

Outsourcing real estate management: Learning from experience

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Compared to other business process outsourcing activities, the real estate outsourcing market has been slow to grow. Fulcrum Corporate thinks this is set to change.

This Fulcrum Corporate White Paper identifies the prime candidates for real estate outsourcing, sets out the key factors that determine successful outcomes, discusses some of the barriers to success and looks briefly at market trends.

The business case

Outsourcing: 10 fast facts

- The *Harvard Business Review* believes outsourcing to be one of the most important management ideas and practices of the past 75 years.
- Outsourcing is now a mainstream business strategy.
- The primary motivation continues to be cost, with 70% of organisations citing 'reduced costs' and 'better value for money' as their main drivers.
- Reported cost savings now average 50% over 10 years.
- Worldwide, 65% of private and public sector organisations now engage in collaborative outsourcing activities.
- In a recent survey of pan-European corporates and financial institutions, including FTSE 100 companies, 94% of those responding have outsourced services and functions in the past three years.
- In the UK, FTSE 100 companies spent over £3 billion on outsourcing in 2001.
- Spending by US organisations on outsourced business services in 2002 is estimated to be over \$300 billion.
- Information and Communications Technology is the activity most often outsourced, followed by Business Process outsourcing.
- Outsourcing activity is now monitored by financial analysts who use it as a one of their key indicators in assessing a company's fiscal health.

Organisations – and their stakeholders – are now reaping the tangible rewards of outsourcing non-core activities and, importantly, are learning to manage the outsourcing partnership effectively.

On paper, the business case for outsourcing real estate activities is compellingly strong:

- Lower fixed costs; increased cash flow
- Controllable costs
- Reduction in asset utilisation, e.g. training
- Transfer of payroll and liabilities
- Flexibility; variable service level agreements
- Access to experts and specialist knowledge
- Impartial and objective solutions
- Transfer of risk

And senior decision-making executives in 300 major companies worldwide recognise it as one of the top five business processes that has the potential to be outsourced successfully.

Business process	Currently outsourced	Best candidate for outsourcing
Human resources	42%	59%
Finance and accounting	41%	70%
Payroll	37%	70%
Real estate	32%	65%
Procurement	15%	33%

Source: PricewaterhouseCoopers

But what types of organisations benefit most? And does it always pay off in practice?

Prime candidates

We have identified the following scenarios where tangible benefits can be gained from outsourcing some or all real estate functions:

- Within organisations where property is not core to business activities.
- Where the size of the real estate portfolio does not merit full-time resourcing.
- Where day-to-day real estate management is administered by non-professionals.
- Within organisations that are undergoing change or are active in mergers and acquisitions.
- Within organisations whose brand values are not synonymous with their environments and spaces.
- Within multi-national organisations with a diverse real estate portfolio.
- Within the public sector, particularly in the transfer of assets and liabilities.

Whereas other outsourcing functions usually follow the rule of ‘the bigger the firm, the larger the scale of outsourcing’, it’s not necessarily so in real estate management. Indeed, small organisations are often more likely to outsource real estate management than their larger counterparts.

We would argue that almost all organisations – including retailers – could benefit from outsourcing all or part of their real estate activities.

Combining resources

Sometimes the operational needs of an organisation mean that in-house control is preferable, particularly on the manufacturing side where plant and specialist equipment are key assets. Blended resources can work well – with in-house capability working seamlessly alongside outsourced support and expertise for specific functions or projects, such as sales and leasebacks, facilities management and fit-outs.

Resourcing options

Organisations can choose to partially or fully outsource:

	Objectives	Delivery and ownership
Partial outsourcing:		
Small and focused team	Set strategy	Central
Combination of professional in-house team and out-sourced team	Own budget Asset management	Grouped shared services
Fixed variable cost	Maintain performance of service provider	
Fully outsourced:		
Professional outsourced team	Create overall strategy	Local
Variable cost	Run the portfolio Maintenance and fit-out	Implementation with local customers Rent payments and treasury management

Factors for success

To paraphrase McKinsey, if outsourcing is not being used strategically, and aligned with an organisation's corporate and business objectives, then it probably shouldn't be used at all. This is particularly true of real estate management, where portfolio costs are often the second highest costs in an organisation, after people. In this strategic context, we define below some of the driving factors in successful outsourcing.

Joint commitment

Key to the success of real estate outsourcing is a well-managed relationship. An outsourcing partnership, where risk and rewards are shared, demands a long-term commitment and trust. Commitment from both sides to the partnership, together with a common aim, will create sustainable value to both businesses. The common aim should be: to balance continued growth with value creation.

Clear goals

The best outsourcing relationships operate in a climate of openness, transparency and mutual respect. Whether the outsourcing is project-driven or ongoing portfolio management, it's essential to define goals and objectives from the start so that both parties understand the endgame.

Good interfaces

Data should be shared freely. Reporting lines and communication channels should be logical and straightforward. The interface between the two parties should be kept as simple as possible to create a more seamless, effective relationship.

A focused gatekeeper

Fulcrum Corporate has identified a key role, the 'Intelligent Client', who acts as the gatekeeper between the two parties: controlling and administering the contract and owning the goals and objectives, while devolving day-to-day tasks and responsibilities to the service provider.

Expectations defined

Once the objectives and resourcing levels have been set, a sensible Service Level Agreement can be drawn up. It should be realistic and fair. It's not about getting a cheaper price or squeezing the best deal; it's about balance, value for money and delivery. Both parties should revisit the contract regularly. Finally, formal confidentiality agreements both uphold mutual obligations and help bind the team together.

The right level of performance measures

We believe it is better to measure the service provider on four or five key indicators rather than a raft of performance measurements that are cumbersome, time-consuming to monitor and often a distraction from the main goals.

Performance measurement mix

Performance should be measured on a mix of task-led and service-led indicators: identifying achievements over specific timeframes. Key cost/benefit equations should be created and KPIs developed and agreed. Softer criteria, e.g. how the service is delivered, are more difficult to quantify but should be assessed as part of the overall relationship monitoring.

Consistent resourcing

Arguably, you get more dedication from contracted-out resources – service providers are more inclined to go the extra mile. And some organisations prefer to deal with a service provider on the premise that it's a great deal

easier to manage a contract rather than a department of people. The onus is then on the service provider to deliver a consistent quality of staffing and expertise.

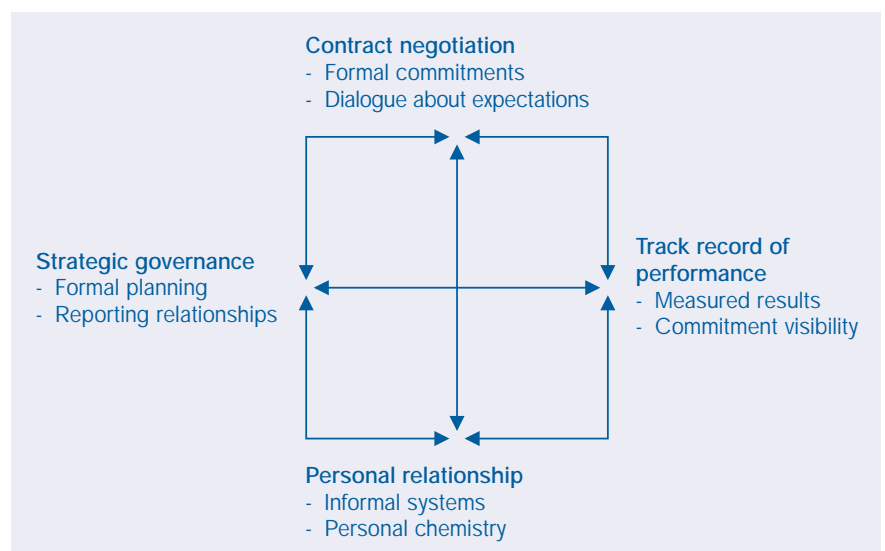
Implanted resources

One of the keys to effective long-term real estate outsourcing is for the service provider and the team who resource the client to integrate themselves into the organisation; to be viewed as 'on-the-ground' personnel rather than external advisors. This approach, where advisors become 'honorary employees' and carry the organisation's business cards, helps create a 'virtual' team that has good, productive dynamics.

Balancing integration and impartiality

While team integration naturally facilitates effective working, it's important for service providers to maintain an apolitical, advisory stance. A key benefit for many organisations is that outsourcing brings impartiality and objectivity to the task. Service providers can apply themselves with less emotion and bias; they are driven by business needs and strategic objectives rather than personal views. Keeping an objective perspective and thus delivering the right real estate advice and solutions for the business, rather than the politically correct decisions for the people, is a critical quality for the service provider.

Four levers for relationship management



Barriers and downsides

As a less mature market, real estate outsourcing can benefit from experiences gained and lessons learned in other business process outsourcing activities. Organisations should approach real estate outsourcing with eyes wide open, and with a clear understanding of the potential pitfalls.

Loss of control; retention of knowledge

Handing over important assets and portfolio knowledge to a service provider can be seen as a step too far – but only if there is a lack of trust and confidence in the alliance. Organisations who have developed a strong partnership with a service provider that has joint commitment and a common aim are far less anxious about control and knowledge retention issues.

A troublesome legacy

It's not unknown for organisations to offload problematic departments or business units through the outsourcing route. Transferring people and politics to the service provider lightens the management load but doesn't resolve the situation. Service providers will naturally wish to assess the level of risk before contracts are drawn up, so it's in the organisation's best interests to be open and honest about personnel issues and, wherever possible, put the situation in good order before outsourcing.

Inappropriate levels of investment

The level of investment at the beginning of a relationship will tend to dictate the overall performance of the service provider unless a degree of flexibility is built into the Service Level Agreement. Care in setting up the contract and addressing any potential limitations at the start is critical.

A threat not a benefit

The outsourcing team can often be seen as a threat, particularly by long-standing in-house property managers and sometimes by business units concerned that their decision-making will be undermined. It's important to communicate clearly the advisor's role and objectives from the outset. They are there to add value and to help achieve corporate goals. If concerns and hostility are not addressed, service providers tend merely to fulfil their basic contractual obligations rather than becoming 'honorary employees.'

David vs Goliath

The size of a real estate management service provider does matter to a buyer – particularly in asset and liability transfers and in service level commitments. However, organisations should realise that they are buying experience and expertise rather than scale.

A non-strategic mindset

A recent Dun & Bradstreet survey reported that 20%-25% of all outsourcing relationships fail within two years and 50% fail within five years. Why? Because 'suppliers didn't understand what they were supposed to do' and 'the cost was too high and they provided a poor service.' This suggests that the outsourcing projects were seen as a traditional purchasing activity rather than a strategic partnership that collectively delivers value. Organisations should view their partner as a strategic ally, not a conventional vendor.

Trends in outsourcing

We expect the outsourcing of non-core activities to continue to grow strongly, and that real estate management outsourcing, or the outsourcing of some aspects of the real estate function, will become far more common practice. This growth will be seen across all types of organisations, from multi-national companies to smaller corporates and, particularly in light of PFI and PPP developments, the public sector.

There are four further important business trends:

1. A 'grown-up' approach to non-core outsourcing

Outsourcing is maturing as a business tool. It has moved from a supplier-based operation to a strategic, holistic, added value function. Organisations have realised that they can be quicker to exploit new opportunities or strategic changes by outsourcing to more agile, nimble and responsive teams and functions. Lessons learned in early outsourcing ventures have informed the structuring, pricing and resourcing of today's partnerships.

2. A rise in core function outsourcing

We are now starting to see critical core processes and functions being outsourced. This is happening within organisations whose business imperatives demand that functions are brought up to a benchmarked performance level, creating a new breed of high-performance support operations.

3. A slowdown in the transfer of private sector assets to service providers

The recent trend towards transferring assets, e.g. real estate portfolios, as well as services and supply chain to outsourcing service providers has slowed to a trickle in the private sector due to lower market ratings. However, we believe the trend will continue in the public sector, again in light of PFI and PPP developments.

4. Business Transformation Outsourcing

This trend in outsourcing, first identified by Accenture's Institute for Strategic Change, enables organisations to achieve transformational outcomes at speed. Business Transformation Outsourcing (BTO) can leverage an organisation's critical processes through partnerships with expert, specialist services providers. It measures outsourcing success not on conventional indicators but on 'enterprise outcomes' – results that stakeholders and competitors can see.

The benefits of BTO* are far-reaching:

- Step-change improvement in enterprise-level performance
- Reduced time to market
- Shared risk
- Increased innovation through access to world-class skills, resources and industry knowledge
- Enhanced core capabilities
- Strengthened competitive positioning

*Source: Accenture

Real estate advice, support and solutions

Our global services

Business consulting: defining real estate strategies

Asset management: recognising portfolio potential

Analytical services: financial and strategic modelling

Transaction management: acquisitions and consolidations

Programme management: implementation and delivery

If you would like to discuss any of the outsourcing issues discussed in this White Paper in more detail, please contact:

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