutions for business, nor did they face pressure from shareholders insisting that efficiency be maximised in order to maximise their dividends. The provision of a safe and stable return to members was all that was expected from their unassuming, risk-averse members, and because the manager was undiversified in his earnings capacity, he had no incentive to act contrary to their expectations by taking excessive risks. A 'self-enforcing contract' therefore existed between the manager and the members, which involved providing steady returns to investors based on cautious investments by managers. Living also within small and local communities, the manager had a limited range of investment options and was more accountable to his peers, with his standing and reputation within the community being tied to his prudent management of the local building & loan.

This low-risk behavioural equilibrium was disturbed by developments in England in the inter-war period. The expansion of the more ambitious building societies beyond their own native towns brought societies into direct competition with each other for investor funds and mortgage business, and in turn placed more pressure on managers to offer decent returns to attract and retain customers. In this context, the pressure to provide competitive returns to members did not come from over-zealous shareholders clamouring for the efficient management of their firms, but from the demands of competition in a market where investors and borrowers had a wider range of other building societies (or financial institutions) to choose from, each competing to offer the best returns to attract customers. In other words, the effect of the non-distribution constraint on firm behaviour in the O'Hara-Rasmusen model was circumvented by the greater opportunity of investors to switch to other investment options providing higher returns. While members may not have engaged in costly monitoring to induce efficient management, they could easily punish under-performing building societies by switching their funds to societies providing better returns. The loss of funds from the society is a natural concern for the manager as funds in a building society are mainly tied up in long-term investments (house mortgages) despite the short-term callability of their funds (deposits were withdrawable at call and shares redeemable at relatively short notice, between 1-3 months). Managers therefore had to ensure that investor confidence and expectations were maintained in order to remain solvent, especially given that the non-local investor of the inter-war period lacked the same commitment to the society as the parochial investor of old who invested in his local building society as much out of civic pride and duty than out of material self-interest.[16]

The arrival of increasingly wealthy investors in the inter-war years was also important, being a consequence both of the expansion of building societies beyond

[16] The building societies received a massive injection of capital from risk-averse investors amidst the turmoil in financial markets in the late 1920s. They received this capital in large part because of their reputation of stability and safety.

their local communities, as well as stock market instability in the late 1920s.[17] This change was not lost on Harold Bellman as the Chairman of the second largest building society (Abbey Road) of the time:

> …following 1929, when the world economic blizzard was reaching its climax… the investor lost confidence to an appreciable extent in stock exchange securities... In consequence, much new money flowed to the building societies. These funds largely came from a somewhat different class of investor from that which habitually used building societies before 1914. There was a stronger middle-class element and the average sum invested was doubtless somewhat higher."[18]

Figure 1 below shows the course of this rise in the larger building societies, from £101 in 1896 to £149 in 1920 and £318 in 1939. In contrast, the rise in the average shareholder balance of small building societies was more modest, from £79 in 1896 to £78 and £179 in 1920 and 1939 respectively, indicating the stable profile of small-society investors. Not surprisingly, the big investors channeled their money into the large building societies, who subsequently became more dependent on their capital for funding. As Harold Bellman observed:

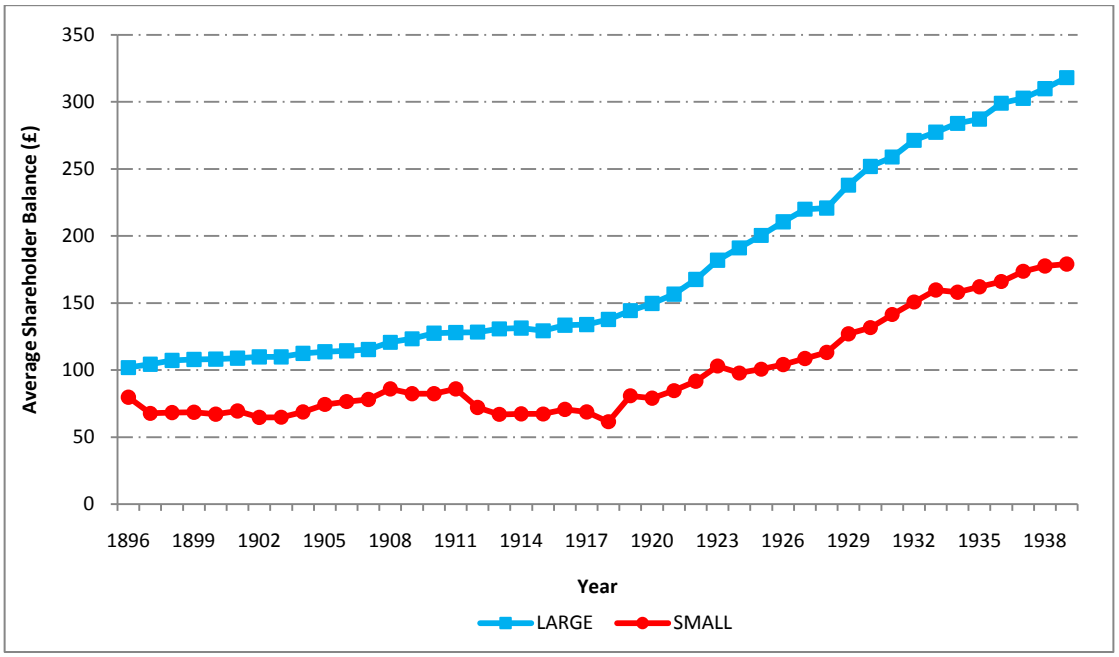
> In 1913, 77.8 per cent of the number of accounts (for sums less than £100) were responsible for only 21.8% of the total sum held by shareholders. The proportion of the amount at credit of accounts in the higher ranges – say over £2000 - was negligible… Coming to recent times still – namely, 31st December, 1947 – 95 per cent of the number of accounts were in respect of sums up to £1000, which accounted for 54% of the total sum at credit.[19]

[17] Wolfenden recollected the savings behaviour of his aunts and uncles from his childhood memory of spending his holidays with them, who went to great lengths to ensure timely payment of their subscriptions to the local building society. Wolfenden noted that investing in the local society was considered a respectable practice, and brought with it social prestige for the thrifty family (Wolfenden, 'The purpose and influence of the British building society,' p.2).

[18] Bellman, *Bricks and Mortals*, p.138.

[19] Bellman, *Bricks and Mortals*, pp.138-9.

Figure 1: Average size of share capital accounts: 1896-1939



Source: Annual reports, various societies (see Appendix 1). The figures are the averages of the amount of share capital per member in large and small building societies, where the amount of share capital per member in a society is calculated as balance of share capital at the end of the year divided by number of shareholders in the society.

The drawback of this new kind of capital (pejoratively referred to by contemporaries as "bad money") flowing into the larger building societies was its lack of commitment. This can be seen in the first instance by the difference in the withdrawal rates between large and small building societies. Of particular note is the gap which opened up in withdrawals in the 1920s. Withdrawals amounted to no more than 10 per cent of average share capital in small societies during that decade, compared to withdrawal rates of nearly 20 per cent in large societies. Indeed, an ANCOVA model found that the withdrawal rate was higher in larger societies than small ones, adjusting for annual fluctuations, regional differences, and macroeconomic conditions.[20]

Competition through geographic expansion and the subsequent influx of new capital coming from high-wealth investors gave managers strong incentives to take greater risks to find a profitable outlet for funds, and the only outlet available to building society managers was the housing market. This had both good and bad consequences. By channeling funds into the housing market, the building societies were helping to ease the interminable housing problem which had long denied decent housing to the lower and lower-middle classes. Indeed, the virtues of the building societies as an institution *par excellence* of 'directed saving' in this regard were hailed by building society evangelists for directing capital away from the formal capital markets (with its bias for international securities) and repatriating it onto local

[20] See Table A3.3 in Appendix 3.

investments in the national interest.[21] Richardson and Aldcroft noted that "no less than 75 to 80 per cent of the new privately built properties coming onto the market in the 1930s were financed by the building societies."[22] Aggregate figures for the movement show a sharp increase in the growth of funds and of mortgage lending well before the inter-war housing boom began (Figure 2). In the five years between 1920 and 1925, the growth rate of funds and mortgage assets rates rose at a much faster rate than they had in the five years prior to 1920 (96 and 113 per cent versus 34 and 15 per cent respectively) and grew even faster during the next five years to 1930 (121 and 177 per cent). House building in Britain had also picked up momentarily between 1920 and 1927, but slowed and contracted in the subsequent years leading up to 1931. In each year between 1920 and 1935, growth in building society mortgages remained in double-digit figures (with the exception of 1932 when the growth rate fell temporarily to 6 per cent). The sustained rate of lending throughout these years no doubt propped up house construction activity during the depression years, and fuelled the housing boom from 1932 onwards, when mortgage lending grew at rates of 2.1, 10.5, 45.8, and 36.5 per cent in the years between and including 1932 to 1935.

From our own panel of annual report data, the early increase in building society activity can be observed, and, consistent with our theory, was especially high among the large building societies whose growth rates rose much faster than the movement on average. Figure 3 shows that in fact most of the growth can be attributed to the phenomenal growth of large societies during this period, with small societies growing much more slowly.

The high growth rates of lending by building societies were not achieved by being passive agents in a process driven purely by market forces. This was emphasized by Humphries in her critique of the cheap money hypothesis of the inter-war housing boom, which posited that the boom was caused by the advent of cheap money in the early 1930s because of the conversion of war loans in 1932.[23] In highlighting the fact that the building societies were expanding their lending well before cheap money became available, Humphries argued that building societies influenced both the supply and demand for mortgage loans, that is, that 'they made the market.' One of the important ways in which they did so was through their aggressive advertising. Figures for advertising intensity rose substantially among societies throughout the 1920s and 1930s, showing that building societies were devoting a larger share of their resources to it during this period. Advertising intensity is defined as the amount spent on advertising divided by the interest revenue accrued on loans. Figure 4 shows the upward trend in this ratio since the pre-war period when many building societies spent relatively little on advertising.[24] The growth of advertising expenditure was phenomenal: advertising expenditure in the movement tripled between 1920 and

[21] Cohen, 'Building societies and the capital market,' p.367.

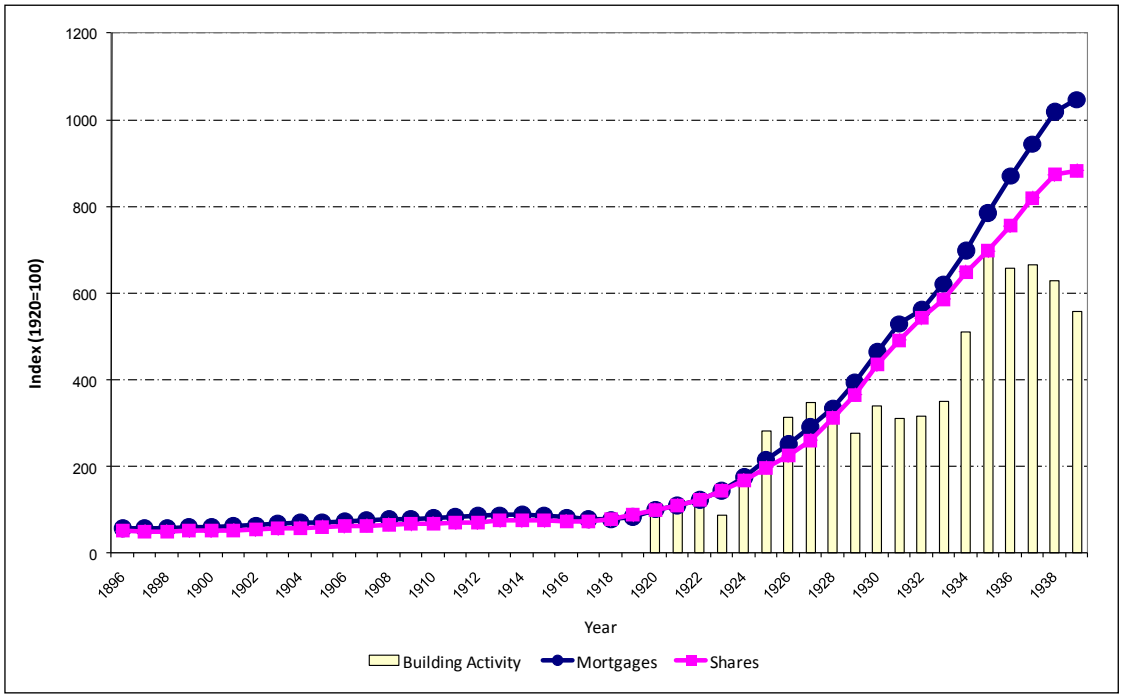
[22] Richardson & Aldcroft, *Building in the British Economy between the Wars,* p.206.

[23] Humphries, 'Inter-war house building, cheap money and building societies.'

[24] In 1910, the average amount spent on advertising by the 33 building societies in our sample was £590, compared to £4772 in 1925, £26,808 in 1930 and £81,659 in 1938. Most of this expenditure was made by large building societies in all of the time periods covered.

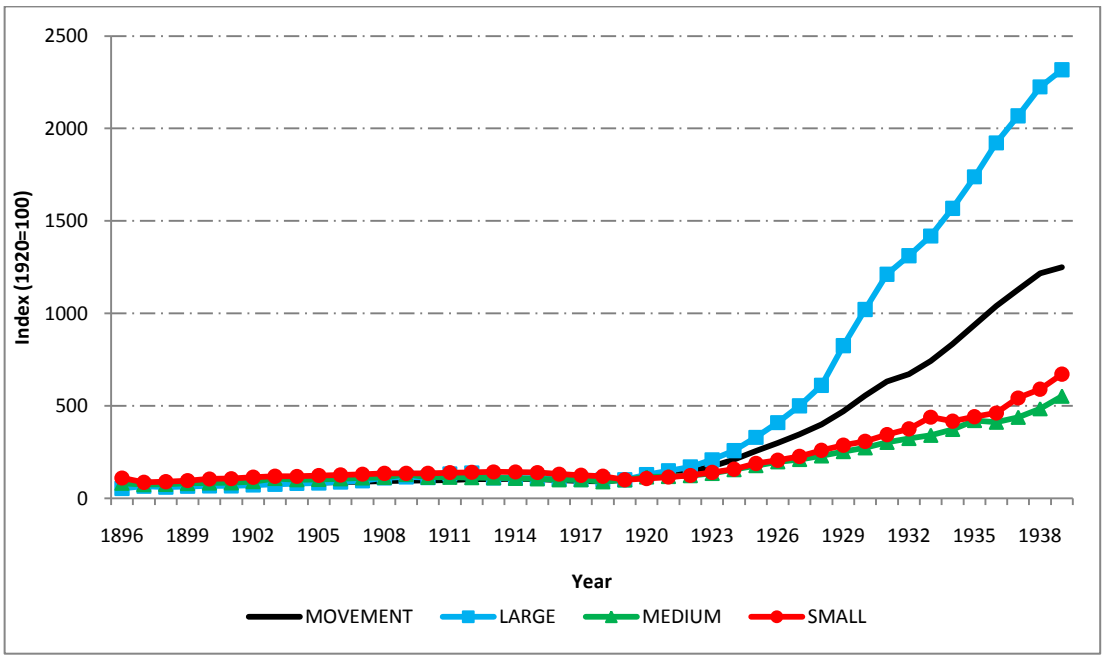
1930, quadrupled between 1925 and 1930, and tripled once again during the 1930s housing boom. By 1939, the average amount spent on advertising per year was 59 times more than the average expenditure on advertising in 1920.

Figure 2: Index of Mortgage Assets and Share Funds for all Building Societies & Index of Building Construction: 1896-1939



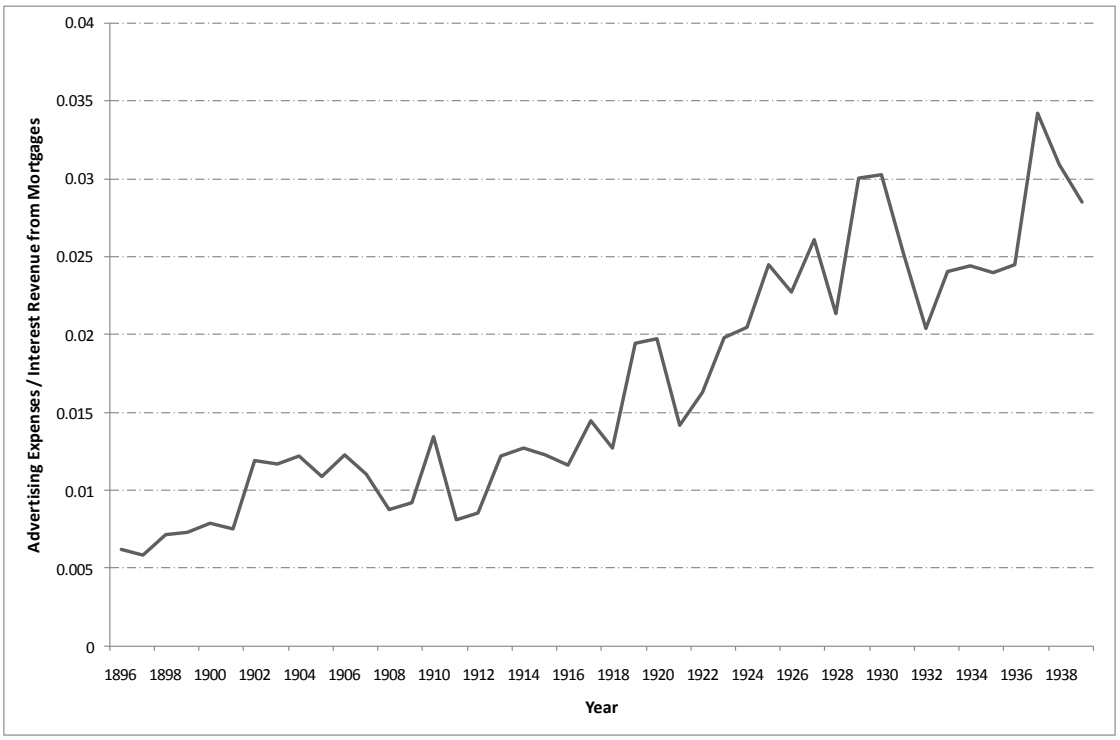
Sources: Building Activity: Weber in Mitchell & Deane, *British Historical Statistics,* Table 5, p.390; Mortgages and share figures: RFS, *Annual reports*, various issues: 1896-1939.

Figure 3: Index of Mortgage Assets for Small, Medium and Large Building Societies (1920=100)



Source: Annual reports, various societies (see Appendix 1).

Figure 4: Advertising Intensity of Building Societies: 1896-1939



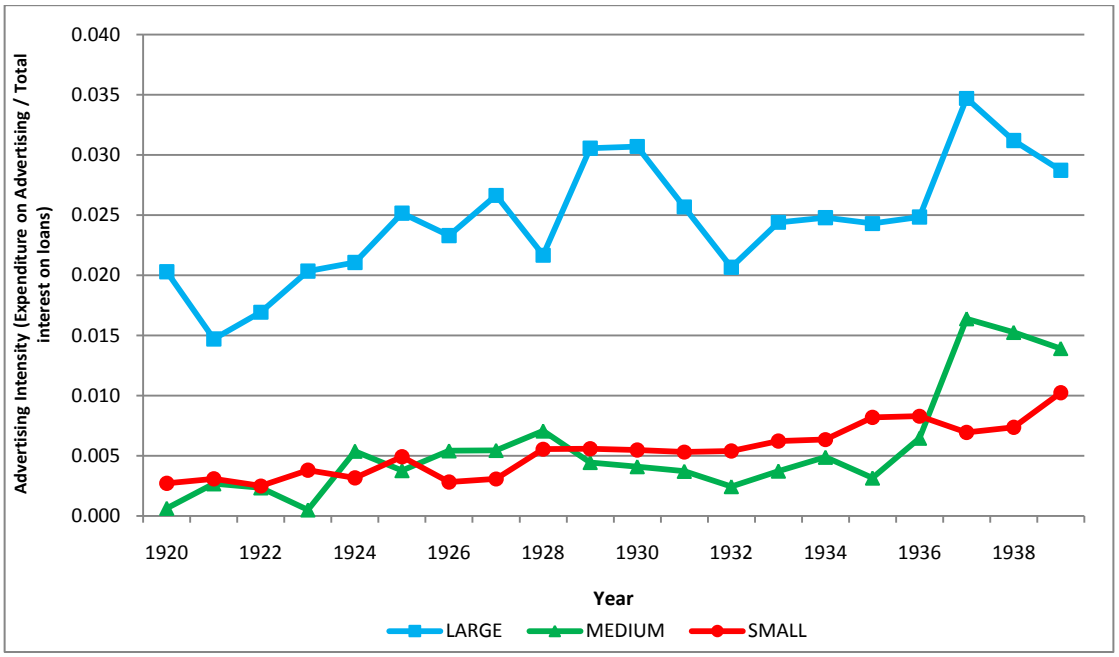
Source: Annual reports, various societies (see Appendix 1).

The effectiveness of advertising in this regard can be seen in its statistically significant effect on the growth of funds and mortgage assets of our panel of building societies. Advertising growth had a significant marginal effect on the growth of funds in the econometric models mentioned earlier, even after adjusting for other microeconomic and macroeconomic factors that affect demand. Again, consistent with our theory, this was more so for large building societies than for small regionalised societies, the former spending considerably more than the latter on average (see Figure 5).[25] The same is true for mortgage lending, which was also positively and significantly affected by advertising. Indeed, the use of advertising by building societies, pitched for the first time to lure working-class customers into the housing market, has received some attention in the literature on housing.[26]

[25] In 1930, the large societies spent on average more than 100 times the amount on advertising than small societies (£27,263 versus £160). In terms of advertising intensity (defined as the ratio of advertising expenditure to interest income on mortgage loans), large building societies advertised with almost three times the intensity of small building societies between 1900 to 1939.

[26] For example, Scott, 'Selling owner-occupation to the working-classes'.

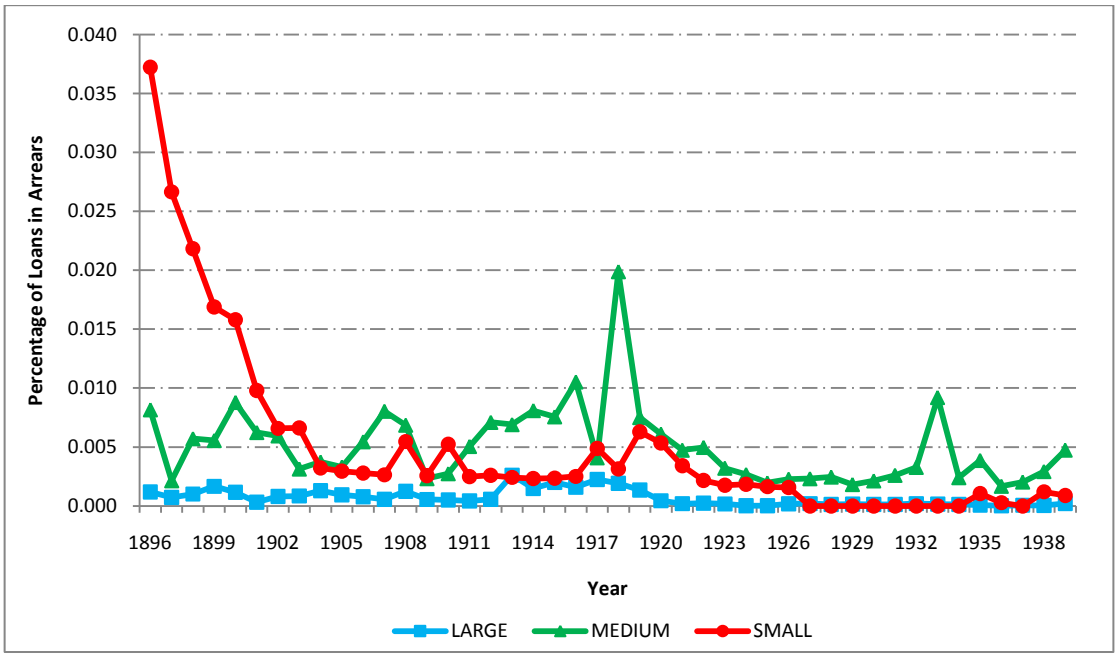
Figure 5: Breakdown of Advertising Intensity by Size of Building Society



Source: Annual reports, various societies (see Appendix 1).

The downside of this pro-active behaviour by building societies was that a large part of it involved lowering their lending standards in order to expand the pool of mortgage clients. But consistent with our revised theory, the historical record shows that there was a major difference in way in which large and small building societies adjusted their lending policy. For one thing, the small building societies did not experience the same spike in arrears in the 1940s because of years of imprudent lending as did other societies. Figure 6 shows the average proportion of loans in arrears between 1896 to 1950, and reveals that the small societies had little to no arrears in the inter-war period and recorded the least rise in arrears after the outbreak of war in the 1940s. Of the 10 small societies in the sample, seven reported no arrears in the early 1940s, and six had no repossessions. In contrast, large and medium-size building societies both experienced spikes in the number of distressed loans. For the medium-sized societies this was more of a problem as the arrears and repossessions constituted a much larger proportion of their loan portfolios.

Figure 6: Percentage of mortgages in arrears by size of building society: 1896-1950



Source: Annual reports, various societies (see Appendix 1).

What has been argued for the difference between large and small building societies applies equally to the observed change in building society behaviour between the pre-war and inter-war periods. The theory presented in this chapter suggests that the O'Hara-Rasmusen model prevailed in an era when societies were local and funded by predominantly local, committed, and less sophisticated investors. But this ceased to be the case when market competition and the arrival of the sophisticated investor changed the objective functions of the building societies, and in turn their low risk-taking behaviour.

The empirical data over these two time periods support the theory. There is ample evidence to show that the movement was a predominantly small and localised one in the pre-war era. Figure 7 shows the secular fall in the number of societies after the Liberator crash of 1891, from a peak of 2,752 in 1890 to 1,478 in 1913 and 971 in 1938. Societies were not only more numerous before the First World War but the movement was much less concentrated than in later periods. In 1891, building societies classified by the Chief Registrar as "large" accounted for only 26 per cent of the total mortgage assets of all building societies, and by 1913 accounted for still less than half of all mortgage assets. Moreover, none of the so-called 'large' societies (i.e. those with more than £300,000 in mortgage assets) held a substantial share of the market: for example, the largest society (which at the time was the Leeds Permanent) held only 4.5 per cent of the total. They were also relatively localised, such as the Halifax Permanent Building Society which was contained almost exclusively within Yorkshire and Lancashire before 1914.[27] By 1937, however, the landscape had altered dramatically. Fifty-five building societies had mortgage assets exceeding £1,500,000,

[27] Hobson, *A Hundred Years of the Halifax,* p.90.

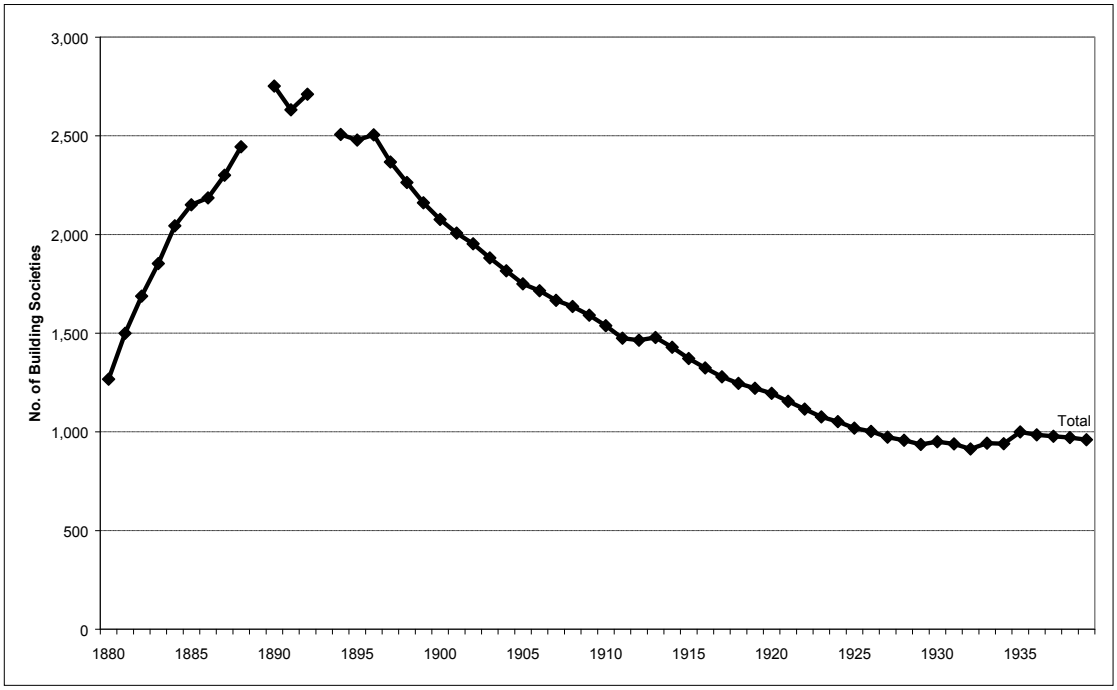
the largest now being the Halifax with a market share of 15.7 per cent. Between them, the large societies commanded over 77 per cent of a mortgage market that was 14.4 times larger than in 1901 (with total mortgage assets exceeding £586 million).[28] The lower number of smaller societies (922) accounted for a much smaller part of the movement: their combined sum of mortgage assets (£132,100,100) was only slightly higher than the mortgage assets of the Halifax (£92,195,989), and the average size of their mortgage portfolio (£143,276) being 643 times smaller than the size of the Halifax's portfolio. The market had become dominated by the large building societies, which by that time had a truly national presence with thousands of branches or agencies throughout England.[29] These changes brought the societies into direct competition with each other and with other (smaller) societies, with the resulting deterioration in the loan portfolios discussed earlier.

The marked deterioration in firm behaviour across these two periods raises a series of questions about the benefits of building society growth and competition during the period. Did this growth, expansion and competition between societies yield a movement of more efficient institutions than previously? Did the mega-societies of the inter-war period provide a superior return and service to investors and borrowers, as the promoters of building society consolidation during this period had promised if building societies combined forces? The evidence from the annual report data suggests not.

[28] *Source*: RFS, *Annual reports*, various issues: 1901, 1937.

[29] The Building Societies Yearbook for 1938 provides a list of building societies in all of the major townships throughout Britain, revealing the ubiquity of large building societies across the country.

Figure 7: Total No. of Building Societies in England & Wales

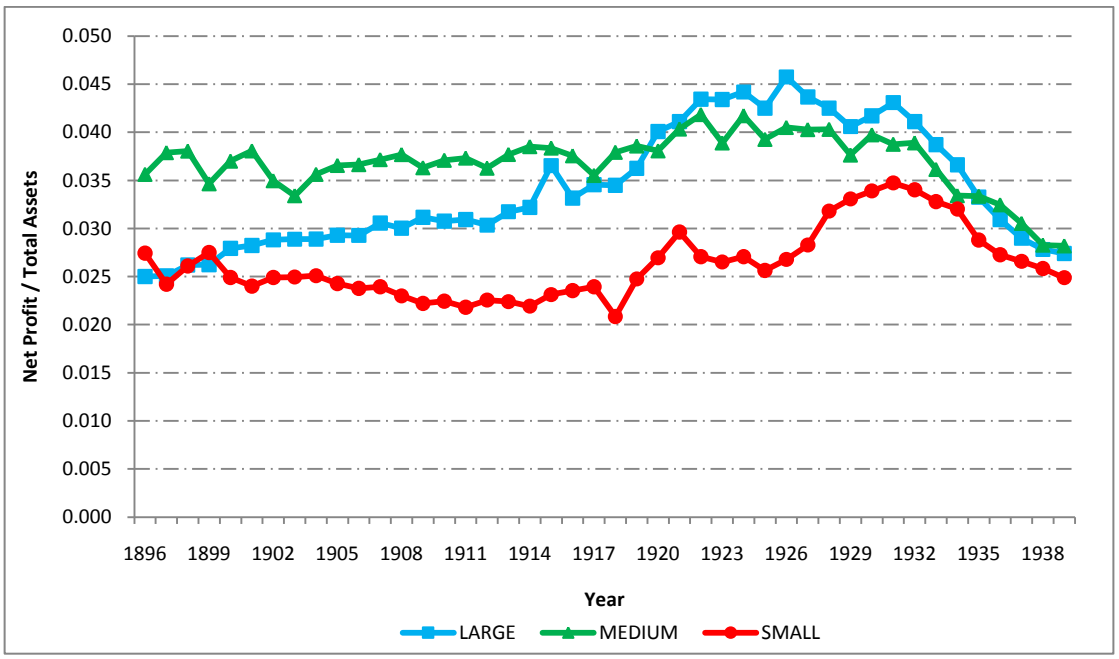


Source: RFS, Annual reports, various issues (1890-1939)

Ordinarily, it is inappropriate to evaluate building society performance according to measures that apply to firms whose objective functions are to maximise productive efficiency. That said, the use of efficiency gains by the advocates of large-scale building societies as an argument in favour of amalgamation warrants the use of efficiency measures to compare large versus small societies. On the one hand, the comparative figures for profitability and cost efficiency would suggest that large building societies were in most years slightly more profitable and efficient than smaller societies. This was especially true before the inter-war period when the return on share capital and return on assets figures were higher (by approx. 1 percentage point) in the large building societies than in the small ones in every year. But whether size was the driving force behind efficiency is questionable. The average profitability of small-to-medium sized societies in the sample (marked as 'medium') was higher than the profitability figures of large societies in 28 of the 43 years between 1896 and 1939, and both profitability and cost-efficiency (management expenses to total assets) ratios converged for all kinds of societies in the 1930s (see Figure 8 and Figure 9). Thus it would seem that size was not a major factor behind efficiency or profitability, a conclusion consistent with the findings of numerous econometric studies of economies of scale and scope in building societies in the post-war period, in which no scale economies were found.[30]

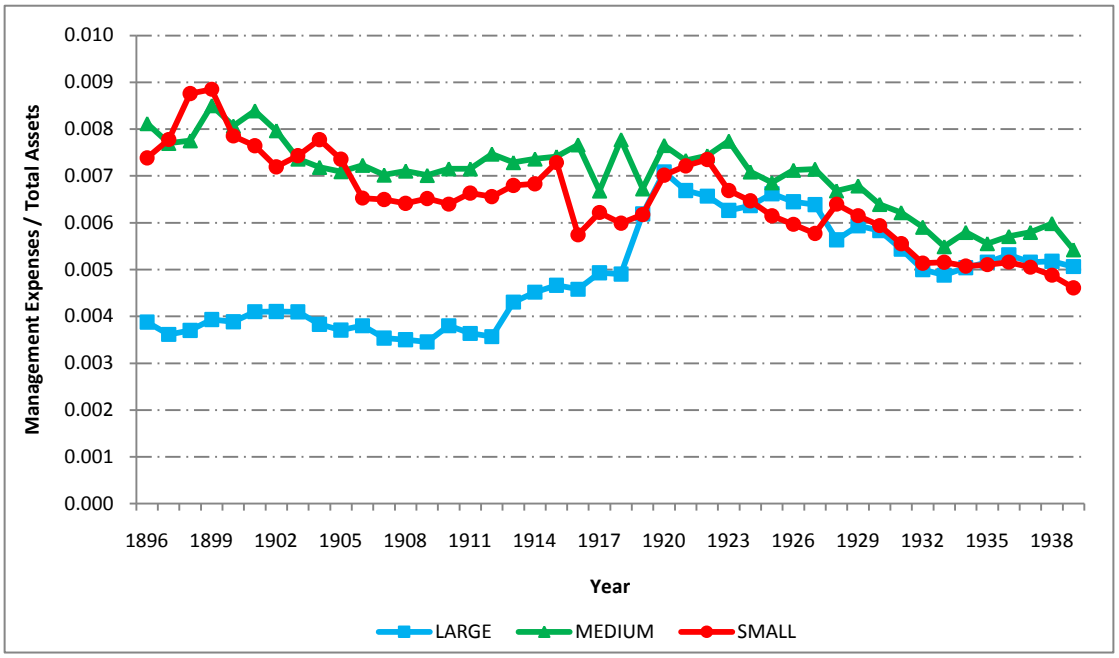
[30] For example, Drake, 'Testing for expense-preference behaviour in UK building societies'; Worthington, 'Efficiency in Australian Building Societies'.

Figure 8: Profitability by Size of Building Society: 1896-1939



Source: Annual reports, various societies (see Appendix 1).

Figure 9: Management Cost Efficiency by Size of Building Society: 1896-1939

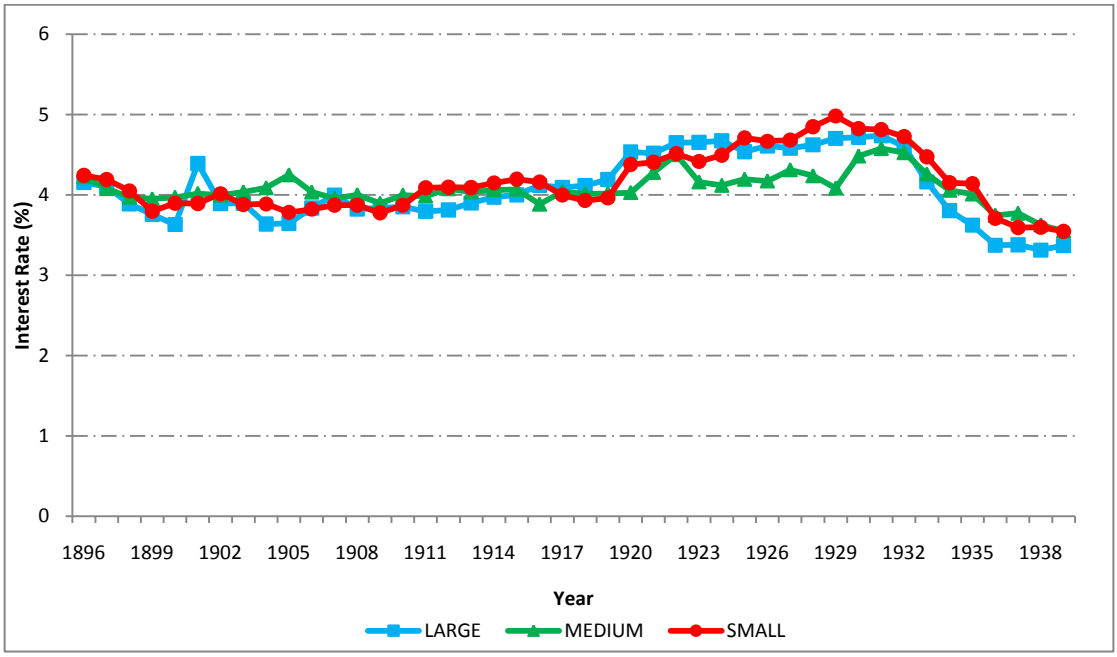


Source: Annual reports, various societies (see Appendix 1).

Nor did larger societies provide higher returns to members. Interest rates paid to investors were virtually identical across all societies in our sample, that is until a small gap emerged in the 1930s when small building societies offered on average a 0.5

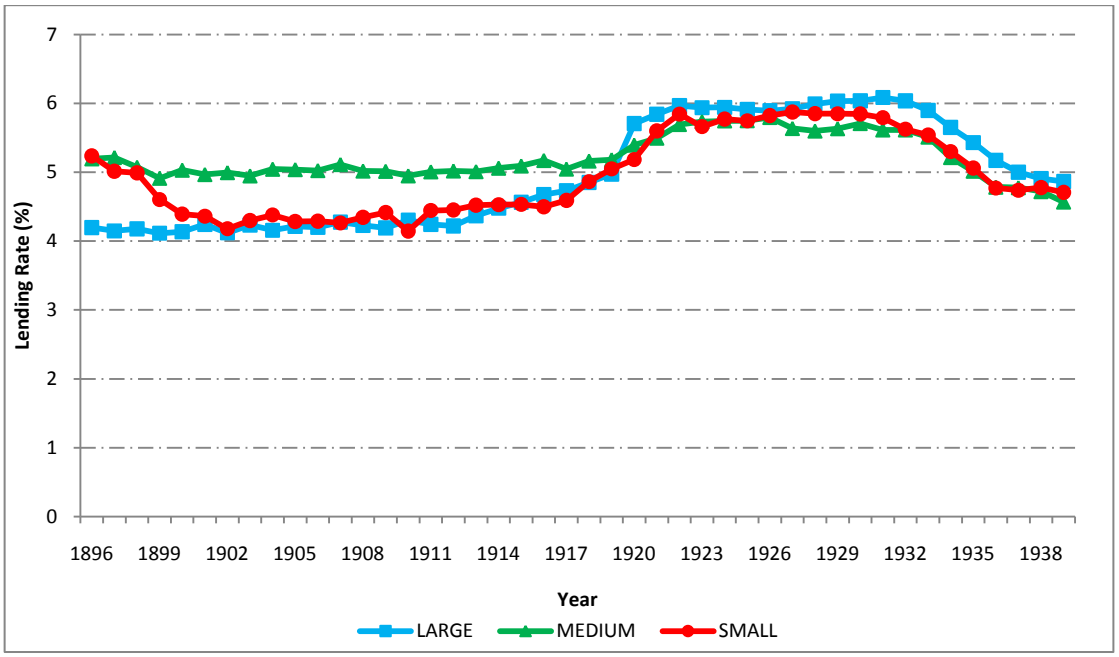
percentage point premium on shares (see Figure 10). Where interest rates did differ was in the rates charged to borrowers, with small building societies charging lower interest rates than large societies in every year since 1915 (approx. a third-of-one percentage point lower than large societies) (see Figure 11). The lower borrowing charges and the (sometimes) higher returns to shareholders paid by small building societies meant that their interest rate margins on investment and borrowing were smaller than for the large societies, particularly in the inter-war period (see Figure 12). The difference was statistically significant, as shown by an ANCOVA model of the interest rate margin which also controlled for dynamic trends, regional variations and macroeconomic factors (see Table A3.4 in Appendix 3). For large and medium-sized societies, interest rate margins increased continually over time, from around 0.5 per cent in the pre-war period to around 1.5 per cent by the late 1920s. Small societies on the other hand operated on margins that were never much higher than 1 per cent: from as low as 0.15 per cent in 1911 to 1.06 per cent in 1938. In short, small building societies extracted a smaller share of value than the larger societies to finance their operations. These margins were not nominal in value: a gap of 1.5 percentage points represents a quarter of the rate charged to borrowers (assuming an interest rate of 6 per cent) and over 37.5 per cent of the rate paid to investors (assuming an interest rate of 4 per cent). These point to a more complex shift in the distribution of value among patrons of the organisation.

Figure 10: Interest rate paid to shareholders by size of building society: 1896-1939



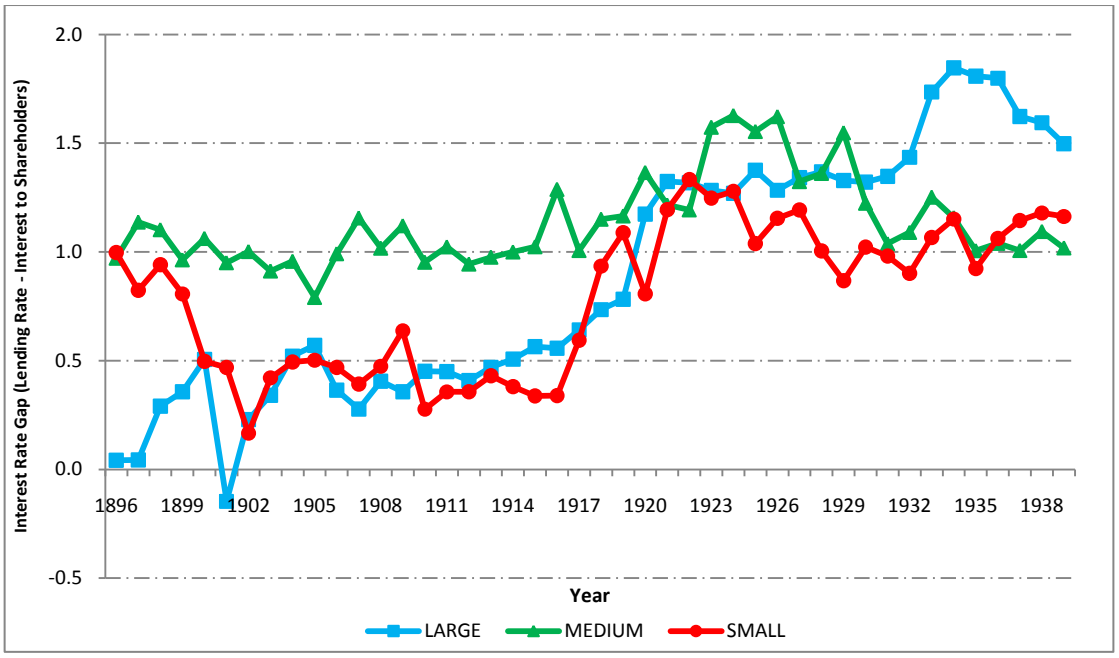
Source: Annual reports, various societies (see Appendix 1).

Figure 11: Interest rate charged to borrowers by size of building society: 1896-1939



Source: Annual reports, various societies (see Appendix 1).

Figure 12: Interest rate margin on loans and shares by size of building society: 1896-1939



Source: Annual reports, various societies (see Appendix 1).

It is tempting to suggest, given the clear preference among the investor public for large societies in the inter-war period, that larger societies were preferred because they were perceived to be less risky than small societies. On the other hand, our contention that small and regional societies were more likely to exhibit the risk-averse traits suggested by O'Hara and Rasmusen, and our observation that small societies did

not engage in the same risk-taking behaviour as large societies in the inter-war period, disproves this suggestion. After all, though the investors of the inter-war period did not have the benefit of hindsight, none of the small or medium societies in our sample collapsed at any point in their existence, nor did they ever require expensive bail-outs to save them from speculative excess.

Who then were the main beneficiaries of building society growth? The answer to this question was not unknown to certain contemporaries within the movement. In his analysis of the annual reports of 110 societies, James Brace, a manager of a small society in Eastbourne, compared the rates of return, the cost of borrowing and the efficiency of a variety of societies throughout England in 1929. Finding that the most efficient firms within the movement were small-to-medium sized societies located in the northern counties, Brace concluded that:

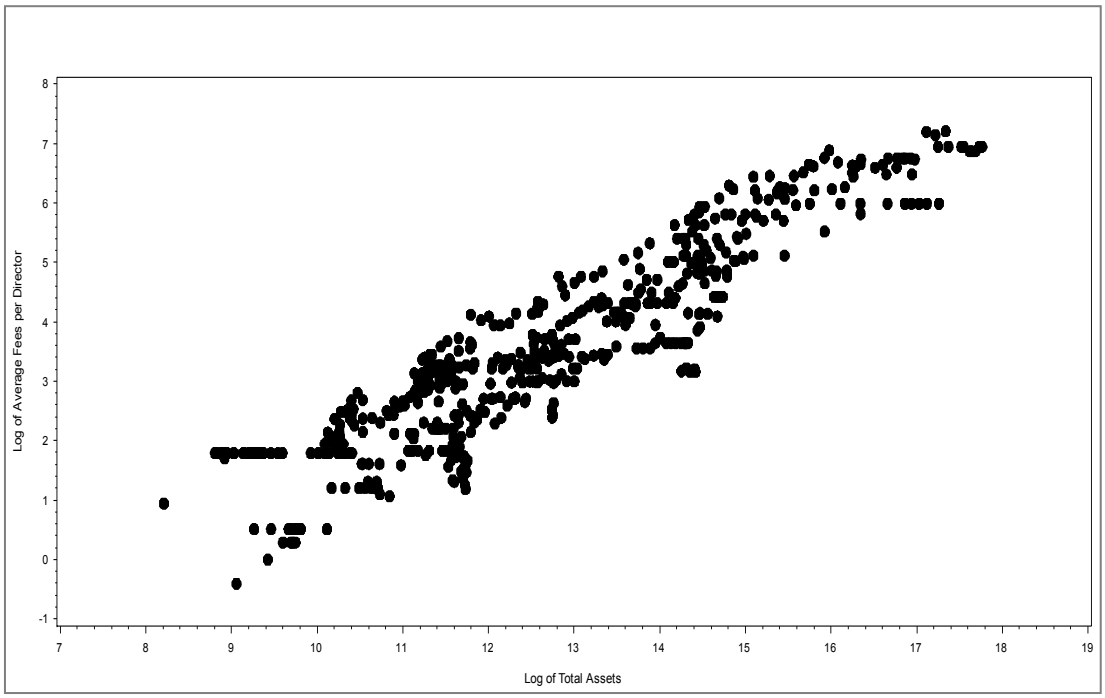
> The only people to benefit by the growth of a building society, whether the growth be the result of normal increase in business or in consequence of amalgamation, would appear to be the directors and chief administrative officers [of the societies].[31]

While Brace did not substantiate this assertion by showing the statistical relationship between firm size and the fees paid to executives, subsequent analysis using the annual report data compiled for this thesis supports his conclusion. Figure 13 shows the relationship between the average fees per director and the level of total assets between 1890 and 1939. The average fees per director were calculated as the total fees paid to directors, divided by the number of directors in a given building society. The former figure was reported in the profit and loss statement of the annual report, while the latter was obtained by counting the number of directors listed on the front page of the annual report. As Brace had said, there was a clear positive relationship between firm size and the level of directors' fees, with a statistically significant correlation coefficient of 84 per cent.

Looking at the evolution of directors' fees in individual societies reveals that the growth of their emoluments was not only rapid but exponential in the largest societies. Figure 14 shows the trend for some of the large building societies for which these figures are available. The fastest growth in fees occurred in the Woolwich Building Society (the second largest society in London and the fourth largest society in England in 1937) and the Abbey Road Building Society (the largest in London and the second largest in the movement): in 1935, the fees in these societies were 4 and 11 times their 1920 levels respectively. The rise in directors' fees in other large societies – CPBS, National (NBS), Westbourne Park (WtPkBS), Temperance (TempBS) – was also quite large, particularly in contrast to smaller societies whose director fees changed little over time.

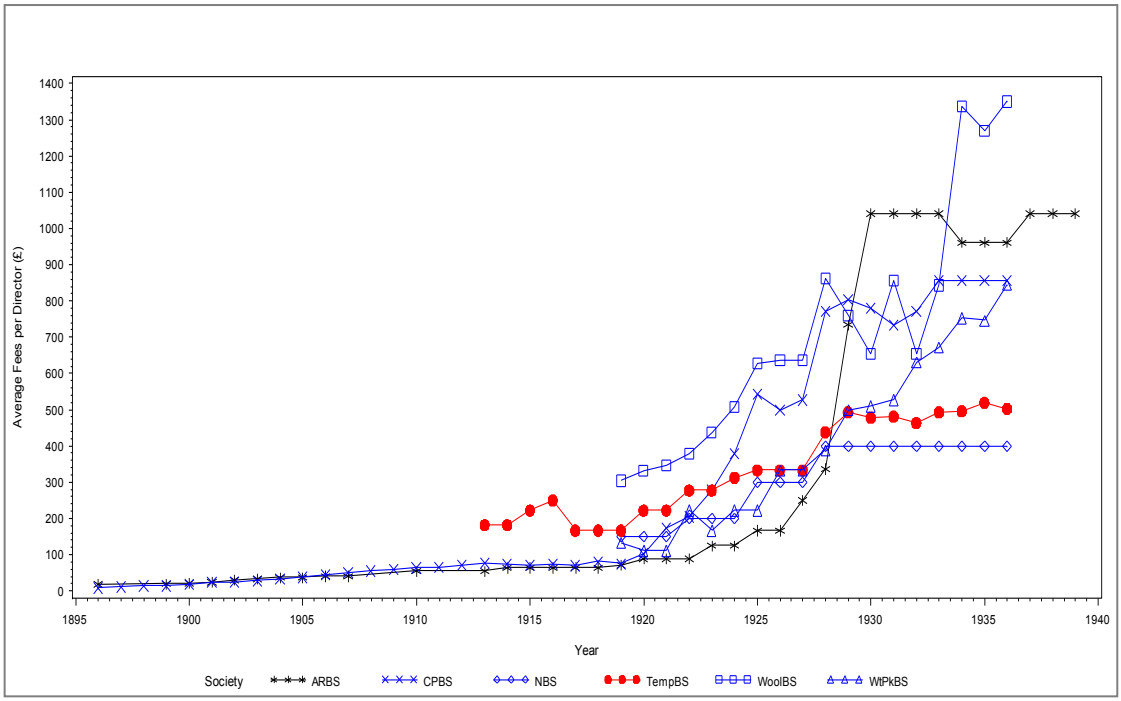
[31] Brace, 'A statistical analysis of building societies,' p.201.

Figure 13: Scatter plot of Average Fees per Director (£) vs. Log of Total Assets: 1896-1939



Source: Annual reports, various societies (see Appendix 1).

Figure 14: Fees per Director in selected large London societies: 1896-1939



Source: Annual reports, various societies (see Appendix 1).

A huge disparity therefore existed between the salaries of directors in large versus small societies. In 1935, directors of the Woolwich Building Society were earning over 20 times the salary of the highest-paid directors of the smaller societies. But the

salaries of large society directors were also high in relation to the salary levels of people employed in professional occupations outside the movement. According to Agatha Chapman, the average annual earnings of doctors, clergymen and teachers were £416, £322 and £281 in 1935.[32] Building society directors at the Woolwich were therefore earning over 3 times the salary of doctors, 4 times the salary of clergymen and 4.5 times the salary of teachers in that year, despite having lower levels of training and education than those engaged in these professions. Only scant evidence is available about the pay levels of managers and directors in corporate banks and companies during this period, and most available sources relate to the pre-war period.[33] These sources show that managerial pay in building societies was commensurate with those of large corporations, despite the fact that the large societies were still smaller in size than the largest corporations of the time. For example, Chapman & Knight's book on wages and salaries cites a contemporary reference from 1932 which calculated the average fee paid to directors in a sample of fifteen 'large' companies in Britain in that year to be £1066 per director.[34] Building society directors were therefore claiming executive pay packets that were near commensurate with their counterparts in big business.

Knowing that the growth of a firm delivered massive pecuniary benefits to managers helps to explain many of the sweeping changes that occurred during the inter-war period. Indeed, the ability of managers to influence their pay by growing their firms explains the intensive efforts made by societies to expand their market after 1920, be it through advertising, securing tax concessions with the Inland Revenue or liberalizing loan terms. The final point connects with the third reason given earlier for why the prudent behavioural equilibrium of the O'Hara-Rasmusen models broke down in the inter-war period. In the model developed by Rasmusen, a great importance was attached to the inability of managers to influence their own pay, in that it ensured that neither the manager nor the owners would be residual claimants in the firm, and that therefore neither would gain from the extra profits generated from risk-taking. Otherwise:

> If he were free to set his wage at whatever level, hire ghost managers and sell shares in his salary to outsiders, then the mutual association would be no different from a stock company.[35]

In the United States, caps on directors' fees were imposed by the law, limiting directors to supplement their incomes with non-pecuniary perks which, according to

---

[32] Chapman & Knight, *Wage and salaries in the UK,* p.202.

[33] For example, Cassis, *City Bankers*, which gives a brief account of the pay levels of bank directors in the pre-war period. Directors of banks were reported to have earned salaries of £500, far greater than building society directors during the inter-war period, with general managers earning much higher salaries of approx. £4000 (see p.64). The general managers of building societies were also paid more than society directors. For example, the General Manager of the Co-operative Permanent Building Society earned a considerably higher salary than the directors as reported in the minute books for the 1930s, though admittedly not as high as those in the large corporate banks, even during the inter-war years.

[34] Chapman & Knight, *Wages and Salaries in the UK,* p.227.

[35] Rasmusen, 'Mutual banks and stock banks,' p.398.

Rasmusen, only served to reinforce their incentive to be prudent in their management. In England however, no such legislative restrictions existed, and owners had few incentives to curb directors fees given the disproportionate co-ordination costs involved. Managers were therefore free to set their wages, which they could directly influence by pursuing an aggressive growth strategy. In one way, this could be achieved by the aggressive marketing and lending strategies described earlier. But yet another important way of growing their societies was the take-over of other societies, a strategy which had been largely underutilized in the preceding periods. Achieving growth in this way however meant overcoming two major obstacles working against the consolidation of the sector: (1) old-fashioned attitudes within the movement favouring localism; and (2) legislative requirements making the amalgamation of societies cumbersome. Not for the first time in the movement's history, the directors cleverly took advantage of changing economic and political conditions to successfully break down these barriers.

III. Firm growth by capture: the ideology of rationalisation and the triumph of the building society manager

In *The Rise of the Corporate Economy*, Lesley Hannah documents how a paradigm shift had occurred in the conventional view about the optimal size of businesses in industry in the inter-war period, from one favouring small enterprises to one favouring large. This had multiple causes, some of which Hannah notes:

> The tenor of business opinion had.... changed greatly since before the First World War, both because of the enthusiastic espousal of the doctrines of rationalisation and because of more direct pressure from foreign countries which had espoused them earlier."[36]

In like manner, the tenor of business opinion also changed within the building society movement. Many of the arguments used in the industrial debate about rationalisation were rehashed in the debates taking place within the movement about the virtues of competition versus combination throughout the 1920s. Proponents of amalgamation claimed that the combination of societies would yield greater cost efficiency, more effective application of funds available, the convergence of interest rates and the standardisation of practices in those societies which combined. Larger societies would also be less vulnerable to trade conditions in a particular area, and thus mitigate firm risk through a more diversified mortgage portfolio. In a nutshell, the amalgamation of firms promised significant benefits to societies and their members, especially for smaller firms whose scale of operations were too small to be efficient.

The most compelling need for rationalisation, so they argued, was the need to eliminate the pernicious effects of competition within the sector, which was destabilising the movement by fostering imprudent lending practices in the struggle for business. As Leonard Grundy Hodgson, the author of a popular book about the movement for the investor public and a prominent figure in the movement in the 1920s, wrote in the Building Societies Gazette in 1927:

> The subject of amalgamation is once more to the fore, fostered no doubt by the expansion of business generally, but also by some uncertainty as to the soundness of the present competition, which is constantly getting keener.[37]

According to Hodgson, competition may have a beneficial role in fostering efficiency and innovation in other sectors, but was an altogether destructive force within the building society world:

> A keenness of competition which might be very salutary in the building trade may quite conceivably be idiotic amongst Building Societies. In the one case, competition tends to improve methods, or to produce devices which can increase output and render the final product cheaper or better.

---

[36] Hannah, *Rise of the Corporate Economy,* p.43.

[37] *BSG*, 'Competition or Combination' (January 1927), p.9.

> The Building Society however works on perfectly well ascertained margins, first the margin between the rate of interest paid to the investor and that charged to the borrower, and, secondly, the margin of security in the initial advance.[38]

Competition according to Hodgson forced societies to reduce these margins, exposing them in turn to problems later on. The solution according to Hodgson was to reduce the number of firms in the industry:

> When [competition] comes to a paring down of the fundamental margins of safety it is time to call a halt, and some form of combination between societies to fix limits in this direction becomes a necessity.[39]

It is ironic however how competition, which was once used to justify the incursion of large building societies into the territory of other societies, quickly became the menace which had to be overcome by concentrating the movement into the hands of the large societies which benefited most from this competition. Only a few years earlier, the merits of competition as a force for good were extolled when the Halifax Building Society opened its first branch in London in 1924, marking the start of a new era of competition on a national scale. Speaking at the opening ceremony of the branch in Holborn, an event which attracted the Mayor, Parliamentarians and representatives from other building societies, the President of the Society, William Ramsden, assured the local societies that the directors of the Halifax had:

> no intention whatever to encroach on the business of the Building Societies already established in London. They thought there was room for all of them. A reasonable amount of competition was a good thing.[40]

Far from wishing to harm the movement in London, the directors had come with a "love offer to Londoners of the great advantages they have learned to value for themselves"[41] in the form of their building society:

> The Halifax Society desired to do nothing to injure the movement in London, but to increase its usefulness. They wanted first of all to be safe and then to be as helpful as possible. He had been associated with the establishment of more than 100 branches and had never known a case where a Halifax Society had opened a branch in a district where there was a Building Society, large or small, that the result had been not only satisfactory to the Halifax but had been greatly helpful to the other societies already established there.[42]

---

[38] *Ibid.*, p.9.

[39] *Ibid.*, p.9.

[40] *BSG*, "Halifax comes to London" (August, 1924), p.168.

[41] *Ibid.*, p.169.

[42] *Ibid.*, p.169.

Such a rosy view of competition was not shared by those commentators, like Hodgson, who saw competition like John Ruskin, as the 'law of death.' Yet the targets of their scorn were not the larger societies which were expanding into the markets of other societies and paring down prudential standards in order to grab market share, but the humble, smaller societies. Nonetheless, a disdain for small societies was present in an increasing number of *BSG* articles[43] calling for their absorption by the larger societies. Hodgson was blunt in expressing his opinion of them:

> Many of these societies are antiquated in method and lack imagination... Some method of quickening "The Sleepy Hollow and District Permanent Building Society" is badly wanted, some way by which it could be united or amalgamated with a more live concern, otherwise it seems that with the spread of agencies and branches the small society will gradually be superseded and becoming more and more moribund will eventually be wound up. Within limits, this process will do no harm, as there are many more societies in existence than are actually needed.

Such articles became more numerous over time, gaining greater coverage in the *BSG*. A consensus emerged within the movement that the small societies posed an unacceptable risk to the building society's brand name. This very point was in fact made explicit by J. B. Leaver in an article appearing in the *Building Societies Yearbook* for 1931. Leaver contended that just as banks had undergone an amalgamation phase before and after the War, so too was it in the best interests for the building society movement to do so as well. Leaver questioned the judiciousness of a structure where 96 per cent of its societies collectively owned only a quarter of the total mortgage assets of the movement. Leaver argued that the "efficiency, stability and general standing of the larger building societies are comparable with the like qualities of the larger banks", in terms of having ample funds, excellent organisation, efficient service, up-to-date premises, abundant publicity, and valuable data with respect to mortgage business.[44] The same could not be said of small societies, which among other things were too susceptible to the trade conditions of a local area. As such, the small societies were a ticking time-bomb which threatened the good name of the movement, and that the only sensible solution was to combine them or absorb them into the larger societies.

The consolidation of the building society sector became a major priority for the movement's elites. One major barrier however stood in the way of the wide scale amalgamation of firms: legislation. As C. Pearson Derbyshire, the assistant secretary of the CPBS, complained in a prize-winning essay printed in the Jubilee history of his society:

> There is, however, one serious difficulty, and that is the cumbersome amalgamation procedure prescribed by the Act. While it may be possible to obtain a three-fourths majority of members

[43] The *BSG* was published by an independent entity, although the extent to which the editorial board was dominated by the larger societies is not known.

[44] *BSY*, 'The Small Society' (1931), p.358.

> present at the special meetings of both societies, the obtaining of the written consent of those holding two-thirds of the shares makes the machinery almost unworkable... No good purpose is served by making it difficult for societies to amalgamate. On the contrary, all reasonable facilities should be afforded and the procedure accelerated. I sincerely hope the national association will take prompt steps to persuade our legislators to deal with this.[45]

His hope would not take long to fulfil. In 1940, the constraints on amalgamation were eased by the passing of the Societies (Miscellaneous Provisions) Act, which allowed the Chief Registrar to dispense with the two-thirds majority requirement if he felt that the merger was not prejudicial to the interests of members. At his discretion, he could authorise either or both of the societies to bypass their memberships and merge by way of a simple resolution of a general meeting or of the board of directors.[46]

Only two years earlier, however, the Chief Registrar himself had expressed consternation at the dubious terms under which many amalgamations were being carried out. He described the scandalous example of the merger between the Wrexham Building Society and the larger Brighton & Sussex Society, where the self-serving managers of the two societies enriched themselves at the expense of the shareholders in the merger deal:

> It will be remembered that in the case of the Wrexham Society, the directors received payments representing about 61 years' salary and the secretary the equivalent of his salary in perpetuity. The Brighton Society, whose reserves and un-appropriated profit represent less than 2 per cent of the balance outstanding on mortgage as compared with 11 per cent shown by the five societies taken over, absorbed into its funds 42 per cent of their reserves and un-appropriated profit, whilst 29 per cent went in compensation to directors and officials and 11 per cent was used in expenses, leaving only 18 per cent to be distributed to shareholders. The principal items of expenses appear to have been travelling, hotel expenses, surveying, investigation and salaries.

Looting the reserve assets of small societies provided the directors of the large societies with a free way to incentivise all parties concerned to agree to the transfer, whilst also providing a means of mending the reserves positions of their own societies.

Not all small society directors however could be sold out. Articles in defence of the small societies were relatively few, but a case was still mounted to the effect that small societies still had an important place within the movement. The key argument was that the small societies provided a better service to their members, in that their service was more personal and informal. This was one of the arguments made by L.

---

[45] Derbyshire, 'Is the present constitution of building societies the best that can be devised?' in Mansbridge, *op. cit.*, pp.205-6.

[46] Cleary, *Building Society Movement*, pp.231-2.

G. Mead, the manager of the Harrow Building Society (another small London-based society) in reply to an article by H. C. Heales, a director of the Halifax Building Society, appearing in the *Gazette* in 1938:

> May I say, in regard to the "personal touch" with members, that I think that most borrowers prefer to discuss what are in fact the most important financial transactions of their lives with the executive officials of the society with which their houses are to be mortgaged, and that is why the smaller local societies, who can more readily afford such facilities have a decided advantage over the large ones whose executive official can of necessity only be approached by correspondence.... In building society work, I think size has disadvantages which the ordinary borrower is quick to sense, as he feels that his account is just one amongst thousands being handled literally by machinery each month, and that his particular problems cannot possibly be given special consideration owing to the volume of work to be dealt with by the staffs of the large societies.[47]

That a different culture prevailed within large national societies versus small local societies was not disputed by either side. The managers of the large societies saw the use of technology and large staffs to process high volumes of business as a virtue of their organisation, as compared to the antiquated (but albeit more personable) methods of small societies. What the argument centred on was whether diversity was in the interests of the movement or not, given that the conventional wisdom was that the standardisation of business practices was an ideal that would yield a more stable system. Advocates of rationalisation dismissed the "personal touch" line of argument as sentimental:

> Apparently all small societies have violent objections to any kind of amalgamation, but the only objections to any kind of amalgamation which I have so far been able to discover are sentimental ones: I recognise, of course, that most Building Societies were founded from philanthropic motives, but I would suggest that the magnitude of Building Societies today is such that they must be managed on strictly business principles, and that the old ideas must eventually give way to the necessities of modern-day requirements.[48]

This was an exaggeration. The case for small societies was more sophisticated than mere sentimentality, for it not only questioned the supposed technical benefits of large-scale business but furnished statistical evidence to prove it. Two particular rejoinders by representatives of two small societies stand out in the literature. The first by F. C. Pearce, Secretary of the Goldhawk Building Society, was a direct reply to Leaver's article in the *Yearbook*. Pearce "strongly rejected the inference that small societies are a danger to the larger societies" and argued that small societies were not failure-prone at all. While Leaver had argued that small societies in districts were

---

[47] *BSG*, 'Factors operating against absorption of small by large building societies' (August 1938), p.751.

[48] *BSG*, 'Amalgamations' (October, 1927), p.253.

potentially more exposed to fluctuations in trade activity, Pearce retorted that such societies were also governed by local boards of men who would make use of their acute knowledge of local business conditions to adjust their lending policy accordingly. Cleverly, Pearce quoted Enoch Hill (the President of the Halifax) who had numerous times commented that in spite of the depression in the textile industry, large increases in assets had been obtained by societies operating in these areas.[49] To Leaver's speculation that small societies were more likely to collapse if a run on their deposits ensued, Pearce asserted that the small societies were more likely to weather such a situation, as it was precisely their small size which would enable bankers to provide sufficient liquidity to them and allay the fears of depositors. This would be less likely (or impossible) in the case of large societies that were too big to bail.

That the large societies took more risks was the reason behind their need to run high levels of reserves, which according to Leaver was inadequately provided for in the reserves policies of most of the large societies. Overall, Pearce turned the charge onto the larger societies and concluded that the small societies:

> hold a good trump card by reason of the strength of their reserves, their more conservative policy with regard to advances, and are not in any way tied to making advances to all and sundry on large building estates, preferring safety to magnitude.[50]

The second article in defence of the small societies and against amalgamation was by James Brace in a paper given to the Royal Statistical Society in 1931. Brace produced statistics on the interest rates paid to shareholders and charged to borrowers, the reserves accumulation, and the cost efficiency of the societies in his sample. Some of his key findings were that the interest rates charged on mortgages in 1929 increased with the size of the building society, the highest rates being charged by societies in London and in the south of England, and the lowest in the northern counties.[51]

Constructing an overall measure of efficiency, Brace concluded that the smaller building societies were the most efficient within the movement, and the most accessible to the modest borrower.[52] But Brace also concluded that the expansion of large building societies in regional markets, especially by the southern metropolitan societies, threatened the existence of small building societies offering value for money to their members in the provinces. Turning to the topic of amalgamation, Brace stated that his figures showed that the combination of societies would yield no benefits to members, nor lead to businesses that were better administered. As noted earlier, the primary beneficiaries were managers.

The privileged place which managers enjoyed within the movement was not something which came naturally with the territory of their position. They worked hard to obtain it. To wit, the logic that building society executives should be paid high fees in reward for the success of their institutions was built upon a concerted campaign by

---

[49] *BSG*, 'The Small Society' (November, 1931), p.823.

[50] BSG, 'The small society' (November, 1931), p.824.

[51] Brace, 'Statistical Analysis of Building Societies,' p.184.

[52] *Ibid.*, p.201.

building society executives to raise their public profile and reputation for trustworthiness in society. An important tool in this propaganda effort was their trade publication, the *Building Societies Gazette*. Between 1921 and 1925, the *Gazette* published a series of articles containing biographical sketches of over 40 building societies and their managers. Titled 'Building Societies and their Managers', each monthly issue of the Gazette featured a long and detailed article about the history of a society, with effusive biographies of its managers and directors. The articles continually conveyed the idea that the success and growth of the societies were attributable to the extraordinary skills of its managers. As the prelude to the first article in 1921 reads:

> The Society and the managers... are of course one, because the Society is what the Manager makes it, aided naturally by the Board of Directors. The man on the bridge continually, by whose navigation the Society has to make a prosperous voyage, is the Secretary or the Manager.[53]

As such, the articles provided flattering biographies of the executives, praising them in superlative terms and giving fantastic anecdotes of their business exploits. The articles are significant given the wider debate at the time about the quality of English managers to manage the demands of large-scale industry.[54] Not surprisingly, most of the interviews were with the managers and directors of the largest societies in the movement: in fact, thirty-six of the forty-four societies whose managers were profiled in the series were classified as 'large' societies by the Chief Registrar in his annual report (i.e. holding mortgage assets in excess of £500,000). The articles were an important part of the propaganda produced by the elites of the movement to create an image of professional expertise that would be crucial to assuring investors of the safety of building societies, and ultimately to justify the high salaries they were to be paid when their firms had been successful.

The high public profile that these men were able to build for themselves also constituted another reward that was of equal (if not greater) value than the massive pay cheques which they could command from it: fame. The profiles of these men show that they were not quiet achievers altruistically committed to furthering the semi-philanthropic aims of their organisations. Many of them thrived in the spotlight, and had a penchant for publicity. Thus, the Annual General Meetings of the large societies were more like public gala events than the sober annual meetings of a humble building society. As Bellman himself wrote in *Bricks and Mortals* about the AGMs of the Abbey Road since 1925:

> To consider them merely as shareholders' meetings, however, was to take an unduly narrow view of them. They were something more... there was no annual meeting which was not thus graced by someone distinguished in the national life. An impressive list of

---

[53] BSG, 'The Leicester Permanent and Mr J. H. Davis,' (1921), p.224.

[54] Hannah, *Rise of the Corporate Economy*. Hannah discussed how one of the perceived limits of scale economies in English industry was not technology or labour, but the competence of local managers to manage the complex organisations of large-scale production concerns.

> those who honoured the Society in this way... includes Lord Baldwin, Lord Sankey, Lord Derby, Sir Kingsley Wood, Sir Austen Chamberlain...[55]

What the meetings were were a platform for spirited speeches, publicising the society and its achievements and for brushing shoulders with the elite of society. In short, the building societies provided the perfect stage for many ambitious middle-class men to raise their own profile in society. Many managers of the building societies became virtual celebrities, and the more prominent among them were given the highest honours of the kingdom. Harold Bellman of the Abbey Road, Enoch Hill of the Halifax, and Hubert Newton of the Leek & Moorlands to name a few were all knighted for their contributions to finance. For some of them, this represented a significant turnaround of social status from their humble beginnings. For example, Enoch Hill was "the son of a proletarian, a mill-worker at Leek," who started working life at eight years of age turning "the wheel of a manual engine providing power for silk-winding frames in a garret workshop."[56] At the end of his career, he was a knight of the realm and a giant of the movement, having managed one of the largest financial institutions of his day. In this way at least, the movement successfully played its part in helping people of modest origins to climb the ladder of opportunity to wealth and respectability.

Thus, the growth of building societies held out significant benefits (pecuniary and non-pecuniary) for those at the top of the movement. The managers of the large building societies had a lucrative personal stake in growing their societies as large as possible, be it through cut-throat competition with other societies, or by the absorption of small societies with ample reserve funds. Cleverly, as with other issues, managers capitalised on the changed tenor of business opinion within industry and government favouring large-scale enterprise to achieve their aim of eliminating the small societies, and imported the arguments in those debates to promote the idea within the movement that rationalisation was as inevitable as the laws of nature, and a necessary step in the long march towards perfection.[57] As this paper has shown, the case was not based so much on facts, but on the clever use of propaganda to ultimately serve the self-interest of managers bent on maximising their personal wealth at whatever cost. The era of managerial capitalism had dawned, with managers grabbing a larger share of the profits, which grew with the size and success of their firms.

---

[55] Bellman, *Bricks and Mortals,* p.125.

[56] Hobson, *A Hundred Years of the Halifax*, p.63.

[57] BSG, 'Amalgamations,' (October, 1927), p.253-4: "Amalgamation will come, whether we like it or not, so do not let us bury our heads in the sand; it is surely better to sail out now and make terms rather than to be forced out later on any terms that can be got. The day of the small society is on the wane – especially the Peter Pan sort that never grows up."

IV. Conclusion

It has been argued in this paper that competition, caused by the rapid expansion of building societies, had an adverse effect on their risk-taking behaviour. An associated factor behind this process for change was the arrival of a different class of investor in the late 1920s, whose uncommitted capital the societies became increasingly reliant upon to operate. Catering to the demands of this "city-minded" investor reinforced the transformation of the societies into institutions that more and more resembled corporate banks than mutuals, relinquishing in turn the very qualities of safety and stability that had been the hallmark of their success and popularity during the economic uncertainty of earlier times. In this lies the paradox of success for the movement: the tendency for the success of the societies, based on their virtues as mutuals, to be the very seed of their degeneration into corporate entities. The building societies followed a trend that was taking place economy-wide at the time, a trend that was helped along by an emerging consensus within the corporate and political world that big business was preferable to small. What resulted was a bifurcation within the movement, an expanding world of commercial building societies and a shrinking world of small societies that preserved what the movement once was in the pre-war period. The trend towards large-scale societies did not yield any appreciable benefits to members, nor did it produce more efficient firms in the sector. Rather, the beneficiaries of firm growth were the managers and directors of the societies, for whom firm growth brought massive pecuniary gains in the form of large executive salaries and massive non-pecuniary gains in the form of fame and regard. The changes which occurred in the movement did not occur passively with the changing economic and financial conditions in Britain after the First World War, rather, it was a process that was controlled and manipulated by managers. The expansion of the societies through competition, and then through the concentration of the movement by the absorption of small societies, were both deliberate strategies which the managers of the large societies used to build their empires. The ultimate consequence of their actions however may have been a devastating one if not for the outbreak of war in 1939, when the event of a major housing downturn was averted by strict government controls on the economy during the war. Nonetheless, the building society model had been redesigned at great cost, namely, at the loss of an inherently stable business model that had been so popular with simple, risk-averse investors. Some societies struggled against these changes to preserve their identity as authentic mutuals, but the force of an emergent ideology and vested interests favouring the move to big business would prove in time to render their resistance futile. The building societies had fallen victim to a modernization trend sweeping British business in the inter-war period and beyond, one which had clear distributional consequences for the patrons involved. The narrative in this paper provides an account of how managers served their own interests to appropriate all of the spoils, converting an inherently stable model of financial intermediation into one whose propensity for risk-taking would eventually prove to threaten the stability of the late inter-war economy. The story is similar to those of our times: the sacrifice of financial stability at the hands of managerial self-interest.

References

I. Printed Secondary Sources

BELLMAN, H., *Bricks and Mortals: A Study of the Building Society Movement and the Story of the Abbey National Building Society* (London: 1949).

BRACE, J., 'A statistical analysis of building societies' *Journal of the Royal Statistical Society,* 94/2 (1931), pp.173-217.

BROWN, R. and O'CONNOR. I. 'Measurement of economies of scale in Victorian credit unions', *Australian Journal of Management,* 20/1 (1995), pp.1-24.

DEPARTMENT OF EMPLOYMENT AND PRODUCTIVITY, *British Labour Statistics: Historical Abstract 1886-1968* (London: 1971).

CAPIE, F. and WEBBER, A. A., *A Monetary History of the United Kingdom, 1870-1982* (London: 1985).

CAPIE, F. and WEBBER, A. A., 'Profits and Profitability in British Banking, 1870-1939', Centre for the Study of Monetary History Discussion Paper no. 18, The City University (1985).

CASSIS, Y. *City Bankers, 1890-1914* (Cambridge: 1994).

CHAPMAN, A. L. and KNIGHT, R., *Wages and Salaries in the United Kingdom 1920-1938* (Cambridge: 1953).

CLEARY, E. J., *The Building Society Movement* (London: 1965).

COHEN, J. L., 'Building Societies and the Capital Market', *Building Societies Yearbook* (1932), pp.362-8.

DAVIES, D. G. 'The Efficiency of Public vs. Private Firms, The Case of Australia's Two Private Airlines', *Journal of Law and Economics,* 149 (1971), pp.149-65.

DE LONG, B. & GROSSMAN, R. 'Excess Volatility on the London Stock Market', Bradford de Long's Working Papers no. 133, University of California at Berkeley (1992).

DRAKE, L. 'Testing for Expense-Preference Behaviour in UK Building Societies: The Implications for Measures of Scale and Scope Economies', Economic Research Paper no. 94/2, Loughborough University of Technology (1994).

HANNAH, L., *The Rise of the Corporate Economy: The British Experience* (London: 1976).

HANSMANN, H. *The Theory of Enterprise* (Canada: 1996).

HOBSON, O.R., *A Hundred Years of the Halifax: The History of the Halifax Building Society: 1853-1953*, (London: 1953).

HODGSON, L.G., *Building societies: their origin, methods and principles* (London: 1929).

HUMPHRIES, J. K., 'Inter-war house building, cheap money and building societies: the housing boom revisited', *Business History*, XXIX/3 (1987), 325-345.

JENSEN, M. and MECKLING, W. 'Rights and Production Functions: An Application to Labour-Managed Firms and Codetermination', *Journal of Business,* 52/4 (1979), pp.469-506.

KEELEY, M. C. 'Deposit insurance, risk and market power in banking', *American Economic Review,* 80 (December 1990), pp.1183-1200.

MANSBRIDGE, A. *Brick upon brick* (London: 1934).

MITCHELL, B. And DEANE, P. *British Historical Statistics* (Cambridge: 1988).

O'HARA, M. 'Property rights and the financial firm', *Journal of Law and Economics,* 24/2 (1981), pp. 317-332.

POOLEY, C.G. and HARMER, M., *Property Ownership in Britain c.1850-1950: The Role of the Bradford Equitable Building Society and the Bingley Building Society in the Development of Homeownership*, (Cambridge: 1999).

RASMUSEN, E. 'Mutual banks and stock banks', *Journal of Law and Economics*, 31/2 (1988), pp. 395-421.

RICHARDSON, H. W. and ALDCROFT, D. H. *Building in the British Economy between the Wars* (London: 1968).

SCOTT, P. 'Selling owner-occupation to the working classes in 1930s Britain', Discussion Paper no. 023, Business School, University of Reading (2004).

SCOTT, P. 'Did owner-occupation lead to smaller families for inter-war working-class households', *Economic History Review*, 60/3 (2007), pp.99-124.

SHEPPARD, D. K. *The Growth and Role of UK Financial Institutions 1880-1962* (London: 1971).

SMITH, B. D. 'Private information, deposit interest rates and the 'stability' of the banking system', *Journal of Monetary Economics*, 14 (1984), pp. 293-317.

WOLFENDEN, J. 'The purpose and influence of the British building society', Speech given at the 1966 Bellman Memorial Lecture (Abbey Road Building Society: 1966).

WORTHINGTON, A. C. 'Efficiency in Australian building societies: an econometric cost function approach using panel data', *Applied Financial Economics*, 8 (1998), pp. 459-467.

II. Unpublished theses

SAMY, L., 'The Building Society Promise: The accessibility, risk and efficiency of building societies in England c.1880-1939' (DPhil: University of Oxford, 2010).

SPEIGHT, G., 'Building society behaviour and the mortgage lending market in the inter-war period: risk-taking by mutual institutions and the inter-war house-building boom', Unpublished Thesis (DPhil: University of Oxford, 2000).

MORRIS, S. 'Private profit and public interest: model dwellings companies and the housing of the working classes in London, 1840-1914', Unpublished Thesis (DPhil: University of Oxford 1998).

III. Manuscript and Archival Sources

DURHAM RECORD OFFICE (Durham), D/DCB/39-110 (City & County of Durham Building Society (DBS), Annual Reports: 1890-1950).

HARROW REFERENCE LIBRARY (Harrow), Ref. A4/1(Harrow Building Society, Annual reports: 1890-1950).

HBOS GROUP ARCHIVES (Edinburgh), Acc.2004/013/158-161 (Halifax Building Society (HPBS), Minute books: 1880-1914; Annual Reports: 1890-1950).

HBOS GROUP ARCHIVES (Edinburgh), Acc.2004/013/152 (Leeds Permanent Building Society (LPBS), Annual Reports: 1890-1950).

IPSWICH BUILDING SOCIETY (Ipswich), (Ipswich Freehold Land Society (IFLS), Minute books: 1880-1939).

KENSINGTON CENTRAL LIBRARY (London), (West London Permanent Building Society, Annual reports: 1896-1939).

LANCASHIRE RECORD OFFICE (Burnley), DDX 2153/1/2/1-11 (Burnley Building Society, Annual Reports: 1890-1950).

LONDON METROPOLITAN ARCHIVES (London), ACC/1975/001 (London Grosvenor Building Society (LGBS), Minute books, Annual Reports: 1879-1938).

LONDON METROPOLITAN ARCHIVES (London), B99/062 (Abbey Road Building Society (ARBS), Annual Reports: 1870-1941).

LONDON METROPOLITAN ARCHIVES (London), B99/062 (National Building Society (NBS), Annual Reports: 1870-1941).

LONDON METROPOLITAN ARCHIVES (London), ACC/1975/07/016 (United Friendly Building Society, Annual Reports: 1890-1938; Minute Books: 1931-1937).

LLOYDS TSB GROUP ARCHIVE (London), S/2/44/b/20 (Warwick & Warwickshire Building Society, Annual Reports: 1890-1950).

NATIONWIDE BUILDING SOCIETY ARCHIVES (Northampton), (Co-operative Permanent Building Society (CPBS), Minute Books, Mortgage Registers, Investor registers, Annual Reports, Other Miscellaneous Records: 1884-1941).

NATIONAL RECORD OFFICE (London), FS14/20 (Ashton-under-Lyne Stamford Permanent Benefit Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/28 (Barnstaple Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/52 (Bradford Permanent Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/60 (Bristol and West Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/67 (Cambridge Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/97 (Cumberland Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/134 (Grantham Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/162 (Huddersfield Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/2 (National Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/268 (Saddleworth Permanent Benefit Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/270 (Saffron Walden Benefit Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/269 (Saffron Walden and Essex Mechanics Permanent Benefit Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/311 (Stroud Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/315 (Swindon Permanent Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/317 (Temperance Permanent Building Society, Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/350 (Westbourne Park Building Society (WtPkBS), Annual Returns: 1913-1939).

NATIONAL RECORD OFFICE (London), FS14/366 (Woolwich Equitable Building Society (WOOL), Annual Returns: 1913-1939).

ST HELEN'S LOCAL HISTORY AND ARCHIVES (St Helen's, Lancashire), SR/2/1 (St Helens & Rainford Building Society, Annual Reports: 1890-1938).

SUFFOLK RECORD OFFICE (Ipswich), GF406 (Eastern Counties Building Society (ECBS), Minute books: 1880-1939; Securities Books: 1880-1938).

SURREY HISTORY CENTRE (Woking), (Chertsey, Walton, Weybridge and Woking District Building Society: Minute books, Annual Reports: 1890-1937).

TYNE & WEAR ARCHIVES SERVICE (Newcastle-upon-Tyne), DX 767/3/4-18 (Commercial Building Society, South Shields, Minute books, Annual Reports: 1890-1950).

TYNE & WEAR ARCHIVES SERVICE (Newcastle-upon-Tyne), Ref. 535/1-7 (Newcastle Portland Permanent Building Society, Minute books: 1890-1939).

TYNE & WEAR ARCHIVES SERVICE (Newcastle-upon-Tyne), Acc. 661/1/5-11, Acc.2420/1/1 (Northern Counties Building Society, Minute books, Annual Reports: 1890-1941).

TYNE & WEAR ARCHIVES SERVICE (Newcastle-upon-Tyne), Acc. 1574/1-62 (St Andrews Building Society, Annual Reports: 1890-1950).

IV. Printed Primary Sources

BOOTH, C. *Life and Labour of the People in London*. Various series (London: 1902). Digitised poverty maps available online: http://booth.lse.ac.uk/.

BUILDING SOCIETIES GAZETTE, Various articles. (London: 1870-1939).

CHIEF REGISTRAR OF FRIENDLY SOCIETIES. *Reports of the Chief Registrar of Friendly Societies*, Various Issues: 1895-1938.

APPENDIX 1: PRIMARY SOURCES

I. Case Studies

The archival records of six building societies were studied in detail in order to investigate the actual lending behaviour of individual building societies. They were chosen to represent the diversity of different societies in the movement, both in terms of their size and location (London vs. regional). The six societies were the Co-operative Permanent (CPBS) and the London Grosvenor (LGBS) building societies (a large and a small society respectively, based in London), the Eastern Counties (ECBS) and Ipswich & Suffolk (IFLS) building societies (based in Ipswich), and the Northern Counties (NCPBS) and Newcastle Portland (NPBS) building societies (based in Newcastle-upon-Tyne). The mortgage registers and minute books of these societies were analysed in the author's doctoral thesis on the accessibility, efficiency and risk-taking practices of building societies in England between 1880 and 1939.[58] Table A1.1 below shows the number of mortgages that were sample for each society in each period.

Table A1.1: Number of mortgages per case study society

Society	Pre-War	1920s	1930s
CPBS	1,792	600	900
ECBS	1,036	400	398
IFLS	421	250	500
LGBS	258	218	214
NCPBS	379	356	724
NPBS	177	34	63

II. Annual Reports

Figures from the annual reports of 33 building societies were used in this analysis. The sample included a mix of building societies of different sizes and from different regions across England. In total, the combined assets of these societies in 1930 comprised 61 per cent of the total assets of the movement, according to the aggregate figures reported by the Chief Registrar of Friendly Societies in his Annual Reports. A

[58] Samy, 'The Building Society Promise: The Accessibility, Risk and Efficiency of Building Societies in England c.1880-1939.'

list of the building societies in the sample is provided in Table A1.2, and map of their locations is provided below in Figure A1.1.

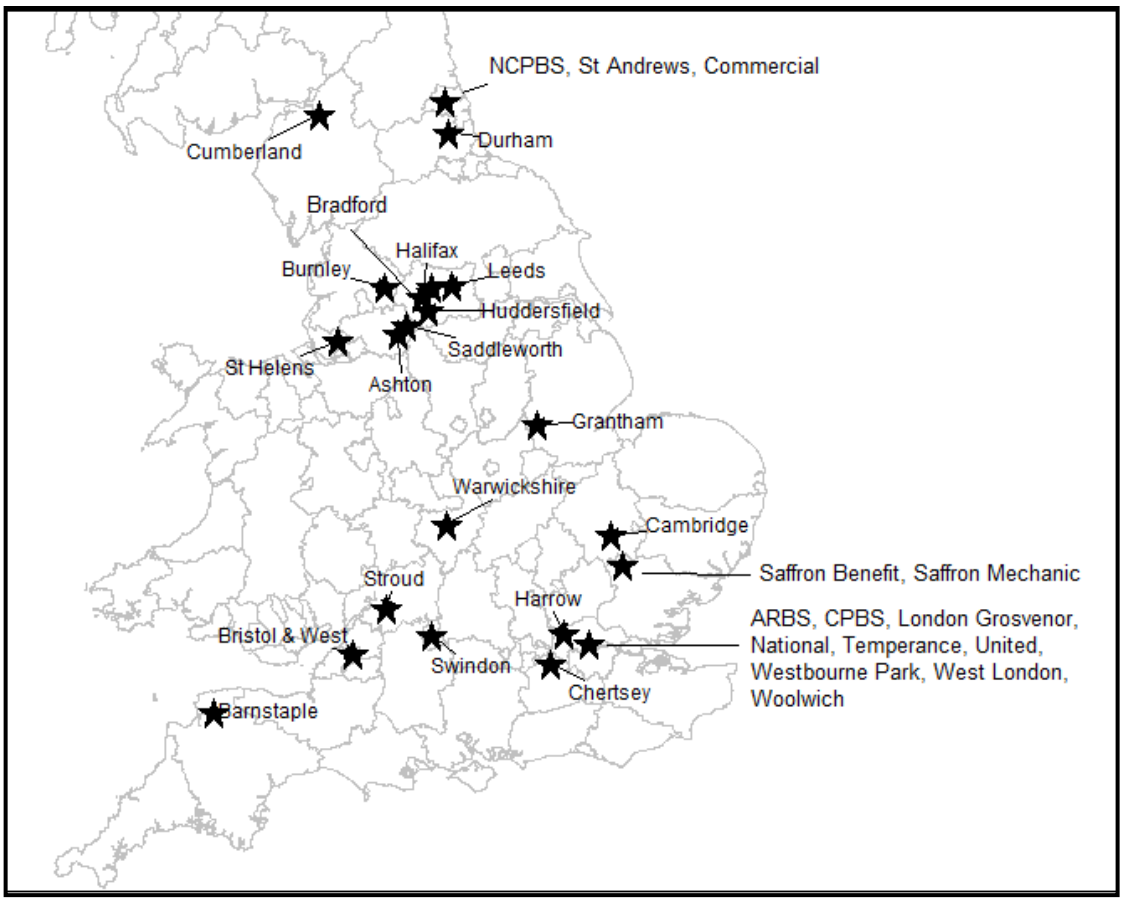
Table A1.2: Years for which annual reports were collected for the listed societies, and their respective market shares in 1930

Society	Market Share in 1930	Annual Reports collected
Abbey Road[+] (London)	10.00%	1890-1939
Ashton[*]	0.03%	1919-1950
Barnstaple[*]	0.02%	1919-1950
Bradford Permanent	0.20%	1919-1939
Bristol & West	0.39%	1919-1939
Burnley[+]	2.6%	1890-1934
Cambridge Permanent	0.10%	1919-1950
Cooperative Permanent[+] (London)	4.10%	1890-1945
Chertsey & District[*] (Surrey)	Less than 0.01%	1890-1936
Commercial (Newcastle-upon-Tyne)	0.12%	1890-1950
Cumberland Permanent[+]	0.62%	1919-1950
Durham[*]	Less than 0.01%	1890-1950
Grantham[*]	Less than 0.01%	1919-1950
Halifax Permanent[+]	19.17%	1890-1939
Harrow	0.19%	1891-1950
Huddersfield[+]	3.5%	1919-1939
London Grosvenor	0.02%	1889-1939
Leeds Permanent[+]	4.6%	1919-1939
National[+]	4.0%	1919-1939
Northern Counties Permanent (Newcastle-upon-Tyne)[+]	0.6%	1919-1941
St Andrews (Newcastle-upon-Tyne)	0.08%	1890-1950
St Helens[*]	0.01%	1890-1938
Saddleworth[*]	Less than 0.01%	1919-1950
Saffron Benefit[*]	0.05%	1919-1950
Saffron Mechanics Permanent Benefit[*]	Less than 0.01%	1919-1950
Stroud	0.08%	1919-1950

Society	Market Share in 1930	Annual Reports collected
Swindon	0.11%	1919-1950
Temperance Permanent+	1.53%	1919-1950
United Friendly Co-operative (London)	0.02%	1890-1938
Warwickshire*	0.08%	1890-1950
Woolwich+ (London)	5.6%	1919-1939
West London Permanent	0.05%	1890-1950
Westbourne Park+	2.9%	1919-1939

Note: + denotes 'large' building societies; * denotes 'small' building societies; all others classified as "medium".

Figure A1.1: Map of Sample Societies



APPENDIX 2: DATA ITEMS AND SOURCES

Variable Name	**Description**	**Source**
Building Society Variables (BS)		
SMALL_DUMMY	Dummy variable: 1 for small building societies, 0 otherwise	Annual Reports
MEDIUM_DUMMY	Dummy variable: 1 for Medium-sized Building Societies, 0 otherwise.	Annual Reports
LARGE_DUMMY	Dummy variable: 1 for large building societies	Annual Reports
AVERAGE SHAREHOLDER BALANCE	Balance of Share Capital / Number of Shareholders	Annual Report
PROFIT : TA	Net Profit : Total Assets	Annual Reports
PERCENTAGE OF LOANS IN DEFAULT	Percentage of loans in arrears or repossession	Annual Reports
PERCENTAGE OF LOANS LESS THAN £500	Percentage of mortgages less than £500 in debt	Annual Reports
GROWTH OF ADVERTISING EXPENDITURE	Growth in Advertising expenditure	Annual Reports
GAP_INTSH_BS	Interest rate paid to shareholders – Average Interest Rate paid to shareholder by all other societies	Annual Reports
GAP_INTSH_CONSOLS	Interest rate paid to shareholders - yield on consols	Annual Reports; Capie & Webber (1985), pp.494-5.
GAP_INTSH_DIVIDENDS	Interest rate paid to shareholders – dividend yield on stocks	Annual Reports; DeLong & Grossman, pp.28-29.
GAP_INTADV_CONSOLS	Interest rate paid charged on loans – yield on consols	Annual Reports; Capie & Webber (1985), pp.494-5.
GAP_INTADV_DIVIDENDS	Interest rate charged on loans – yield on dividends	Annual Reports; DeLong & Grossman, pp.28-29.
MARKET SHARE	Total Assets of Society / Total Assets of the Movement	Annual Reports; Chief Registrar Reports
TURNOVER	Turnover: (New Advances + Change in the balance of mortgage assets) / Balance of Mortgages at start of year	Annual Reports
Macroeconomic Variables (MACRO)		

Variable Name	Description	Source
GROWTH IN BUILDING ACTIVITY	Growth in Building Construction	Weber in Mitchell, Table 5, p.390
UNEMPLOYMENT RATE	Unemployment Rate	British Labour Statistics: Historical Abstracts, Table 159, p.305

APPENDIX 3: PANEL DATA REGRESSIONS

Several panel data models were estimated to test the determinants of:

- the growth of funds (share capital plus deposits) (Table A3.1);
- the growth of mortgage assets (Table A3.2);
- the withdrawal rate of funds (Table A3.3);
- interest rates (interest rate on shares, interest rate on loans and gap between interest rates on loans and shares) (Table A3.4).

1. The growth of funds and mortgages

The same specification was used for the first two dependent variables (growth of funds and growth of mortgages). These included dummy variables to control for year and region (7 regional dummies for the 7 regions in the sample: East, Midlands, London, North-East, North-West, South, Yorkshire) and a mixture of firm-level and macroeconomic variables (both contemporaneous and lagged). The firm-level variables included were:

- net profits divided by total assets, to capture the profitability of the society;
- the margin between the interest rate paid by the society and the average interest rate paid by all societies in the sample (a measure of the responsiveness of the dependent variable to competition between the societies);
- the margin between the interest rate paid on shares by the society and the nominal yield on consols (a measure of the risk of the society) (gap_intsh_consol)[59];
- the margin between the interest paid on shares by the society and the average dividend yield paid on the publicly-traded stocks (a measure of the competitiveness of building society investments with risky securities) (gap_intsh_dividends)[60];
- the percentage of small loans made by the society; and
- the ratio between advertising expenditure and the interest earned by the society from mortgagors.

The macroeconomic variables included were:

- the growth of building construction[61]; and
- the estimated rate of unemployment[62].

[59] Source: Capie & Webber, *A Monetary History of the UK,* pp. 494-5.

[60] Source: DeLong & Grossman, 'Excess Volatility on the London Stock Market,' pp.28-29.

[61] Source: Mitchell & Deane, *British Historical Statistics*, Table 5, p.390.

[62] Source: Department of Employment and Productivity, *British Labour Statistics*, Table 159, p.305.

The model results for funds and mortgage growth are given in Tables A3.1 and A3.2, and include separate parameter estimates for models estimated over restricted sub-samples, namely sub-samples including pre-war data only, inter-war data, data for only large societies in the inter-war period and data for small societies in the inter-war period. Fixed effect models were estimated in order to account for any unobserved heterogeneity in the data.

The findings of the model reveal that advertising intensity is one of the main determinants of both the growth of funds and the growth of mortgages. Advertising intensity was significant in all models, except the model including only small societies in the inter-war period, reflecting the fact that small societies neither invested heavily in advertising nor benefited much from it. Several of the interest margin variables were also significant. In terms of funds growth, the interest rate margin with the dividend yield on stocks was significant in all of the models, except for small societies whose dependent variables were not sensitive to interest rate movements. This suggests that investors who substituted between stocks and building society shares invested in large building societies rather than small ones. Interestingly, the interest rate margin with the average interest rate paid by other building societies (a proxy for competiveness with other building societies) did not have a significant impact in any of the models, which at once reflects the fact that there was very little difference in the rates paid by building societies and that building societies were not competing so much on price but on other bases such as advertising, firm size etc. The same cannot be said for mortgage growth: increases in the lending rate were associated with falls in mortgage business. Macroeconomic conditions did not have a particularly significant contemporaneous or lagged effect on funds or mortgage growth, except for the unemployment rate which was negatively associated with mortgage growth, particularly in the inter-war period.

2. The withdrawal rates and interest rates

The model of the withdrawal rate of funds was estimated in order to test whether the withdrawal rate varied between societies according to size, after controlling for other relevant factors such as the region and macroeconomic conditions (see Table A3.3). The model was estimated for the inter-war period only, when a gap in the withdrawal rate opened up between societies. The size of the society was captured by market share (defined as the total assets of the society in proportion to the aggregate assets of the movement). The same specification was used for separate regressions of the interest rate on shares and loans, and the gap between these rates (Table A3.4). The models were estimated to test for significant differences in the levels of these dependent variables in large, small and medium-sized societies, controlling for other relevant factors as before. To test for significant differences between the societies, two dummy variables were included in lieu of the market share variable, one denoting small societies (D_SMALL) and one denoting (D_LARGE). The dummy variables represent the difference in the interest rates for these societies in relation to medium-sized societies.

Table A3.1: Estimated regression coefficients of panel data model of the growth of funds (G_FUNDS) using fixed effects specification -

$$g\_\ddot{funds}_{ij} = c + \sum^{K} \beta_k \ddot{BS}_{ij} + \sum^{L} \delta_l \ddot{MACRO}_{ij} + \alpha_i + u_{ij}$$

	Full Sample Period (1896-1939)		**Pre-War (1896-1914)**		**Inter-war (1919-1939)**		**Large Building Societies (1919-1939)**		**Small Building Societies (1919-1939)**	
Explanatory Variables	**coef.**	**s.e.**	**coef.**	**s.e.**	**coef.**	**s.e**	**coef.**	**s.e**	**coef.**	**s.e.**
Intercept	0.2124 ***	0.040	-0.0198	0.128	0.1797 ***	0.051	0.4515 ***	0.105	0.1686	0.152
Building Society variables										
Year_dummies	not reported		not reported		not reported		not reported		not reported	
Region_dummies	not reported		not reported		not reported		not reported		not reported	
Net Profit : Total Assets	-0.0006	0.005	-0.0126	0.013	0.0064	0.007	-0.0126	0.018	0.0056	0.011
Percentage of loans less than £500	-0.0898 ***	0.031	-0.1334 *	0.071	-0.0629	0.045	-0.2114 ***	0.081	-0.1369	0.161
Advertising Intensity	0.0203 ***	0.005	0.0602 ***	0.012	0.0193 ***	0.006	0.0299 ***	0.008	-0.0039	0.016
gap_intsh_bs	0.0264 *	0.014	Dropped		0.0017	0.008	-0.0146	0.015	0.0147	0.013
gap_intsh_bs (lagged)	0.0081	0.020	Dropped		-0.0181 **	0.009	-0.0249	0.015	-0.0126	0.015
gap_intsh_consols	-0.0269 *	0.015	0.0188	0.017	Dropped		dropped		dropped	
gap_intsh_consols (lagged)	-0.0109	0.017	0.0217	0.015	Dropped		dropped		dropped	

	Full Sample Period (1896-1939)		Pre-War (1896-1914)		Inter-war (1919-1939)		Large Building Societies (1919-1939)		Small Building Societies (1919-1939)		
Explanatory Variables	**coef.**	**s.e.**	**coef.**	**s.e.**	**coef.**	**s.e**	**coef.**	**s.e**	**coef.**		**s.e.**
gap_intsh_dividends	0.0147 ***	0.005	0.0116	0.013	0.0119 **	0.005	0.0322 ***	0.008	-0.0011		0.009
gap_intsh_dividends (lagged)	0.0021	0.006	-0.0244 **	0.012	0.0199 ***	0.007	0.0105	0.012	0.0216	*	0.012
Macroeconomic Variables											
Growth in Building Activity	-0.0062	0.017	Dropped		0.0007	0.018	-0.0082	0.030	0.0324		0.032
Growth in Building Activity (lagged)	-0.0355 *	0.019	Dropped		-0.0061	0.014	0.0098	0.024	-0.0212		0.025
Unemployment Rate	-0.0017	0.002	0.0006	0.005	0.0032	0.003	0.0015	0.005	-0.0050		0.005
Unemployment Rate (lagged)	0.0007	0.002	0.0072	0.006	-0.0026	0.002	-0.0069 *	0.004	-0.0029		0.004
Number of Observations	776		242		534		168		193		
R-square	0.3644		0.3629		0.2914		0.5939		0.2584		
F-test all FE = 0	0.0000		0.0000		0.0000		0.0000		0.0155		

Table A3.2: Estimated regression coefficients of panel data model of the growth of mortgage assets (G_MORTAGES) using fixed effects specification - -

$$g\_\ddot{mortgages}_{ij} = c + \sum^{K} \beta_k \ddot{BS}_{ij} + \sum^{L} \delta_l \ddot{MACRO}_{ij} + \alpha_i + u_{ij}$$

	Full Sample Period (1896-1939)		**Pre-War (1896-1914)**		**Inter-war (1919-1939)**		**Large Building Societies (1919-1939)**		**Small Building Societies (1919-1939)**	
Explanatory Variables	**coef.**	**s.e.**	**coef.**	**s.e.**	**coef.**	**s.e.**	**coef.**	**s.e.**	**coef.**	**s.e.**
Intercept	-0.1604 *	0.093	0.3743 ***	0.111	-0.2361 **	0.118	-0.3845 **	0.178	-0.0495	0.254
Building Society variables										
Year_dummies	not reported		not reported		not reported		not reported		not reported	
Region_dummies	not reported		not reported		not reported		not reported		not reported	
Net Profit : Total Assets	-0.0008	0.006	-0.0184	0.013	0.0075	0.008	-0.0315	0.019	0.0084	0.013
Percentage of loans less than £500	-0.1467 ***	0.035	-0.3253 ***	0.069	-0.1352 **	0.052	-0.2587 ***	0.069	-0.0387	0.178
Advertising Intensity	0.0187 ***	0.566	0.0551 ***	0.012	0.0171 **	0.007	0.0249 ***	0.007	-0.0008	0.175
gap_intsh_bs	-0.0664 ***	0.020	0.0078	0.023	-0.0534 **	0.024	-0.0502	0.038	-0.0593	0.042
gap_intsh_bs (lagged)	0.0283 **	0.012	Dropped		dropped		dropped		0.0475 **	0.021
gap_intsh_consols	dropped		Dropped		0.0482 *	0.025	0.1498 ***	0.042	dropped	
gap_intsh_consols (lagged)	dropped		Dropped		dropped		dropped		dropped	

	Full Sample Period (1896-1939)		Pre-War (1896-1914)		Inter-war (1919-1939)		Large Building Societies (1919-1939)		Small Building Societies (1919-1939)	
Explanatory Variables	**coef.**	**s.e.**	**coef.**	**s.e.**	**coef.**	**s.e.**	**coef.**	**s.e.**	**coef.**	**s.e.**
gap_intsh_dividends	0.0707 ***	0.017	Dropped		dropped		dropped		0.019	0.037
gap_intsh_dividends (lagged)	dropped		-0.0005	0.021	0.0297 **	0.014	0.0158	0.022	dropped	
Macroeconomic Variables										
Growth in Building Activity	0.0244	0.019			0.0242	0.020	0.0075	0.029	0.0.414	0.034
Growth in Building Activity (lagged)	-0.0123	0.017			-0.0093	0.019	0.0351	0.028	-0.147	0.034
Unemployment Rate	-0.0065 ***	0.002	0.0005	0.004	-0.0067 ***	0.002	-0.0134 ***	0.003	-0.0033	0.004
Unemployment Rate (lagged)	0.0023	0.002	-0.0091 **	0.004	0.0022	0.002	0.0000	0.003	0.0031	0.004
Number of Observations	775		241		534		168		193	
R-square	0.3315		0.2652		0.2744		0.5600		0.1391	

Table A3.3: Estimated coefficients of panel data regression of withdrawal rates

Variable	**coef.**	**s.e.**
Region Dummies	Not reported	
Market share (% of society's mortgage assets to aggregate mortgage assets)	0.4416 ***	0.1119
Average balance of share investment by shareholders	-0.0012 ***	0.0000
Gap between Interest rate on Loans and Rate on Consols	-0.0179 ***	0.0032
Gap between Interest rate on Loans and Stock Returns	0.0002	0.0003
Unemployment	-0.0010	0.0009
Constant	0.0483 ***	0.1846
Number of Observations	600	
R-square	0.3623	

Table A3.4: Estimated coefficients of panel data regression of interest rate on shares, interest rate on loans and the interest rate margin between lending and investment

Dependent Variable	**Interest Rate on Shares**		**Interest Rate on Loans**		**Interest rate gap between shares and loans**	
	coef.	**s.e.**	**coef.**	**s.e.**	**coef.**	**s.e.**
D_SMALL	-0.0007	0.0008	-0.0026 ***	0.0007	-0.0036 ***	0.0007
D_LARGE	0.0007	0.0007	-0.0009	0.0006	-0.0015 **	0.0007
Average Shareholder Balance	0.000003	0.000003				
Average balance on mortgage			-0.000008 ***		0.000007 ***	0.000002
Turnover: (New Advances + Change in the balance of mortgage assets) / Balance of Mortgages at start of year	0.0088 **	0.0040	0.0150 ***	0.0032	0.0082 *	0.0043
Percentage of loans in default	-0.0261 **	0.0129	-0.0434 ***	0.0071	-0.0006	0.0100

Dependent Variable	**Interest Rate on Shares**		**Interest Rate on Loans**		**Interest rate gap between shares and loans**	
	coef.	**s.e.**	**coef.**	**s.e.**	**coef.**	**s.e.**
Growth of Building Activity	0.0020 **	0.0008	0.0045 ***	0.0006	0.00008	0.0010
Unemployment Rate (%)	0.0002 ***	0.0000	0.0005 ***	0.00003	-0.00003	0.00008
Constant	0.0349 ***	0.0018	0.0385 ***	0.0015	0.0108 ***	0.0014
Number of Observations	861		897		897	
R-square	0.0739		0.4918		0.1374	

*Note*s: These models also include dummy variables for region and period (pre-war, WW1, 1920s and 1930s). The above table therefore does not contain all of the parameter coefficients estimated.

University of Oxford Discussion Papers in Economic and Social History: Recent publications

69 Guillaume Daudin, *Domestic Trade and Market Size in Late Eighteenth-Century France* (April 2008)

70 Avner Offer, *Charles Feinstein (1932–2005) and British Historical National Accounts* (June 2008)

71 Sandra González-Bailón and Tommy Murphy, *When Smaller Families Look Contagious: A Spatial Look at the French Fertility Decline Using an Agent-based Simulation Model* (September 2008)

72 Luke Samy, *The Building Society Promise: Building Societies and Home Ownership, c1880–1913* (October 2008)

73 Leigh A. Gardner, *To Take or to Make? Contracting for Legitimacy in the Emerging States of Twelfth-Century Britain* (November 2008)

74 Avner Offer, *British Manual Workers: From Producers to Consumers, c.1950–2000*

75 Pablo Astorga, *A Century of Economic Growth in Latin* America (January 2009)

76 Scott Andrew Urban: *The Name of the Rose: Classifying 1930s Exchange-Rate Regimes* (April 2009)

77 David Chacko: *Medical Liability Litigation: An Historical Look at the Causes for Its Growth in the United Kingdom* (April 2009)

78 Mark Koyama: *The Price of Time and Labour Supply: From the Black Death to the Industrious Revolution* (September 2009)

79 Cliff Bekar and Clyde Reed: *Risk, Asset Markets, and Inequality: Evidence from Medieval England* (October 2009)

80 Pablo Astorga, *Mean Reversion in Long-Horizon Real Exchange Rates: Evidence from Latin America* (January, 2010)

81 C. Knick Harley, *Prices and Profits in Cotton Textiles during the Industrial Revolution* (May, 2010)

82 Avner Offer, Rachel Pechey and Stanley Ulijaszek, *Obesity under affluence varies by welfare regimes: the effect of fast food, insecurity, and inequality* (July, 2010)

83 Paul A. David, S. Ryan Johansson and Andrea Pozzi, *The Demography of an Early Mortality Transition: Life Expectancy, Survival and Mortality Rates of Britain's Royals, 1500-1799* (August, 2010).

84 Florian Ploeckl, *The Zollverein and the Formation of a Customs Union* (August, 2010).

85 S. Ryan Johansson, *Medics, Monarchs and Mortality, 1600-1800: Origins of the Knowledge-Driven Health Transition in Europe* (October, 2010).

86 Luke Samy, *'The Paradox of Success': The Effect of Growth, Competition and Managerial Self-Interest on Building Society Risk-taking and Market Structure, c.1880-1939*

UNIVERSITY OF OXFORD DISCUSSION PAPERS
IN ECONOMIC AND SOCIAL HISTORY

are edited by

Rui Esteves (Brasenose College, Oxford, OX1 4AJ)
Luke Samy (Nuffield College, Oxford, OX1 1NF)

Papers may be downloaded from
http://www.nuff.ox.ac.uk/Economics/History