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What drives developers? Understanding vertical (dis)integration strategies in the land development process

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ABSTRACT

Real estate developers play a crucial role in the production of our cities. Yet, the knowledge about how they operate is limited. They are often portrayed as a homogeneous group, while in practice we see a large variety of different types of developers and of their strategies. Particularly striking are the differences in the extent to which real estate developers cover the land development process. Some limit themselves to development, while others incorporate strategic land acquisition, construction, and/or long-term investment. With the help of theories from organisational economics, we explore different vertical integration strategies and the motives behind them. We apply these insights to cases from the Dutch homebuilding industry. Our analysis leads to a conceptualisation and categorisation of real estate developers according to their vertical integration strategy and we identify different motives behind those strategies. We find that vertical (dis)integration strategies are informed by strategic considerations, such as land assembly in order to secure future workload in construction, by price advantages, and by transaction-cost considerations that are related to the highly specific nature of some activities in the land development process.

1. Introduction

Real estate developers are crucial actors in the production of our cities. Yet, academic scholars from economics, planning, and geography know relatively little about them (Logan, 1993; Healey, 1998; DiPasquale, 1999). They are often portrayed as a homogenous group with a single goal (i.e. profit or rent-seeking) (Coiacetto, 2001; Brown, 2015). However, although there are clearly similarities between real estate developers, there are equally great differences in the strategies they choose and the goals they pursue. This seems to be particularly the case with regard to which part(s) of the land development process they are involved in. Some stretch all over it, while others focus on certain activities only. Given that private-sector influence in real estate and urban planning appears to be growing (Heurkens, 2018, p.107; Leffers and Wekerle, 2019, p. 319), a better understanding of the way real estate developers work increases our understanding of the (lagging) supply of housing and others forms of real estate in terms of quantity, speed, location, and so on.

The aim of this paper is twofold. First, we want to provide a framework for categorising different types of real estate developers, mainly those concerned with housing, across different national, cultural, or institutional contexts to make sense of both their differences and similarities. They are categorised according to the types and number of activities that they undertake within the land development process, that is, their vertical (dis)integration strategy. Second, by making use of insights from organisational and industrial economics (e.g. Harrigan, 1984; Williamson, 1985; Mahoney, 1992), we seek to conceptualise, categorise and empirically illustrate the different factors that drive their vertical (dis)integration strategy. The empirical illustration is based on case-study research in which Dutch real estate developers have been investigated.

The outline of this paper is as follows. First, we discuss the literature on real estate development and developers (Section 2). Second, we explore what can be learned from the organisational economics on vertical integration strategies (Section 3). In the empirical section (Section 4), we cluster Dutch housing developers according to which activities in the land development process they undertake. From each of the categories, developers have been selected and interviewed to understand drivers. The last section discusses the results and reflects on their implications (Section 5).

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2. Real estate developers: a review of the literature

Real estate development can be defined as 'a particular state of transition or change in the form of real estate toward a different state with an associated change in potential or real value' (Drane, 2013, p. 2). This production process, also referred to as the 'land development process', is similar to that of commodities in the sense that a sequence of events leads to the completion of the end product but is very different in the types of goods produced. In comparison with other production processes, the products are highly heterogeneous and bound to a specific location with its locational characteristics (Coiacetto, 2001; Alexander, 2014). That leads to a great variety between supply chains and development projects.

The land development process and its different stages has received much attention from scholars since the 1970s (Barrett and Underwood, 1978; Ratcliffe, 1978; Dreimuller, 1980; Gore and Nicholson, 1991; Healey, 1991; Needham and Verhage, 1998; Alexander, 2001). When looking at it from a greater level of abstraction, there are many similarities between the types of activities that are performed in the land development process across various institutional contexts. In line with the logic of 'event-sequence models' of the land development process (Gore and Nicholson, 1991; Healey, 1991), we follow a rather crude distinction in four stages or activities: 1) land acquisition, 2) development, 3) construction, 4) end ownership/long-term investment.

Land can be acquired strategically, long before it is clear that development is allowed at all (i.e. land banking), or closer to and with greater certainty about the development, either bilaterally or through a public tender. It needs to be noted that the stages, particularly stages 1 and 2 sometimes occur in parallel and in interaction with each other rather than sequentially.

The production of real estate is rarely performed under the control of only one company. Instead, it 'involves a nexus of landowner, financier, construction firm, development company, and planning agency. The balance of power between these agents may vary significantly at different stages of the development process' (Healey, 1991, p. 223). Real estate developers are the actors that develop plots or sites from an initial state to deliver new functions. They 'seek to create and sell entirely new products […] by purchasing real estate, construction services, and professional services – the project costs – and combining them together into a new product that can be sold for a price that is greater than the sum of those costs' (Brown, 2015, p. 38). The ambition to capture the heterogeneity of real estate developers makes descriptions and definitions inevitably broad and unspecific (Coiacetto, 2001).

Real estate developers can be categorised according to basic characteristics. One may be the market *segment* in which they operate, such as the office, retail, housing, industrial/logistics segment (e.g. Brown, 2015). Another could be by the *size* of the company, in terms of equity, turnover, or annual production. *Geographical scope*, that is, whether the company operates at the regional level, nation-wide, or across borders, is yet another way to categorise developers. Or we could categorise them according to how *active* they are in relation to taking a development initiative: 'active developers' create initiatives while 'passive developers' await them (Coiacetto, 2001).

We want a deeper understanding of the *behaviour* and the *motives* of developers in relation to the whole supply chain. Do they choose to integrate or disintegrate, and why? There is some literature on this. Bacow (1990) links vertical integration in the American real estate industry specifically to foreign investment. Dewald et al. (2007) explores variables that drive small firms in the homebuilding industry to choose quasi-integration in situations of high asset specificity. Anikeeff and Sriram (2008) focus on the effects of vertical integration strategies on business *performance.* There is one paper by Lind (2017), on vertical integration in the Swedish real estate industry, which comes closest to our intentions. In this study theories about vertical integration are tested in the Swedish real estate sector. The main findings are that no support was found for vertical integration strategies with the goal of monopolizing a market and only marginal support was found for vertical integration theories regarding contracting problems. Unlike Lind, our study focuses on the whole production chain of housing development, since we include land ownership and investment (besides development and construction). Furthermore, we focus also on factors behind disintegration. In addition, our paper also tries to develop a framework that captures different degrees and forms of integration; we are not only considering explanatory factors behind vertical integration.

3. Real estate developers and vertical integration

3.1. Vertical integration strategies

Vertical (dis)integration refers to a firms' strategy of combining (sequential) activities of the production process within the firm, in order to use the output of the first stage as input for the subsequent stage. A firm's place in the production process relates to other parts and actors in this process. If it only operates in the early stages of production, for instance, it needs buyers that continue the development subsequently, and ultimately sell the product to customers, or sell it on to others who do that. The way in which firms choose their strategic position within the production process and therefore the amount of vertical ownership they have, is referred to as the vertical integration strategy.

Within organisational economics, vertical integration has become one of the key topics. This literature originates with Ronald Coase's seminal 1937 paper about the nature of the firm, in which he put forward the 'make-or-buy-decision': actors within a production process can decide to either make a product themselves, which creates or extends 'the firm', or to buy it from somebody else. According to the theory of Coase, the size of the transaction costs is the deciding factor in that decision. Since then, a vast literature has developed in which firms are considered in relation to the entire production process or supply chain, from raw material to end product. This literature focuses on 'vertical integration', that is, the extent to which firms have integrated different activities within the supply chain into their business (e.g. Williamson, 1975; Harrigan, 1984; Porter, 1985; Williamson, 1985; Grossman and Hart, 1986; Mahoney, 1992; Diez-Vial, 2007; Guan and Rehme, 2012; and applied to land-use planning by Alexander, 2001). The direction of the vertical integration is given particular attention within this literature, both 'forward' and 'backward' integration of the supply chain, also referred to as 'downstream' and 'upstream' integration.

The literature distinguishes between three strategies (or 'governance structures'). One is 'vertical ownership', a firm covering multiple parts of the production process within its own organisation as a result of the 'make' decision. Next to 'make', there are two types of strategies through which the 'buy' decision can be made. The first is the classical market transaction through the price mechanism, whereby the relationship between buyer and seller is 'one-off' and transient. This is referred to as 'spot-market trading'. And the second strategy is one where buyer and seller engage in a long-term relationship, through which, over time, multiple transactions take place. In this case, trust, experience, and familiarity – not price – are the coordinating mechanisms. We call this 'long-term vertical contracting'. It needs to be said, though that pure 'spot-market trading' is rare in real estate markets, where the good is locationally fixed, and local knowledge (and relationships) is required from buyers and sellers (Buitelaar, 2007).

3.1.1. Vertical integration in the land development process

If we look at vertical integration in the land development process, in the context of the production of housing,[1] we need to recall the four main activities identified in Section 2: 1) land acquisition, 2) development, 3) construction, 4) end ownership/long-term investment.

[1] Although this may also include other, related products such energy infrastructure and mobility services.

Carrying out ‘development’ (activity 2) is a minimal and necessary element for a real estate developer to be actually called a *developer* (in line with Dreimuller, 1980). With development, we mean all the activities that are necessary to make a plot of land ready for the actual construction of real estate. This concerns development of the plan, consultation and negotiating with local planners to change the zoning plan, calculate and monitor financial feasibility of a plan, physical preparation of the site, selling real estate to end-owners, obtaining finance for the implementation of a plan and marketing/communication throughout this process.

The availability of land is crucial for developers. Land has some extraordinary characteristics in economic terms (Alexander, 2014). The most important characteristic for the supply chain of land development is that land is a fixed and locationally-specific resource, which cannot be produced when demand increases (i.e. no ‘make’ decision possible). Therefore, we make a distinction between land that is bought strategically by developers, long before and anticipating future development, and land that is bought with the (upcoming) certainty of development taking place (e.g. through a public tender). The former is a case of vertical integration (i.e. ‘make’), while the latter is a form of contracting (i.e. ‘buy’).

Construction is about the physical production of property. This starts with the planning permission to build and ends with the delivery of new property to an end-owner. The last phase of the development process is long-term investment.

In theory, if we combine these four activities in all the possible ways, with development always present, we arrive at eight combinations (Fig. 1). These are eight different vertical integration strategies. In the empirical Section (4), we explore whether these exist empirically (in the Netherlands) and what might drive their existence. But first, we need to explore those drivers conceptually.

3.1.2. *Motives behind vertical integration strategies*

Motives for vertical integration strategies of real estate developers can provide insight into a firms’ drivers for development. This regards why an actor chooses to incorporate parts of the production process within the organisation, why an actor chooses to rely on vertical contracting (either long- or short-term) for other parts of the production process, and how this has changed over time (if at all). A firms’ current vertical integration strategy may be a relic of the past, while others change their strategy over time, and they may have various reasons for their respective choices. Here we use Mahoney’s classification into four major categories of motives: 1) strategic considerations; 2) output and/or input price advantages; 3) uncertainties in costs and/or prices; and 4) transaction costs considerations (Mahoney, 1992; compare to Osegowitsch and Madhok, 2003, p. 27, for a similar distinction). We take the last two categories from this classification together because uncertainty (about costs/prices, among other things), together with the frequency and asset specificity, is exactly what causes transaction costs (see the work of Williamson, 1975, 1985). We will discuss the three remaining categories in more detail and related to vertical integration by real estate developers.

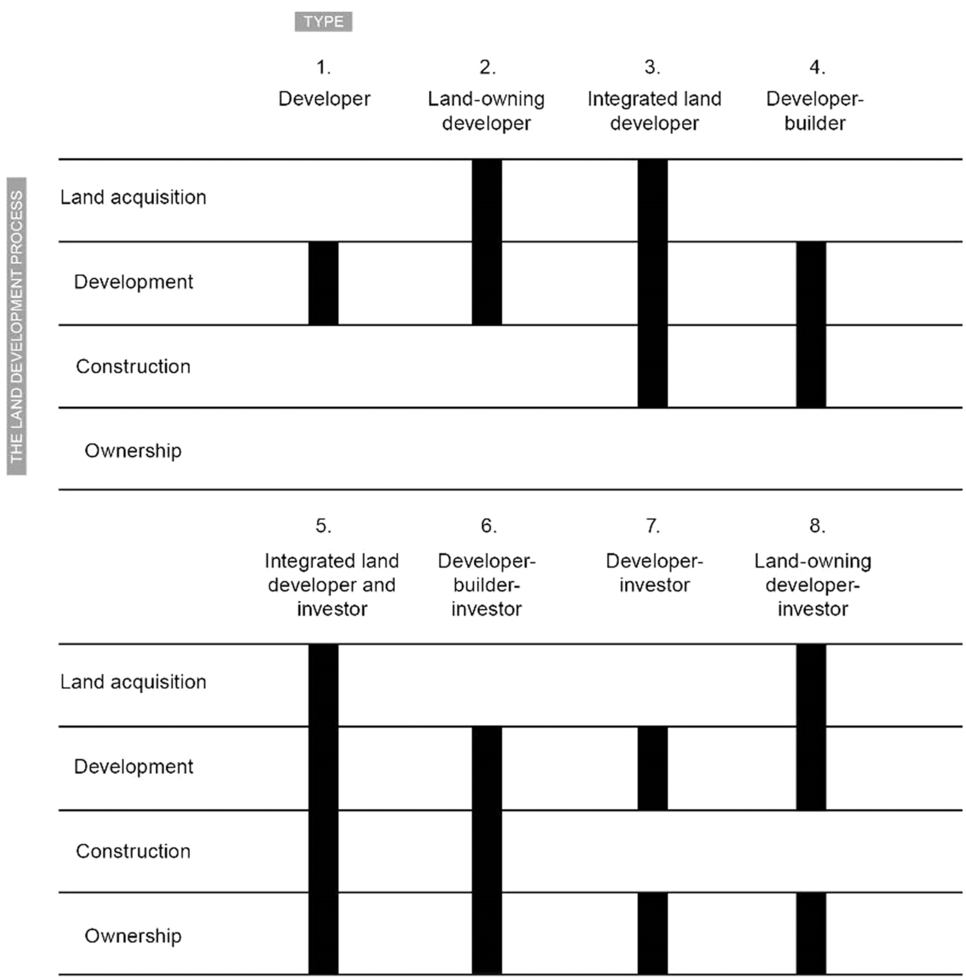

Fig. 1. Vertical integration strategies of real estate developers, Source: authors.

3.1.3. Strategic considerations

Strategic considerations as a motive for the vertical integration strategy relate to a firms' strategic position towards competitors in the market. Vertical integration – mainly 'upstream' – can inhibit competition and confer market power (Bernheim and Whinston, 1998). Another example is 'price squeezing', in which the output price is lowered and the input price is raised simultaneously, in order to eliminate competition (Joskow, 1985). As a result, downstream actors are not able to gain margin and remain competitive on the market, since both their input prices are raised, and the value of their products lowered. This is mostly a motive for vertically integrated firms with a large market share in markets with intense competition. Vertical integration is a means to exclude potential new competitors and limit competition. Strategic advantages for vertical integration in the land development process can for example consist of upstream integration towards land acquisition. This relates to the immobility of land and the locational monopolies as a result of land ownership. Real estate developers can choose to acquire land – even 'land banking' – to secure future construction. If the location can be developed in the future, the ownership guarantees them a 'seat at the table' in the land development process – provided that the right to build is an indispensable part of the ownership right, as it is in most countries – and excludes competition from these specific development sites. An application of price squeezing in the land development process can be the integration of supply-chain activities within the firm with the aim of gaining as much margin as possible. Vertically integrated firms can then settle for lower margins for individual activities, compared to non-integrated competitors, because they carry out more activities and gain more margin in those other activities. This strategy is an example of strategic considerations when it is carried out to complicate market entry or hinder non-integrated competitors.

3.1.4. Output and/or input price advantages

The land development process is not just a process in which physical goods and real estate are (re)created, it is also a process in which value is created/added. This could be, and has been, referred to as a 'land value chain' (e.g. Gidwani and Upadhya, 2022), analogous to Michael Porter's 'value chain' as introduced in his well-known book *Competitive Advantage.* He defines a firms' 'value chain' as 'a collection of activities that are performed to design, produce, market, deliver, and support its product' (Porter, 1985, p. 36). This value chain consists of primary activities that concern the physical creation of the product and support activities that enable the production process of the primary activities. The total value created in the value chain includes costs of activities and margin.

Price advantages can be a strong motive for vertical integration strategies, especially in cases where the manufacturing of a product passes successive stages of production (Mahoney, 1992). If output and input prices are not a given, and firms can act as price 'setters' rather than 'takers', they can strategically use vertical integration in order to set prices and gain a larger profit margin. A motive for (more) vertical integration in this category can be evading the monopoly power of upstream firms (i.e. firms that perform preceding activities in the production process) and cost savings as a result of more efficient use of resources.

The housing market is a 'stock' market, which implies that prices of newly built units are derived from prices of comparable units in the existing housing stock (since they both compete for the same buyers). The output price of the end product (i.e. the house price) is fixed and the pricing of parts of the production process takes place in a downstream manner, ultimately resulting in the price for 'raw', undeveloped, land. This downstream sequence of value determination is better known as the manner, also known as the 'residual value method' (Davis and Palumbo, 2008). What is left after all costs are deducted from the value of the end product is the 'residual', the pie that all involved in the land development process want a share from. They try that by limiting their costs and maximising their revenues. Therefore, the pricing of inputs and output (thus except for the final output: the houses) is a likely argument for vertical integration of real estate developers. When a firm is able to integrate several parts of the land development process within the firm, the residuals in the different parts of the land value chain can be captured. In other words, when the additional costs of vertical integration can be offset by margin gain, vertical ownership is likely to be preferred over vertical contracting.

3.1.5. Transaction costs considerations: uncertainty, frequency, and asset specificity

Transaction costs are the costs of contracting, such as search and information costs, bargaining costs, and ex-post costs of monitoring and enforcing contracts (Williamson, 1985). Uncertainty, frequency, and asset specificity are the main transaction attributes that determine transaction costs and, therefore, the organisational form (i.e. governance structure) best capable of economising on these transaction costs (Joskow, 1988, p. 105).

Uncertainty and, related to that, risk play a large role in vertical integration strategies (Wernerfelt, 1984). Without uncertainty, the firm need not exist because all transactions can be dealt with by markets (Coase, 1937). Uncertainty is the reason firms need to overcome the transaction costs that are associated with market transactions. By analogy of uncertainty as to the basis of a firm's existence, it is also an argument for vertical integration strategies (Mahoney, 1992). Uncertainty in demand can cause supply failure for the customer and the risk of overproduction for the seller (Carlton, 1979).

Following uncertainty, the *frequency* of transactions is the second transaction attribute that determines the size of the transaction costs. The more often a transaction is needed, the higher the transaction costs (especially with high uncertainty surrounding it) and the more economical vertical ownership may become, provided that the internal bureaucratic costs are lower than the transactions of trading with buyers and sellers. In the context of real estate developers, the frequency of transactions is relatively low, as compared to markets in commodities. Land and real estate markets are 'thin' markets, markets with relatively few transactions (Geltner et al., 2007).

The third transaction attribute is asset specificity, which 'refers to the existence of significant transaction-specific sunk costs, which are durable non-deployable investments in a transaction that thus has little use or economic value outside the buyer-supplier relationship' (Whyte, 1994, p. 288). Land and real estate are highly specific assets due to their unique locational features. In general, the lower the asset specificity, the higher the possible added value for vertical ownership can be (Mahoney, 1992). Asset specificity exposes the buyer/supplier to the opportunistic behaviour of the other (Whyte, 1994), which can be an additional argument for vertical ownership.

4. Vertical integration strategies of Dutch housing developers

4.1. Method

The differentiation among land developers and their motives for development is applied to and illustrated by Dutch housing development. An embedded case study setup is used to compare different types of developers and their vertical integration strategies. We chose to select developers that operate within one specific institutional setting and national context, in order to eliminate other potential factors that can explain differences and vertical integration strategies.

The goal of the case study is to illustrate a wide variety of motives behind vertical (dis)integration strategies. Therefore, we first searched for a developer from each of the eight archetypes within the Dutch housebuilding industry, as identified in the previous section. To test the motives for the vertical integration strategy, we focused on the vertical integration strategies of firms in a general sense, since their vertical integration strategy can differ and in specific projects may deviate from the overall strategy. The focus of the case study is on the firms' overall vertical integration strategy when considering all ongoing development projects. The motives can consist of the categorised motives presented in Section 3.2 and, potentially, other types of motives that are not covered in these categories. The selection of developers is based on public background information, mostly found on developers' websites, real estate media outlets, and annual reports.

The selection of a developer based on their archetype proved difficult, since the development market in the Netherland is not very transparent. In some interviews, the developer archetype that we had attributed to the developer turned out to be not entirely accurate and therefore had to be recategorised. The reason, therefore, was mostly due to our assumption of whether or not a developer owns strategically acquired land. In some cases, the interviewed developers still own a small amount of land as a result of a large-scale purchase of land positions in the 1990s, which was common those days in the light of the execution of a national plan with a massive housing-production scheme (Vinex) (Louw et al., 2003). Their current focus and strategy, however, is strictly on other activities in the land development process, and, more importantly, their stock of acquired land is not an important factor of production in their current vertical integration strategy. The definition of (vertical) 'ownership' of land acquisition ('strategic' land acquisition) is therefore limited to real estate developers that use their available land positions as an 'important' factor of production and/or real estate developers that still substantially acquire new land for future developments. In this study, strategic land acquisition has been considered an 'important' factor of production when at least one-third of the annual developments result from existing, previously established landholdings ('make'). The implication of this choice is that developers who only own a short amount of land for future development are not qualified as 'land owners' in our framework. This eliminates multiple developers in the Dutch context whose main focus for new development plots are on tenders and/or one-on-one purchases of development plots which can be developed in the nearby future.

Ultimately, eight cases were selected: six different types of developers, four types with one case, and two types with two cases. The types 'developer-builder-investor' and 'developer' were not found in Dutch practice. In the interview with the only eligible developer for 'developer-builder-investor', it showed that they are a 'developer-builder', because they do not own rented housing (only other types of real estate). The case that initially qualified as 'developer', turned out to have a substantial stock of land for future development from past acquisitions and is therefore actually a 'land-owning developer' instead. In Table 1 all developers have been listed, with basic key information about the nature of the company and its production. For the sake of confidentiality, we decided to anonymise respondents by numbering them. These cases were subjected to in-depth semi-structured interviews, combined with analysis of available documentation. The interviews were conducted with employees from the respective companies, usually at the level of middle-management.

The semi-structured interviews started with questions about general aspects of the firm, followed by an introduction from the author about the distinguished steps of the production process. Respondents were then questioned about the position of their firm in the land development process, followed by questions about the motivation of the firm in relation to their current position in the land development process and their vertical integration strategy. Respondents were asked about motivation of both ownership and contracting to cover motives for both vertical integration and vertical disintegration.

The transcripts of the interviews were manually analysed. This was preferred over software, because for the linkage of codes to the classified categories of motives for vertical integration strategies the context is decisive. To understand the context, it is better to manually analyse a motive for a specific step in the land development process in its entirety, because with software a relevant aspect of this motive can be (unfairly) eliminated. Also, the search for additional motives outside the defined categories is not possible with software analysis and the number of interviews is such that a manual approach proved manageable. The following steps were taken for the analysis:

1. the motives for incorporating or leaving out activities in the land development process (i.e. land acquisition, construction, and ownership) were marked in the different interviews;
2. the transcripts have been shortened by omitting content that is not about motives, and afterward divided, following the steps of the land development process;
3. the motives for performing each individual activity were summarised and coded;
4. the coded motives for each individual activity were linked to the three theoretical categories for vertical integration strategies (if applicable);

Table 1
characteristics of the companies of the interviewees.

	Interviews							
	1	2	3	4	5	6	7	8
Type	Land-owning developer-investor	Developer-builder	Land-owning developer	Integrated land developer	Developer-investor	Land-owning developer-investor	Land-owning developer	Integrated land developer and investor
Original role	Investor	Builder	Developer	Builder	Investor	Developer	Developer	Builder
Ownership	Shareholders	Independent	Independent	Shareholders	Independent	Shareholders	Concern	Family business
Estimated number of developed housing units (per year)	1.500	50	800	2.500	75	5.000	100	1.500
Number of employees (developers)	20–50	0–20	20–50	100–200	0–20	200–500	0–20	100–200
Estimated input for development (stock, tender, one-on-one)	60% stock, 20% tenders, 20% one-on-one	10% stock, 40% tenders, 50% one-on-one	33% stock, 33% tenders, 33% one-on-one	50% stock, 50% other (mostly one-on-one)	90% one-on-one 10% other	80% stock, 15% tender, 5% one-on-one	40% stock, 30% tenders, 30% one-on-one	75% stock, 5% tenders, 20% one-on-one
Number of owned housing units	23.000	-	-	-	500	1.000	-	500
Geographical scope	National	Regional	National	National	Local	International	National	Regional
Real estate segments	Mostly housing	Housing, schools	Mostly housing	All kinds of real estate	Housing, hotels, parking, retail	Mostly housing	All kinds of real estate	Mostly housing

5. remaining motives were analysed for an additional category of motives for vertical integration strategies;
6. Quotes that appear in this paper have been translated from Dutch into English by the authors.

4.2. Empirical results

4.2.1. Vertical integration strategies

Within the selected group of real estate developers, four respondents chose vertical ownership over at least one additional step (besides development) in the land development process (number 2, 3, 5, and 7), three respondents chose vertical ownership for two additional steps (number 1, 4 and 6) and one respondent chose vertical ownership for three additional steps (number 8). In all cases of vertical ownership, the different activities of development, construction, and/or ownership were placed in different entities of the firm. From the outside, the firms operate with one name, but internally the various business processes are strictly separated from each other. In other words, external integration, internal disintegration. When the development department finishes a development site, for example, the site is *sold* to the investment department of the same firm.

For the steps in the land development process that are not vertically owned, the selected real estate developers are dependent on vertical contracting. Vertical contracting can take the form of long-term contracting and spot-market trading (Section 3). These forms of contracting differ in terms of the intention to collaborate beyond the contract in question. In the selected group of Dutch real estate developers, long-term contracting is favoured over spot-market trading in most steps of the land development process. Long-term vertical contracting only occurs related to construction, since two respondents (numbers 7 and 8) have formal agreements for construction capacity, both because of specific individual circumstances. The firm of respondent 8 has several contracts with contractors in which guaranteed construction capacity was agreed because they deliberately limited their own construction capacity. The development company of respondent 7 was contractually bound to a conglomerate of different developers and constructors in a consortium that operated under joint ownership. The selection of construction partners was primarily limited to firms within the consortium. The consortium was big enough for internal competition and firms were free to negotiate the specific terms for a project-based partnership.

Besides formal agreements as a form of long-term contracting of construction, informal agreements were also found. Respondents 1, 3, 5, and 6 indicated that for construction capacity they rely on a select number of construction partners. This mostly concerns partners they worked with before or already know somehow. Respondent 1 states: “when you’ve worked together before, you just know that it is a pleasant cooperation partner and that the delivered quality is high. It is also convenient because there is not much hassle in the negotiations. You already know what is important for them and vice versa". This indicates a type of long-term contracting based on informal relations. This differs from spot market trading because not all potential construction firms can participate, but partners are approached one-on-one. Respondents 1, 3, and 5 indicated that the construction partner is usually selected based on internal competition between different constructors from within their network, while respondent 6 prefers to select a locally oriented construction partner one-on-one.

Spot-market trading occurred related to gaining development sites for developers who do not own strategically acquired land and related to developers who do not pursue long-term ownership (i.e. investment) after the completion of construction. The first category is about developers who gain development sites by joining market tenders or by one-on-one land acquisition. These developers are dependent on spot-market trading, given the importance of new development sites for developers combined with the unpredictability of the development process. Respondent 3 states: “there is not one recipe available that guarantees new development sites. There are all different sorts of methods. You can be approached by someone from your network, large real estate agencies can sell brownfields and sometimes we take the initiative ourselves and approach an owner. In a way, this process is very untransparent, but we are expected to pro-actively contribute to obtaining future developments sites and it is important to be flexible”. The second category is related to the sales process for developers who do not intend to own developed real estate themselves. The sales process takes place within the housing market in which it is in the developers’ interest to allow as many possible buyers to make a bid as possible. Sales to specific institutional owners such as housing corporations and investors are usually not on a voluntary basis, but a result of planning regulations (mostly a mandatory share of ‘social housing’).

4.2.2. Motives for vertical integration strategies

The interviews reveal a wide variety of reasons for developers to choose for vertical (dis)integration (i.e. more/less vertical ownership). There are some differences and similarities in a firms’ motive for vertical integration strategies.

An important difference in motives for vertical integration strategies is related to the main driver of a developer in the land development process. Developers differ to a large degree in terms of their initial or core business and, related to that, the reason they operate as a developer. There seems to be a distinction between developers that are ‘development-driven’ and developers that develop as a ‘means-to-an-end’. The last category develops to support construction or investment activities, whereas development is the only or most important business for development-driven developers.

The three interviewed developers that also carry out the construction (numbers 2, 4, and 8) mentioned the continuity of building production as an important reason to develop and in some cases acquire land strategically. Respondent 2 states: “we acquire land for continuity. We employ 100 people, and we always want to keep them at work. We develop because then we know we can build in a year or two. […] Mainly, we buy and develop positions for long-term continuity”.

In the same way, two developers (number 1 and 5), with their main focus on investment, indicated that development was mainly intended to add new homes to the investment portfolio. Both examples show that developers sometimes move ‘upstream’ for instrumental reasons, that is, to secure and sustain their ‘downstream’ core business (i.e. construction or investment). Some firms (6 and 8) started as a developer and integrated towards a developer-investor. But securing or extending their original activity in the land development process, from where integration started, turned out to be the dominant motive for the firms’ vertical integration strategy. The newly integrated section of the land development process is therefore initially subordinate to the original activities. In various examples (number 1, 2, 4, and 8), the newly integrated activity grows over time into an independent and equal part of business operations.

Furthermore, none of the firms that do not construct themselves considers integrating this specific part of the development process within the firm. The main reasons, therefore, are the technical expertise and the capital (e.g. machinery) that are required to carry out construction and the limited margins on construction in comparison with development and/or investment. This is partly due to a highly competitive market since many construction firms exclusively focus on construction. This indicates the existence of entry barriers for this specific activity within the land development process.

4.2.3. Strategic motives

Strategic motives for vertical integration strategies are particularly important related to developers that choose to strategically acquire land. Respondent 4 indicates that land is acquired to guarantee future development and/or building production: “We acquire [and develop] land for future construction. The aim is to buy positions to guarantee long term continuity of construction”.

In addition to the future building production, respondent 8 argues that strategic ownership of land is acquired to improve their position for future negotiations for development, which implies a strategic motive for the vertical integration strategy: “When we own land we have the right to speak in future negotiations with the municipality about the development plan. The municipality is not in the position to set and impose conditions all by herself, we have a seat at the table”.

In the literature, strategic considerations were framed as motives for a firm related to its relative position to competitors in the market (Allen, 1971; Joskow, 1985; Porter, 1985; Chatterjee, 1991). The examples of price squeezing and raising entry barriers were motivated by the exclusion of potential new competitors and limiting competition to impose market power. In this specific case of housing developers in the Netherlands, strategic motives are primarily based on guaranteeing their own competitive position towards the future, rather than limiting the position of competitors (although in the absence of competitors the former would not be necessary). This outcome shows similarities with the findings of Lind (2017), who failed to find evidence for vertical integration as a way to monopolize a market in the Swedish’ case.

4.2.4. Output / input price advantages

Sufficient margin is an important precondition for all developers given their entrepreneurial nature (Brown, 2015). For some developers, the pursuit of margin is also an argument for their vertical integration strategy. In this study, the pursuit of margin is mainly an argument for the ‘developing investors’. By operating as a developer, they have more control over (the location and quality of) the new houses that are added to the investment portfolio, with higher margins as a leading argument for vertical ownership. Respondent 1: “When we add new homes to the investment portfolio, we prefer real estate that we have developed ourselves. These properties perform better in terms of financial return because we were able to focus on quality during the development process.” And: “the profitability is simply higher with projects we develop ourselves than with other types of contracts”.

4.2.5. Transaction costs

Transaction costs considerations as a motive for vertical integration strategy is mentioned by respondents 1, 3, and 5, coincidentally (or logically) those who do not construct themselves, as a reason why construction is not an option to do themselves. They choose vertical contracting over vertical ownership because owning a construction department requires totally different expertise in the organisation and it comes with high uncertainty. Respondent 1 states: “It is a conscious choice not to build ourselves. The organization is not set up for this. Building is a highly specialised profession (’asset specificity’) and it can be very risky”. This concerns the level of uncertainty that is linked to construction, which has relatively low profit margins in relation to invested capital. Asset specificity is related to the sunk costs of construction. Most developers develop different types of housing development (i.e. single-level houses and apartments) which require different constructive expertise. This is the reason why respondent 4, who constructs themselves, only focuses on single-level houses, since the constructive department has this specific type of housing as their expertise. Respondent 3: “to work as a constructor demands a totally different expertise in the organisation. It could be possible if we decide to merge, but we will never initiate that on our own”. This uncertainty and asset specificity, combined with the low frequency of having to use this expertise in practice, makes incorporating construction much less attractive.

4.2.6. Beyond economic rationality

In our search for motives behind vertical integration strategies, we held the door open to motives that could not be placed under either one of the three categories that we derived from the organisational economics literature. As it turned out, only one motive for vertical integration strategy that we came across belongs in this miscellaneous category. And in fact, it does not really fit mainstream economic reasoning with its behavioural assumptions of rationality and utility maximization. Respondent 8 mentioned a factor for (partial) disintegration that goes beyond economic rationality. This firm voluntarily limited its building capacity to approximately 750 houses a year (compared to 1600–1700 developed houses a year): “after the economic crisis of 2013 and its financial consequences, it was a conscious choice to operate within an organizational structure that is manageable. Therefore, we’ve limited our maximum construction capacity in terms of turnover and size. Everything beyond that is outsourced”. The primary reason for this strategy is related to the core values of this firm. It is a family business that has grown over the last decades to one of the bigger developers in the Netherlands. To keep up with this rapid growth of the development department asks for a lot of extra capacity for the construction department. The fact that a small number of employees can develop a large portfolio was also mentioned by respondent 4: “we work with 20 people on the developments of our firm, but the total turnover is a few billion”. In the case of respondent 8, the core values of the family business were the main motive to outsource the construction capacity above a certain level to limit organizational growth. This was intended to keep the firm manageable and maintain a certain culture in which most of the employees know each other and the managing board knows most of the employees. The firm has been run by multiple generations of the same family that founded the company for more than 50 years. In line with this business culture a complete disintegration of construction is unthinkable: “completely divesting our construction activities is not an option. The company is run as a family. This comes with a sense of responsibility to the people that work here. Therefore, I think it’s not an option”.

5. Conclusion

This paper explored the diversity amongst real estate developers by focusing on the activities in the land development process that real estate developers choose to incorporate within the firm (vertical integration). Differentiation amongst developers is conceptualised by the analogy of the number of activities in the land development process a developer integrates within the firm (i.e. ‘make’ in regard to the ‘make-or-buy decision’ as referred to by Coase and others). This framework proved helpful in identifying different types of developers by their nature. Besides an organisation-wide application of this scheme in this research, a project-based application can also be helpful since the interviews showed that developers can take a different role per project. Both the number of activities that a firm undertakes within the organisation and the motives for this vertical integration can differ between different ongoing projects and, more importantly, over time. In other words, vertical integration strategies are highly contingent and dynamic.

The three main categories of motives for vertical integration strategies turned out to be the dominant motives for developers’ vertical integration strategies in the cases we studied in the context of land development. Strategic considerations are often mentioned as an argument for vertical integration of land acquisition (i.e. land banking). This fits the strategic advantage of ownership of a development site, given the locationally-fixed nature of land and the control over the production process that follows (Alexander, 2014). Input-output price advantages as a motive for vertical ownership seemed to be less important. Land development is a high-risk business, in which the potential of high margins can make up for these risks. Nevertheless, in the interviews developers mentioned margin mostly as a secondary argument, if at all. Transaction-cost-related motives are mostly mentioned regarding vertical *dis*integration. Developers that choose not to incorporate construction within the firm mostly mentioned the highly specialised knowledge and expertise needed for this activity, in combination with the low frequency of having to carry it out, as the dominant argument behind that.

The results showed, contrary to most existing literature, that strategic considerations were not focused on limiting the market position of potential competitors. Instead, strategic considerations have been mentioned to improve developers' own future position. A possible explanation could be found in the structure of the real estate development sector. Although several larger companies dominate production, real estate development is extremely differentiated, diverse and complex (Coiacetto, 2006).

Almost all the motives mentioned in this study relate to an explanation based on rational actor theories such as neo-classical economic theories. The only additional motive found in the case study that does not fit mainstream neo-classical economic motives for vertical integration is the motive of a family-run business that highly appreciates reliability, job security, and social ties with its employees. This motive seems to fit better in a perspective based on old institutional economic theory (e.g. Hodgson, 2004) or economic sociology (e.g. Granovetter, 1985).

5.1. Future studies

A better understanding of developer behaviour and the motives behind drivers for development is highly desired in this research area where relatively little has been published yet. This can help explain why and how the built environment takes shape. A broader theoretical scope that has a greater awareness of social networks and institutions could be of help. In the case of land and property markets particularly, localised, 'tacit' knowledge of relevant people, ways of working, and institutions is often crucial in being able to operate successfully within the production process. It could also be useful to look across and compare cases in different institutional contexts. The stringency of Dutch land-use planning, and the strong land-acquisition strategies of local authorities could bias vertical integration strategies (i.e. towards more non-land-owning developers). International comparative research of diversity amongst real estate developers can build upon the conceptualisation of real estate developers in this research, in order to expose the diversity of real estate developers in other countries and institutional and cultural settings.

Declaration of Competing Interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

Data availability

Data will be made available on request.

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