Next Generation CRE/FM Sourcing

The Call for Quality, Technology & Innovation

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Introduction

In our last *Trascent Perspectives* article, entitled "Inflexion Point – CBRE-JCI GWS Acquisition", we assessed the impact that the CBRE-JCI GWS acquisition would likely have on the estimated $100 billion Corporate Real Estate and Facilities Management (CRE/FM) outsourcing industry. We suggested that supplier consolidation will provide increased scale efficiencies and a global footprint, albeit at the expense of reduced supplier choices. We expected the emergence of regional supplier specialization, greater overall differentiation and industry maturation.

This article continues our focus on the CRE/FM industry in terms of how corporations are defining their next generation CRE/FM sourcing strategies in a growth-oriented economic environment characterized by the increased digitization of Corporate Real Estate:

- How will legacy outsourcing experience shape their go forward CRE/FM sourcing strategies?
- How will the shifts in the supplier market influence approaches to CRE/FM outsourcing solutions?
- What are the key factors that will redefine the value clients seek in a growth-focused economic environment?

To define the next generation CRE/FM sourcing strategy, we need to analyze client experience with outsourcing to-date, reflect upon strengths and weaknesses in CRE/FM organizational structure and capability, assess the digital possibilities within CRE/FM and evaluate supplier capability and performance in specific geographies. The centerpiece of next generation sourcing strategy should be built upon key stakeholder expectations in a business setting characterized by technology enablement, growth and high employment – factors very different than the conditions under which many corporations initially entered CRE/FM outsourcing. In today's environment, any approach that simply attempts to replicate the previous sourcing strategy is going to be shortsighted at best and perilous at worst.

Industry Experience To-Date

We interviewed and assessed contracts of a diversified set of corporations on their view of past performance and future requirements with a view to define factors shaping next generation strategy. These corporations were large, global Fortune 500 companies that had implemented multiple geography CRE/FM outsourcing deals – Americas, EMEA and APAC. There were some clear observations. Corporations fell into two primary categories – those who had centralized their CRE/FM function into a business partner organization; and those that were decentralized and were in various stages of developing a central framework for the CRE/FM function. One compelling observation was that FM is very much recognized at the C-suite level in terms of how workplace shapes the image of the corporation as a progressive and desirable employer. We noted that the tech and fintech sectors appeared to be the most centralized as well as most outsourced sectors overall.

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Next, we looked at how CRE/FM outsourcing deals have performed and delivered against expectations. What we found made intuitive sense. Shaped in the crucible of economic pressure, most of the CRE/FM sourcing initiatives have delivered and met savings commitments – what they were intended to do. However, this was not without teething pain, especially in first generation deals and particularly in decentralized organizations. Our data shows that the industry succeeded in delivering hundreds of millions of dollars in efficiency over contract terms. One area the market has performed particularly well is in transitions – both in first generation outsourcing as well as in next generation supplier switching scenarios. The market has successfully transferred thousands of employees and subcontracts from clients to suppliers in generation 1 and from supplier to supplier in generation 2. To achieve these transitions in local sites and markets across different geographies without significant disruption is a singular feat and a testament to the commitment and effort of suppliers and CRE organizations alike.

We also looked at things that fell short of client expectations. Problems tended to fall under three types of scenarios:

Aggressive Cost Reduction Contracts with Inadequate CRE/FM Operational Input

Some contracts sometimes stumbled when it came to cost definition (poor quality data and definitions), supplier misestimation of savings opportunities, and in some cases, divergent definitions of what constitutes a saving. Some commercial models were negotiated to drive behavior that in the long term, turned out to be "wrong" – a simple example would be cost at the expense of quality. Clients worried and complained of deteriorating service quality and phlegmatic supplier response or lack of expertise. The most intractable issues were situations where suppliers had financial exposure either due to overspending or underachieving against guaranteed commitments. Most of these situations were remedied eventually, but after a painful effort and investment by clients and suppliers alike to resolve matters.

Inadequate Change Management & Sponsorship

Clients that did not adequately provide change management and sponsorship to help local stakeholders adopt the outsourced model (especially in manufacturing settings) led to unclear accountability, shadow management and strained supplier relationships. Sometimes client behaviors became non-conducive to success. In these opt-in/opt-out situations, there was a low degree of trust between the supplier and client teams. However, high trust alone was not sufficient. There were under-performing deals even in some high-trust situations – for example, when inadequate executive sponsorship resulted in an inability to successfully adopt the outsourced model at a local level.

Misalignment & Lack of Effective Governance

Finally, in the last two years when the business environment turned and corporations increased their focus on the digital workplace, value added services and workplace experience, purely cost driven contracts became incongruous misfits. Suppliers that faced capacity constraints ended up with skill-mismatched teams who did not fully understand the client style of working and even the contract they signed up to. Compounding matters was ineffective governance which impeded both suppliers and clients to effectively remedy issues.

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Resolving these scenarios was a time-consuming and resource intensive process for everyone involved. This led to delayed or eroded benefits that the outsourcing deal was supposed to deliver. Even with these caveats, we believe that well designed and effectively implemented CRE/FM sourcing strategies of corporations have delivered value overall. In addition to significant savings across contract generations, suppliers have transitioned thousands of employees and provided these employees with growth-oriented careers. Suppliers have brought talent and skillsets to CRE organizations to help corporations drive portfolio strategies and value. Finally, improvements in help desk and workplace technology brought reporting and data enhancements to a low data quality environment. While not perfect, the industry clearly made strides and corporations renewed or extended their contracts and adopted new ones at an increasing rate despite the teething pains.

As the economic environment turned positive during the contract term and the CRE focus shifted to the digital workplace, talent retention and growth, the loudest noise about legacy CRE/FM outsourced deals was about lack of innovation, technology expertise, capability and fresh ideas. New and emerging CRE requirements overtook the original purpose of these legacy contracts. This noise was the loudest in contracts that were negotiated with highly aggressive savings targets. High savings, valued at the outset, during a time of intense cost pressure, became comparatively less relevant as the economic tectonic plates shifted. In a sense, the imbalanced cost reduction focus became a poor fit in today's CRE environment that emphasizes quality, digitization, simplicity, flexibility and employee engagement. In the supplier market's defense, however, innovation, technology and quality were not the primary drivers of the outsourcing deal. And, consequently, requirements for quality, consistency, continuous improvement and innovation were poorly articulated in the contract, if at all. And in some cases, the initial contracts were so cost focused that the contract itself became restrictive and inflexible. What made sense under harsh economic times, made increasingly less sense as the environment changed and business needs evolved. However, in fairness to all parties, we believe the industry largely delivered upon contractual promises especially where clients provided the sponsorship, invested resources and facilitated change management.

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Now to address the question we often get asked – are corporations insourcing? In contracts (especially the outer years of the term) where either the relationship is not adding value or the client-supplier relationship is troubled, clients are surgically insourcing some functions. In cases of troubled supplier relationships and after efforts to remedy the situation have been exhausted, clients are switching suppliers rather than abandoning the outsourced model. In cases where suppliers flexed their negotiations muscle aggressively and contract situations became antagonistic, clients responded by dismantling single supplier deals and replaced them with multiple supplier models. Corporations certainly are not abandoning the outsourced model of service delivery, rather, they are optimizing and pruning. So, to directly answer the insourcing question: yes, corporations are surgically insourcing for specific reasons and no, we are not seeing a broad flight from outsourcing.

Flight to Digital, Quality & Innovation

Companies entering the next generation strategy for CRE/FM face an environment radically different than when many of them first entered these relationships. Key CRE drivers today are the emerging digital workplace, workplace experience, technology enabled services, service quality and greater employee engagement. Companies that are assuming they can simply leverage their existing contracts in this next generation environment must perish the thought. Today, the "buy" needs to be redefined. Corporations need a fundamentally redesigned approach that emphasizes new incentives, new commercial models and new technologies. In fact, we would dare boldly assert that legacy deal structures designed to drive significant cost reductions may well be impediments to what's needed today.

The themes of service, quality, technology and innovation also serve as a clarion call to the supplier market. For the supplier market, the strategies and tactics that were successful in generation 1's cost reduction focus will need to be reshaped. Today, the client's "buy" is going to ask the market for expertise, capability, innovation, technology and service quality. What helped the industry grow, mature and develop to this point will not be sufficient to take it to the next level. Suppliers that repurpose and re-tool their structures, processes, capability and talent to meet next generation client requirements will be well positioned to capture new opportunities and drive margins. Those that do not, or those that simply pay lip service without making deeper, capability changes, risk the prospect of a dimmer future. The market simply cannot expect increased margins without increased value and technology. Suppliers will have to fundamentally redefine delivery for technology, innovation and next generation value if they are to achieve sustained high performance in the new CRE/FM marketplace.

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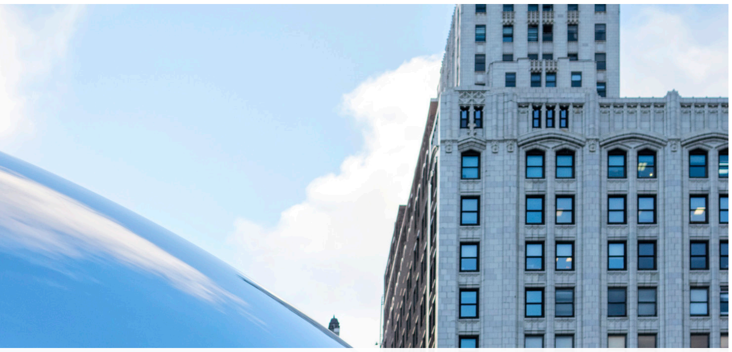
A New Approach to Next Generation Sourcing Strategies

Today, next generation contracts need to be structured with a reimagined definition of value. Corporations have obtained significant experience with CRE/FM sourcing strategies across several contract generations. They take a realist's view to understand the limitations as well as the potential of the supplier market and the outsourced model. Their future requirements, however, have now come into sharper focus:

- Service quality
- Technology driven CRE/FM operations characterized by innovation
- Smart and transparent business cases
- Flexible contracts with balanced risk and reward
- Value for money

The supplier market is different than what it was a decade ago when many clients originally turned to CRE/FM outsourcing. Today, suppliers are more mature, global, sophisticated and are self-performing at a higher technical capacity. They are making investments in capability (organically and through acquisitions) and are embedding technology as a core practice in their operations. With healthy growth in the CRE/FM outsourcing market, suppliers have also become sharply selective of which client opportunities they pursue, for practical reasons and for ensuring they only pursue those initiatives where their models and processes add value. The combination of investor capital flowing into the industry along with increased experience in implementation, is driving suppliers to become more commercially prudent in their negotiations and contract positions.



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To achieve redefined, value-focused objectives, corporations will have to take a different approach to next generation sourcing. Fundamental tenants of a next generation strategy will include:

- ***Stronger cross-functional alignment –*** across business stakeholders, IT, Procurement, HR, Finance and CRE/FM to ensure cost, innovation and quality objectives for the initiative centerpieces are in appropriate balance
- ***Higher call to the supplier market –*** a redefined "buy" in terms of expertise, knowledge, quality and innovation
- ***Reimagined incentives and commercial models –*** abandoning stale, task-focused incentive structures that don't function effectively or drive the right behaviors. Worse yet, some structures in contracts today may unintentionally cause the wrong behavior.
- ***Governance –*** a governance model that is structured for functional excellence and innovation rather than simple oversight of reports that often only show a sea of green lights without actionable insights
- ***New commercial frameworks –*** transparency and flexibility that drives collaboration and fiscal discipline
- ***An inverted procurement process –*** a procurement process that facilitates joint client-supplier expertise, technology, and innovation in pursuit of client objectives
- ***A repositioned mentality of risk & reward –*** collaboration & partnership with the right controls in place

Technology and innovation will define the new CRE/FM frontier. Today, clients are well positioned to capture the potential of the digitization of Corporate Real Estate. It's a great challenge and opportunity for clients and suppliers alike to build higher value partnerships in the industry. These partnerships should be designed to jointly craft and exploit the potential of automation, artificial intelligence, augmented/virtual reality and internet of things in the digital CRE and workplace of tomorrow.

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ABOUT THE AUTHOR

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Rakesh Kishan is a founding partner of Trascent Management Consulting, LLC and the Managing Principal for the Americas and EMEA region. He advises blue-chip companies on global RE/FM outsourcing initiatives to increase efficiency in FM through best practices.

Mr. Kishan is an expert in the growing market for outsourced FM services. He has spearheaded outsourcing initiatives on a global scale and within diverse portfolios and has advised major corporations in virtually all aspects of the entire outsourcing life-cycle: from structuring global Facilities Management outsourcing initiatives, to optimizing governance structures and processes for sustained improvements, and to implementing interventions to renew troubled relationships. Mr. Kishan has pioneered innovative approaches to structuring contract pricing to foster continued supplier innovation across each stage of the contract life-span.

Mr. Kishan would like to thank Monte Marcum, Managing Director, Trascent, for his contributions to this article.

ABOUT TRASCENT

Trascent, a premier global management consulting firm, drives measurable performance improvements and generates quantifiable results in Corporate Real Estate and Facilities Management (CRE/FM). The firm's clients span biopharmaceuticals, consumer packaged goods, diversified industrials, financial services, high technology, media, oil and gas and other sectors. Main areas of focus include current state assessment, sourcing & outsourcing strategy and implementation, supplier governance and CRE/FM technology strategy. Trascent Conferences are attended by CRE/FM and business leaders and held in North America, Europe and Asia Pacific.

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