Analysis of the Supply of Serviced Office Space

by

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Submitted to the Department of Urban Studies and Planning in Partial Fulfillment of the Requirements for the Degree of Master of Science in Real Estate Development

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Abstract

The work environment has experienced tremendous change in the past few decades. Technology has been the prime catalyst to transform the demand for office space into a search for more flexible solutions in a historically inflexible asset.
Serviced offices combine office space, technology and support into a global network of fully furnished, staffed and equipped offices and meeting rooms, available to occupy or vacate on flexible terms, and tailored to the specific business needs of the users.

This thesis explores the objectives of these users, product and service characteristics of the serviced office space delivered to them, and the relationship between the users and the providers of serviced office space.
Further, it explores the similarities and differences of big and small providers emerging as the market of serviced office space matures. The methodologies of the service profit chain are used to compare the relevant service delivery methods used by big and small serviced office providers.

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Table of Contents

1. Introduction

Business organizations of all types are experiencing rapid change in a highly competitive marketplace. They have responded to this challenge by rethinking the way in which they manage their businesses, re-engineering business processes and introducing new working practices. The way in which office space is used and acquired has changed significantly during the last decade. The need for flexibility and rapid market entry has resulted in a growing demand for a new type of property product. Occupiers require space on short-term leases and additional benefits such as facilities management services, the provision of office infrastructure and office management services. This changing demand has led to the emergence and consolidation of a new sub-market: serviced offices space.

Serviced office space is short-term workspace for business users, usually in the form of rooms of varying sizes available for immediate use on flexible lease terms, with some shared support services. The provided space ranges from basic floor space, with no furnishings or services other than maintenance, to highly serviced, lavishly furnished offices. However, the majority of serviced offices offer fully serviced or partially serviced space.

The emerging serviced office space sub-market has been redefined in the past decade, shaking off the image of second-hand space in poor quality buildings. Serviced office space provides property and service solutions for both small start-up companies and corporate users. Fully serviced offices are found in prime buildings in the most strategic locations and form an important element in the mix of high-quality business parks. They have emerged as a small but significant part of the business space market.

When businesses select a serviced office to meet their requirements, they are acquiring not only space but also a bundle of additional services including facilities management, office furnishings and equipment, office management, secretarial support and other administrative services. The core product (space) has been enhanced (furnishings and equipment) and augmented (services) to create value for both customer and office provider. While the value of the space is related to the property market, the value of the service is linked to the entrepreneurial skill and management ability of the service provider. It is clear, therefore, that there are two distinct elements of value: that related to the property and that related to the business.

1.1 Recent Evolutions in Office Markets

Trends in Demand[1]

The business environment today is characterized by high volatility in sales, staff, retention, speed to market, competition and so on. This encourages companies to be extremely flexible to customer demands, to be able to customize and standardize their value adding process rapidly and efficiently.

The changing business environment spurred end users to change their expectations. Increased teamwork, less hierarchical company structures, and further rationalized models of cooperation require a less rigid office space, both in physical and abstract terms. Physically, teamwork necessitates sufficient meeting and working space for different sizes of teams at different locations. Conceptually, end users want to be able to shape this physical environment on a pay-as-you-go basis, so they only want to pay for the time they use the space. "After all, the most expensive square foot is the square foot you're paying

[1] Based on "The Responsible Workplace", Findings in a context.

for that you don't need", says Peter Holland, senior vice president with responsibility for real estate at Hartford Financial Services Group[2].

Next to flexibility, productivity is the biggest user expectation. In order to maximize the value of the time a worker spends in the office, companies will continuously seek ways to improve worker productivity. By providing a finely tuned office environment, corporations will expect higher productivity of their workers.

Technology became an integral part of doing business, as much as the office space itself. Moreover, the livelihood and success of these corporations depends often on telecommunication and technological advancements.

The physical work environment has the potential to impact worker productivity very significantly through lower levels of absenteeism and higher general contentment[3], although documentation of such results is still in its formative stages. Corporations have a higher awareness of broader environmental issues and how they impact the day-to-day operations at the office.

Trends in Supply

The landscape of serviced office space is highly competitive; a number of large and small scale players have entered the field like Regus Business Centres, HQ Global Workplaces, MWB, MC-Square, Genesis, Kensington, Pacific, Your Office USA, Regent, Instant Offices, Abbey, ServCorp, etc. Other office solutions, a.k.a. alternative workplace environments, such as airport business centers and boardrooms, customized hotel rooms,

[2] Wall Street Journal, April 25, 2001
[3] "Measuring Workplace Performance", presented to World Workspace 97, Joe Akinoru Ouye, Ph.D., Principal FT/Systems.

office supply/support stores, home offices, and alternative or intermediate solutions such as subletting, are also competing with serviced office space.

The serviced office market seems to be divided both by type of occupier and by the nature of space and services provided. For example, HQ and Regus, the world's largest suppliers of serviced office space, have supplied serviced space to multi-national, national or regional corporate occupiers in the technology, financial services, insurance, and real estate industries. Whereas, local and regional suppliers of serviced office space, which typically operate one to three locations, cater to entrepreneurs and sole practitioners. In recent years, both standalone suppliers and subsidiaries of larger real estate firms have entered this sector, in which consolidation has already begun.

There are considerable variations in the extent and standard of service amongst the various suppliers. A range of services exists, from providing basic unfurnished infrastructure to fully furnished and serviced space, including catering and social facilities. New market entrants have been forced to expand their service offerings to remain competitive.

Suppliers anticipate market expansion due to the growing awareness on the part of space users of the advantages of flexibility. Further, the changes in business practices are leading to new ways of using and configuring both space and services.

1.2 Practical Overview of the Serviced Office industry

Basic quantitative comparison of the four large suppliers

Supplier	Workstations	Countries	Centers
Regus	77,000	50	376
HQ Global	65,000	27	469
ServCorp	NA	8	160
MWB	13,000	3	33

Source: Company 2001 press releases

The four largest providers operate 20% of the centers. The remaining 80% of the suppliers typically operate 1 to 3 centers. However, through the national and global networks such as the Alliance Network, many small operators achieve an image of a large-scale provider. The center operators refer their clients amongst one another for the use of space and services that they cannot provide.

1.3 Recent evolutions

Three megatrends are changing the way people work: increased outsourcing, increased globalization of business, and increased use of technology. These trends are driving a requirement for greater workforce mobility and flexibility. The result is the need for a solution that enables people to work virtually anywhere.

These trends have expanded the marketplace. The following chart illustrates the evolution of the serviced office space industry.

Evolution of Products and Services

Pre-1995 Executive Suites	1995-1999 Office Outsourcing	2000-Future Officing Solutions
SPACE Office Space Conference Rooms Day Offices Training Rooms	**SUPPORT SERVICES** Office Space Conference Rooms Day Offices Training Rooms Admin Support Copiers, Fax Telephone Answering Mail Services, Catering Concierge Services Desktop Publishing	**TECNHOLOGY** Office Space Conference Rooms Day Offices Training Rooms Admin Support Copier, Fax Telephone Answering Mail Services, Catering Concierge Services Desktop Publishing Teleconferencing Broadband Access Subscription Computing Web Conferencing Video Conferencing Unified Messaging Virtual Assistant

Source: Frontline Capital Group, Form 8-K, November 7, 2000

When support services were added to the real estate function, corporations had an option to completely outsource a portion their real estate function to one provider. Further, the advent of high-speed Internet data transmission and other forms of high-tech communication allows for greater mobility and flexibility from the workforce. The infrastructure is now in place to conduct business virtually anywhere in the world. However, serviced office space remains one of many workplace environments utilized by people doing business.

1.4 Alternative Office Solutions, a.k.a. Alternative Workplace Environments

The increasing need for flexibility of office space manifests itself through a wide variety of solutions, of which serviced office space is only one segment. Also, it is noteworthy that users themselves are implementing some alternatives, while external service providers are handling others.

Airport business centers and boardrooms

International airports today lease meeting and office space on a short-term basis. These leases are available on hourly basis, and usually have full IT support. There are 3 main operators of workspace in airports: the airport managing authority itself, airlines (e.g. Red Carpet Club by United Airlines), and third parties (e.g. Laptop Lane, Aerzone Business Centers).

Telework centers

Because of increasing commuting time and cost, some office developers chose to build office space in suburbs or city edges. This is generally a smaller scale operation, used as a satellite of the downtown office space. Studies show telecommuters use this option about 2 to 3 days per week.

Modified hotel rooms

Hotels were rather late recognizing the need for workspace in their rooms. They recently started to offer business-like accommodations: larger desk space, adequate lighting, printer/fax/copier, fast internet access, office supplies, ergonomically designed swivel chair, expanded voice mail services, etc. Marriott developed the "Room that Works", Sheraton offers a "Smart Room" and Westin the "Guest Office".

Business services providers

Office supplies and business service providers offer a wide variety of office support solutions. Smaller companies are the most common users of these services on an occasional basis. The largest players in this segment are Kinko's and Mailboxes Etc.

Home Offices

The home office has often been set in the spotlight in recent years as *the* solution to a better balance between professional and private life, reducing commuting time and costs. Even though many corporations have thoroughly structured their home office policies, employees in general have not widely embraced this solution. Reasons are lack of team interaction and feedback, lack of managerial supervision, and unsuitability of the job for remote work. Whereas the home office was in theory a great solution for corporations to shed real assets off their balance sheet and contribute to the quality of life of their employees, in reality, the industry has not experienced a substantial shift towards more home offices.[4]

Other solutions and intermediaries

Large office development and management companies have also recognized the increasing need for flexibility, and are providing medium-term leases for serviced office space to their

[4] Telecommuting in the Workplace, Marilyn Young, University of Texas at Tyler, A.S. Campbell, Florida Institute of technology, 1997.

customers, e.g. Fast Office by Equity Office, who provides leases for a minimum of one month.

Subleasing is for many corporations a temporary solution, but this market is far from transparent. A few players have emerged to standardize and clarify the process, such as Offices2share.com.

1.5 Recent Trends in Serviced Office Space

The serviced office space industry is fragmented with a large number of small competitors, many of whom are still in the "executive suites world". In the U.S. market, only a small percentage of office space is serviced; the vast majority is traditional workspace. The industry seems poised to consolidate, as scale becomes a basis of competitive advantage. The providers with a global footprint and brand identity are attracting the business of large corporations and start-ups that value technology based services. Further, providers with a breadth of services are meeting the needs of the customers, while more traditional players may struggle to remain competitive in that growing market segment. Also, large providers establish privileged relationships with property owners to access prime real estate globally. Lastly, global providers have greater access to capital to support center expansion and investments in technology services.

1.6 Methodology

This thesis explores how serviced office space is being provided by the real estate industry. Further, it explores how current models of office space use translate into practical applications against the backdrop of consumers needs in both property and service.

Also, it appears that suppliers of service office space continue to develop their service delivery approach in new ways, especially since the advent of the big supplier. A framework for examining strategic service models on which a manager can build growth and profits, as described in The Service Profit Chain[5], will be explained and compared to those of the serviced office industry.

Structured interviews allow illustrating a snapshot of what is taking place in the real world. The selection of structured interviewees in this study is critical to the correct interpretation of the results. Biased research can lead to the choice of certain suppliers to prove a certain point. The suppliers interviewed in this thesis have been selected because of their significant contribution to the current business models of serviced office space. The particular choice is based on size, exposure and impact on the office market, general and specific relevance to the topic, and leadership position in the application of (r)evolutionary office space management techniques. Any assumptions will be stated.

It is not the goal to reject or support serviced office space, but to analyze and gain a thorough understanding of the challenges and opportunities of serviced office space in real estate markets today.

1.7 Thesis Questions

In this research, four areas of the serviced office space industry will be analyzed; these include the product, service, staff, and relationship. What is the product and how do the suppliers fit in to real estate industry? Which services are available to the consumer and how do suppliers differentiate their products and services? How do suppliers train and

[5] Heskett, James L., W. Earl Sasser, Leonard A. Schlesinger, The Service Profit Chain: How Leading Companies Link Profit and Growth to Loyalty, Satisfaction, and Value, Free Press, 1997.

reward their employees? What kind of relationship do suppliers have in place with their tenants and what kind of feedback do the suppliers gather from their employees and customers?

Questions in these four areas of product, service, staff, and relationship will be asked of owners or senior managers of serviced office space as well as frontline employees of serviced office centers, and consumers.

The goal of this questionnaire is two-fold. The first is to gather data to present a picture of the industry as it stands today. The second is to assess the relevance of current research to the findings.

2. The Office Business Center Industry Overview

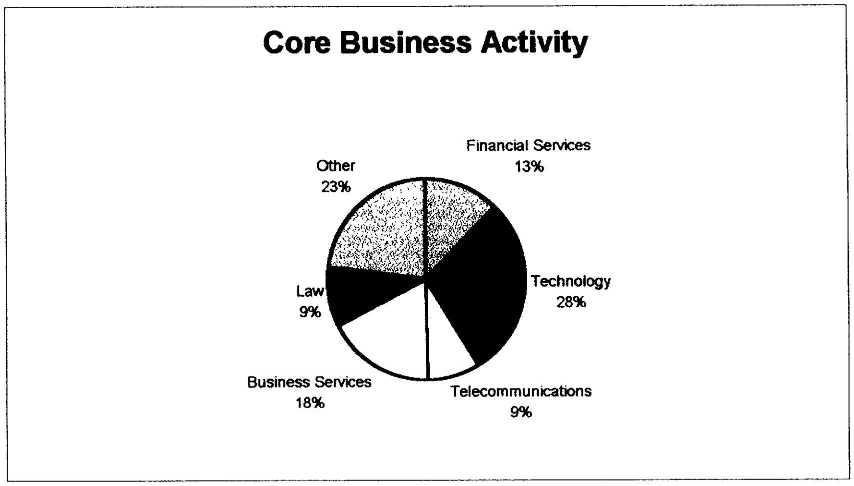
Office Business Centers, a.k.a. executive suites or serviced offices, are shared office facilities and generally include four elements: office accommodations, business services, amenities, and managed technology. The typical Office Business Center is a floor or two in a commercial building, divided into individual offices, workstations, small corporate suites, conference rooms, reception area and other common areas. The facility is staffed, equipped, furnished and managed like a corporate headquarters. Businesses, not-for-profits, government organizations, and other clients pay a monthly fee per workstation that covers the use of office accommodations and such essential services as telephone answering, reception, and facilities management. Other services, e.g. faxing, copying, word-processing, high speed Internet, videoconferencing, are typically available a la carte and are billed separately and only as used.

The not-for-profit industry trade association, Office Business Center Association International (OBCAI), conducted a survey of their worldwide membership to provide current benchmarking data[6]. It is interesting to note that only one large supplier of serviced space is a member of this organization; the vast majority are small operators.

[6] Surveys were sent to all 351 member firms in March of 2000. Completed survey forms were accepted through April 20, 2000. The accounting and marketing firm Industry Insights Inc., Columbus, Ohio, interpreted the surveys. In all, 148 firms completed usable survey forms.

2.1 Client Business Activity

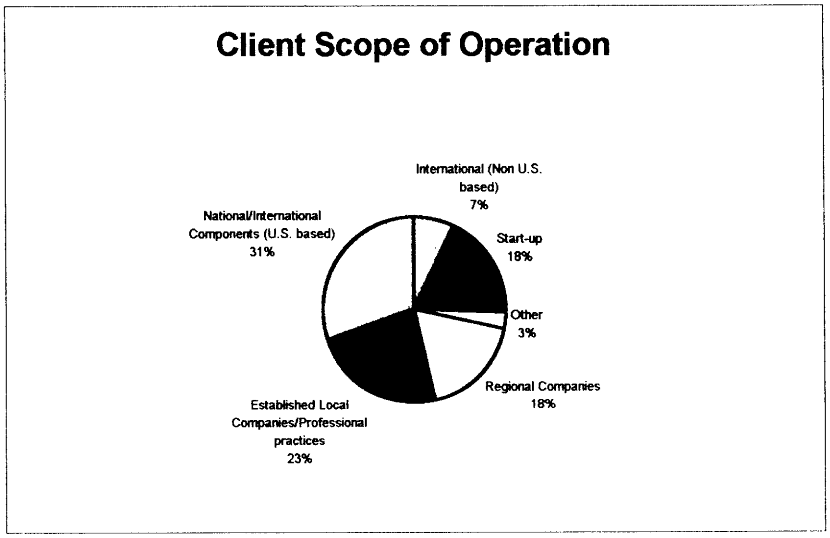
Among various industries, technology accounts for 28% of all office business center clients, followed by business services at 18% and financial services at 13%.



Source: OBCAI

2.2 Client Size

Nearly 40% of the client base are large corporations conducting business on a national or international level, whereas the remaining 60% is made up of entrepreneurs (start-ups), regional businesses, and small firms.

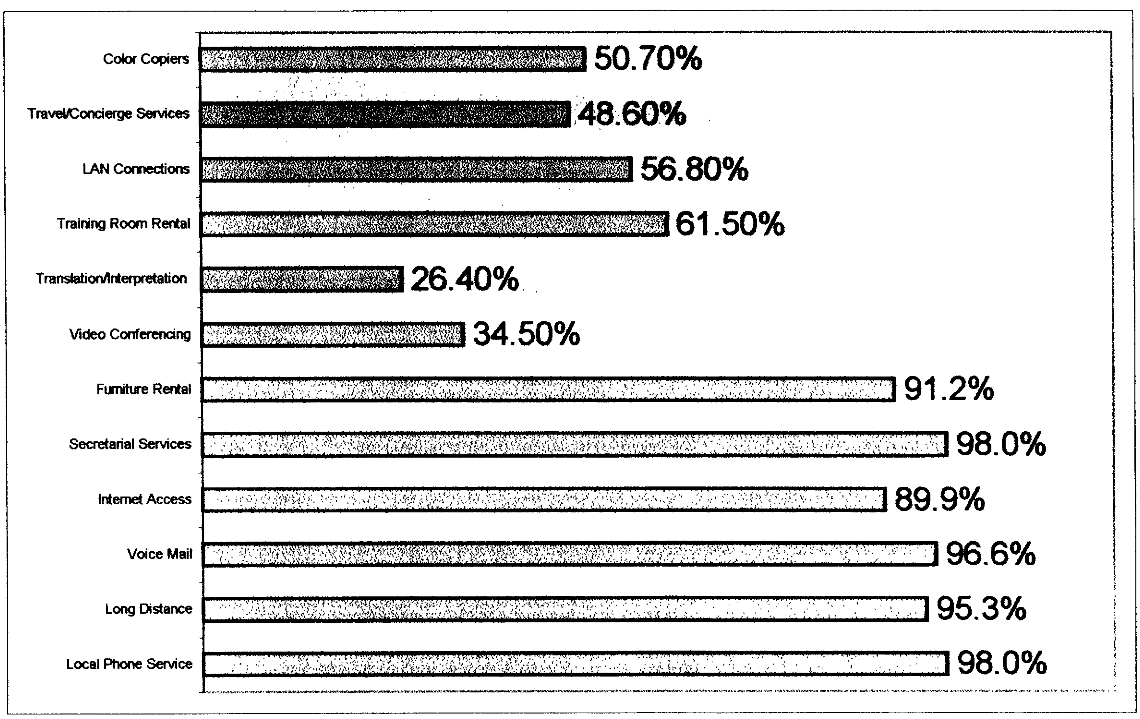


Source: OBCAI

2.3 Products and Services Provided

The most common products and services offered by the Office Business Centers. As one might expect to see, not all products and services described in the current evolution of products and services available in the industry, as described in Chapter 1, are being supplied by every provider. However, most providers supply the core products and services that have been in use since the executive suites era.

Products and Services Provided



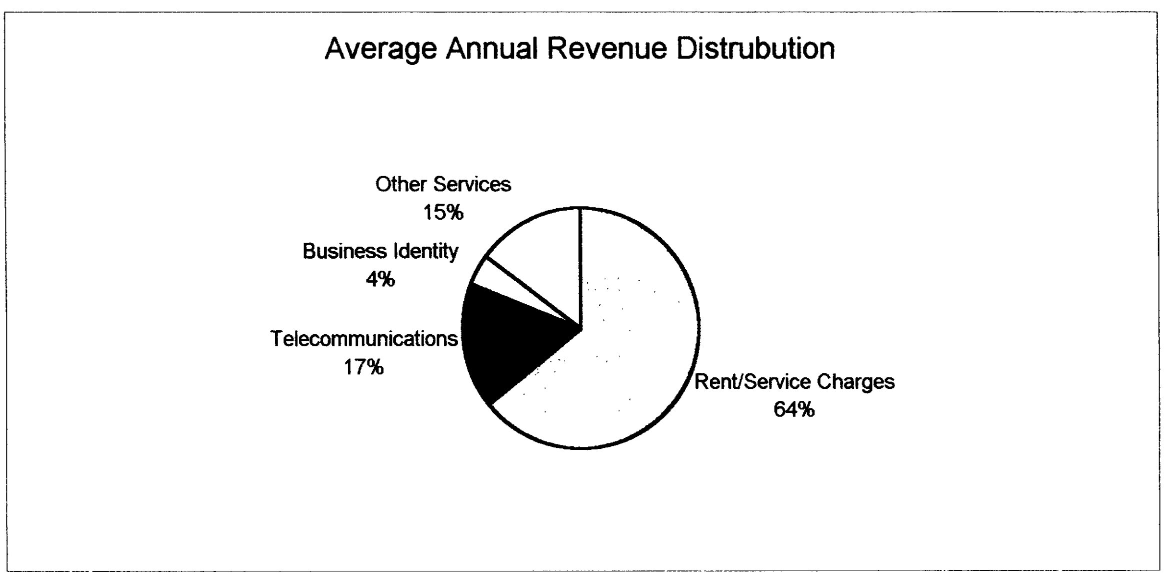
Source: OBCAI

2.4 Tenant Cost

The cost of a single office in an Office Business Center varies depending on the market, the location of the facility within a market, the size of the office, and its location within the facility. In some markets a small, interior office might be as little as $500 per month, while a large, exterior office with excellent views might be $2,500 or more per month. Typically, this fee includes space-related services such as maintenance, cleaning and utilities, as well as such basic professional services as office management, telephone answering, mail handling and reception.

2.5 Owner Revenue Sources

Rent/Service Charges account for nearly two-thirds of annual revenue for the typical firm. Telecom revenue was the next most significant revenue at 17%.

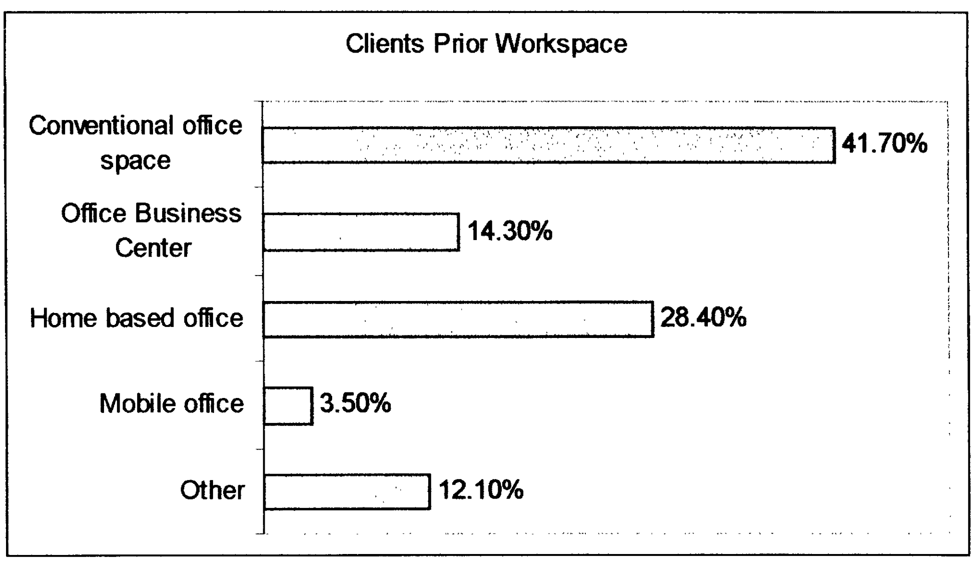


Source: OBCAI

Most Office Business Centers also offer other services such as part-time offices, visitor's day office (e.g. Touchdown space), meeting rooms and workstation arrangements, which are traditionally called corporate or business identity plans. These arrangements typically provide an address, telephone answering, mail handling and a specified number of hours of conference room or office use per month. Plans are usually tailored to the needs of individual businesses and costs vary accordingly. These plans are often used by home-based businesses that want a professional image as well as an office to meet clients.

2.6 Clients Prior Workspace

The following chart illustrates which categories of office space clients occupied prior to using a serviced office environment. The majority of clients were occupying conventional office space, while nearly one-third came from a home-based workspace.

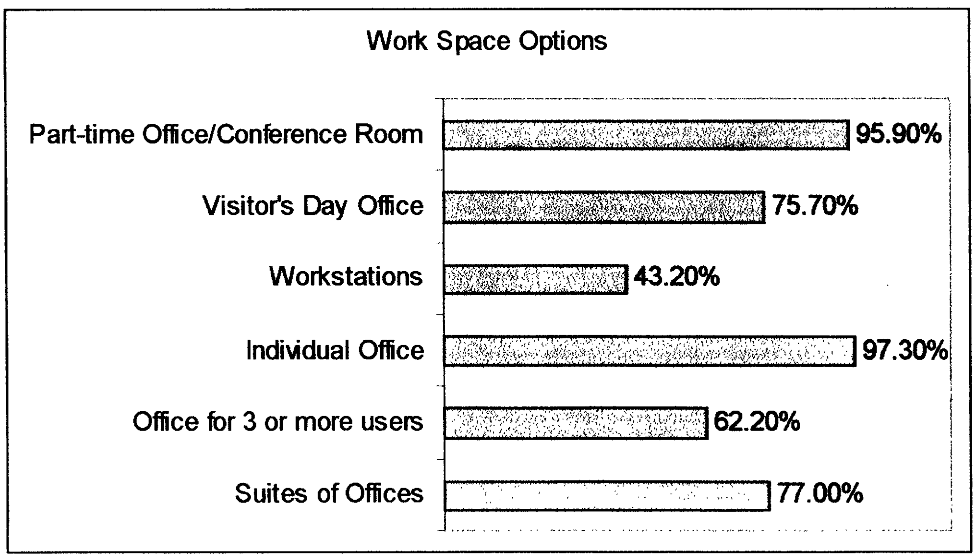


Source: OBCAI

Also, Office Business Centers typically provide offices or conference rooms by the hour. Since locations are often conveniently located in downtown and suburban buildings, many find this service an ideal alternative to meeting in airports and hotel rooms.

2.7 Workspace Options

Individual offices are offered at nearly every center, while open office plans with workstations are offered at less than half. The following chart illustrates the percentage of providers offering various space configurations within the business center.



Source: OBCAI

This data implies that few suppliers (43%) provide workstations in an open floor plan. Research indicates that open floor plans are the preferred work environment because it allows for flexibility and teamwork.[7]

The data presented here reflects the findings of an industry trade association whose membership is comprised primarily of small suppliers of serviced office space. The picture

[7] Duffy, Frank, The New Office, Conran Octopus, 1997.

presented paints only a portion of the dynamics occurring in the industry today. The following industry background details the evolution of the industry. Later, new data will be introduced to highlight the changes in the industry.

2.8 Industry Background

The Office Business Center Industry began to emerge in the late 1960's. In response to the needs of clients, secretarial services firms and telephone answering businesses began offering office space. A natural development that sprang up independently in many locations, these facilities were typically small scale, utilitarian operations with from 10 to 20 offices located in modest buildings. Many of the country's 4000 centers continue this pattern.

In 1968, HQ Business Centers, which would become the largest organization in the industry, created the template for today's Office Business Centers when it opened a sizable, upscale facility in a Class A high-rise at 44 Montgomery Street in San Francisco. OfficePLUS, which started in St. Louis, established similar facilities in the Midwest. Atlanta based OmniOffices pioneered the concept in the Southeast. Such professionally managed and serviced centers in good buildings made Office Business Centers an alternative to conventional office space for businesses of all types and sizes.

By the end of the 1970's, HQ had begun to establish franchises as part of a plan to create a global network. Also in the early 1970's, the east coast US based supplier World-Wide Business Centres opened its first overseas office in London. These developments looked forward to the global expansion of the industry.

By the 1980's, the Office Business Center Industry had expanded greatly. Across the country, enormous numbers of office buildings were constructed, in part, in response to readily available financing from S&L's and others. Anxious to fill their new buildings, landlords offered attractive deals to prospective Office Business Center operators. Terms routinely included one to two years of free rent, interior construction costs, and even cash payments, which were called moving or telephone system expenses.

These incentives made it exceedingly easy to enter the business. As a result, Office Business Center locations multiplied; many were undercapitalized and badly managed. In some parts of the country, there was so much over capacity in office buildings and in Office Business Centers, that even the best-managed businesses had difficulty in succeeding.

Jane Booras, an industry consultant, who in 1985 founded the Executive Suite Network, the forerunner of the Office Business Center Association International, puts it this way: "I remember when you could get off at Orange County Airport [in Southern California] and throw a stone in any direction and hit at least two executive suites. And they were all about 40% occupied."

The S&L scandal combined with the real estate crash of the mid to late 1980's led to a shake-out. Many Office Business Center businesses failed and landlords were often left with a glut of unoccupied office space from tenants who either defaulted on their lease contract or chose not to renew it. The industry did not begin to recover until the early 1990's.

From 1985 to 1992 there were very few new centers built. The lack of new construction and a turnaround in the economy eventually balanced the overbuilding in the 80's and vacancy rates in both large and small Office Business Centers began to drop. New operators took over failed properties and revenues began to rise.

Throughout this period, the OBCAI played a key role in shaping the industry and helping it recover. The organization offered seminars and conventions with learning and networking opportunities. It served as a forum for sharing information and helped improve landlord-industry relations. OBCAI was virtually the only organization providing information about the industry.

As the 1990's progressed and demand increased as a result of the trends described above, the industry began to pick up momentum. To provide a national presence and to compete with the HQ franchise network, several smaller operators formed the Alliance Business Center Network to serve corporations that needed locations in multiple markets. WorldWide Business Centres Network® was similarly formed with a majority of international locations.

2.9 Industry Consolidation

Then, in a series of moves, the industry began to consolidate as major investors sought to create national and international networks to meet the expanding needs of corporations, which were increasingly outsourcing their real estate operations to Office Business Centers. By 1998, the vast majority, or approximately 85% were still small operators with only one or two locations, said David Beale in 1998 as president and CEO of Alliance.[8] Beale was the first person to secure the capital necessary to begin consolidating the industry. Beale secured capital from two investors in 1996: Cahill Warnock, a Baltimore-based private

[8] Brian K. Miller, Portland Business Journal, National players swallow Portland executive suites, September 25 1998.

equity fund with about 40 different institutional investors, and Northwood Ventures of New York, a leveraged buyout fund that makes other investments as well.

"There were no clear brand leaders and nobody with any real access to capital," said Beale. "I just felt there was an opportunity for a company to come in well capitalized and try to create a national brand--be the Marriott Hotel of the executive suites industry." Over a period of two years, predominately through acquisition, Alliance National Inc. grew from 14 executive suites largely on the East Coast to 90 facilities in 31 markets nationwide. Alliance Business Centers merged in January 1999 with Interoffice Holdings Corp. and Reckson Executive Centers to form VANTAS. "Our continued expansion responds to the needs of our corporate clients who have growing requirements for alternative work space and business services in multiple cities worldwide," said David Beale.[9]

CarrAmerica Realty Corporation, the parent company of HQ Global Workplaces, grew through mergers and acquisitions, similar to the development of Vantas. In August 1997, through one of its subsidiaries, CarrAmerica purchased the assets of The OmniOffices Group Inc., a market leader, for $50 million. OmniOffices had 31 executive office suites located in 16 markets nationally, and 27 Optima Business Centers, a concept similar to OmniOffices.

Meanwhile, HQ Global Workplaces was growing through an aggressive acquisition strategy beginning in 1996, whereby it had acquired or merged with 37 entities, which were comprised of 182 business centers. Then in June 2000, in what would become the making of the largest supplier of office business centers, HQ Global Workplaces (CarrAmerica) merged with Vantas, the executive suites affiliate of FrontLine Capital Group, the

[9] VANTAS brings exec suites to Broomfield, Boulder County Business Report, Susan Glairon, August 1999.

investment arm of David Beale's Reckson REIT. As a result of the HQ merger, the combined company became a wholly owned subsidiary of the new parent company, HQ Global Holdings, Inc., under the name HQ Global Workplaces, Inc.

HQ Global Workplaces' now employs 3,000 people and serves 43,000 clients through more than 469 owned, managed, or franchised business centers in 17 countries. Over the period of just 24 months, HQ had become the world's largest provider of serviced business centers. However, because each franchise or newly purchased property came with a unique operational and management system, Beale's original concept of brand identity and operating synergy has not been fully realized.

Currently there is only one other supplier on the scale of HQ. Regus Business Centres, which went public on the London Stock Exchange and the Nasdaq Stock Market in October 2000, was founded in 1989 with one center in Brussels. Regus operates 350 centers, or 66,000 workstations, worldwide. In the U.S., the company launched its service in 1998 in San Mateo, Calif., and now has 70 centers and about 17,500 workstations in 29 cities.

Both Regus and HQ have been quietly expanding their businesses and signing up blue-chip tenants such as Exxon Mobil Corp., Charles Schwab Corp. and 3Com Corp[10]. More than providing just raw real estate, these companies fit out the offices with furniture, Internet connections and copy machines. They also provide various services such as receptionists and catering. Unlike more local, niche firms like TechSpace LLC, eEmerge or KickStart, all founded primarily to cater to start-up companies, Regus and HQ are aimed at larger corporate tenants who might need accommodations anywhere from a small office in a new market to a build-to-suit stand alone building. Regus's Mr. Howland, CEO of the Americas,

[10] PNC Real Estate Finance, Tech and Office, November 2000.

predicts that corporate tenants, who have about 2% of their real-estate portfolios in flexible space, will eventually move toward putting about 20% of their real estate into shorter-term leases. Likewise, Scott Rechler, chief executive of Frontline Capital Group, the New York-based majority owner of HQ Global Workplaces Inc., says that within the next decade, corporate tenants will sign as much as 25% of their real-estate leases on short-term commitments. The rationale for these predictions is that corporations will focus more on their core business.

The Office Business Center Industry may also grow as operators create new products and services to meet client needs. For example, EBC Office Centers of Atlanta saw an opportunity as a result of rapid expansion in the software training industry. EBC took part of the space in one of its centers and turned it into a fully equipped and specially designed software training room. The concept has been very successful according to owner Lydia Howren who stated "by changing the floor plan and adding new technology quickly to align with market demand, we kept our vacancy rate to a minimum". Also, Regus is expanding its services and developing other brands of serviced office space. The brands range in scale, location, and scope from minimum amenities and services at lower prices to state of the art technology, furnishings, and services that may even include an on premise health club.

In order to meet their goal for providing space and service for 25% of corporate real estate, big serviced space providers need to attract a new and larger portion of the workforce. In a recent study, 65% of activities undertaken at serviced offices was new business development and the number of staff using a particular business center was generally 5 staff out of firms sizes from less than 20 to greater than 200 employees.[11]

Competition is vigorous, especially in major markets. However, the creation of brand names and increased investments in marketing may expand awareness of the industry and help continue to stimulate demand.

Growing interest in the Office Business Center industry has resulted in restructuring and consolidation as large investments are made in the industry. The industry continues to reposition itself and market to new types of clients. The services, scope, and economics of serviced office space continue to reach a broader array of consumers. Also, recent economic trends such as downsizing, outsourcing, alternative officing, corporate flexibility and adaptability, and costly technology have fueled the interest in office business centers. [12]

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[11] Change & Flexibility, Virginia Gibson and Colin Lizieri, University of Reading, UK.
[12] Change & Flexibility, Virginia Gibson and Colin Lizieri, University of Reading, UK.

3. Literatures and Research

As an integral part of the growing alternative workplace environment, the office business center industry is redefining the service it provides.

The advent of big suppliers has begun to reshape the landscape of the supply of serviced office space. Big suppliers have distinguished themselves from the small suppliers by delivering new products and services packaged in prime locations on a global scale primarily targeted to corporate real estate organizations. The objective of big serviced office space providers is create value for a corporation by providing them with space and services so the corporations can focus on their core business.

Achieving customer value and satisfaction is directly related to service delivery methodologies. The value of goods and services delivered to customers is equivalent to the results created for them, as well as the quality of the processes used to deliver the results. Office business centers appear to be adopting an important objective of achieving market, operating, and human resource focus around a service concept that delivers results that customers' desire.

A framework for exploring how companies link profit and growth to loyalty, satisfaction, and value is presented in *The Service Profit Chain*[13] by James Heskett, W. Earl Sasser, Jr., and Leonard A. Schlesinger. It links profitability to the human side of the business equation. The authors have numerous examples from excellent companies to support their hypotheses. Featured in the book are: British Airways, Marriott, Nordstrom, Ritz Carlton, Service Master, Southwest Airlines, Taco Bell and Wal-Mart, to name a few. They use real

[13] James L. Heskett, W. Earl Sasser, Leonard A. Schlesinger, The Service Profit Chain: How Leading Companies Link Profit and Growth to Loyalty, Satisfaction, and Value, Free Press, 1997.

examples of companies that have achieved profit and growth by implementing the Service Profit Chain. The following concepts are key to understanding the logic behind the link of profit and growth with people, processes, and service delivery.

3.1 Overview, The Service Profit Chain - A Rationale for Excellence

Service profit chain thinking maintains that there are direct and strong relationships between profit; growth; customer loyalty; customer satisfaction; the value of goods/services delivered to customers; and employee capability, satisfaction, loyalty, and productivity. Central to the chain is the customer value equation. Viewed from the perspective of the customer, value is achieved when results and quality exceed price and acquisition costs. The value equation very simply is:

$$\text{Value} = \frac{\text{Results Produced for the Customer} + \text{Process Quality}}{\text{Price to the Customer} + \text{Costs of Acquiring the Service}}$$

This is in relation to the price of the service to the customer and other costs incurred by the customer in acquiring the services.

Value defined in this way is directly related to customer satisfaction. Service profit chain management provides the means for implementing a strategic service vision. The two concepts are complementary, for both reflect an important objective of achieving market, operating, and human resource focus around a service concept that delivers results that customer's desire.

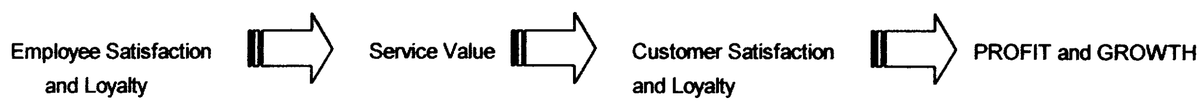
3.2 Capitalizing on the Service Profit Chain

Customers do not buy products and services—they buy the results that those products and services deliver. Thus, service providers that hope to be outstanding must manage for results. This includes defining their business and missions in terms of results rather than in terms of products and services. For example, is the delivery of products and services resulting in growth and profits for the business? Of course the profits and growth are very important, but even more critical, according to the authors, is the value of the services delivered to customers that leads to customer satisfaction and loyalty. This value is achieved primarily through frontline employees who, because of the high degree of capability they possess to deliver results to customers, are satisfied, loyal, and productive. The combination of these measures yields the service profit chain.

While the strength of the various links in the chain may differ amongst service providers, the following pattern is the same:

Profit and growth are linked to customer loyalty; customer loyalty is linked to customer satisfaction; customer satisfaction is linked to service value; service value is linked to employee productivity; employee productivity is linked to employee loyalty; employee loyalty is linked to employee satisfaction; and employee satisfaction is linked to internal quality of work.

The Service Profit Chain



The service profit chain provides a basic framework of management guidelines. However because the concepts are general, several important steps must be taken by managers to build the organizational capability and manage operating units on a continuous basis. The steps include: the measurement of the service profit chain relationships across units; communication of the self appraisal resulting from this measurement; the development of the 'balanced scoreboard" of performance measures; the design of efforts to help managers improve service profit chain performance; the development of recognition and rewards tied to established measures; widespread communication of service profit chain results at the operating unit level; and the active encouragement of internal "best practice" information exchange.

3.3 Managing by the Customer Value Equation

Relating all the links to the service profit chain in a business is not necessarily obligatory for achieving profit and growth. However, the authors Heskett, Sasser, and Schlesinger say that profitability depends upon measuring and managing for just a few central results. One of the most important of these is value equation--- a "customer's eye" view of a particular service that determines its long-term profit potential.[14]

$$\text{Value} = \frac{\text{Results Produced for the Customer} + \text{Process Quality}}{\text{Price to the Customer} + \text{Costs of Acquiring the Service}}$$

This equation suggests that service value can be enhanced by increasing either results delivered or process quality (or both), while reducing either prices or service acquisition costs (or both).

Managing by the value equation demands an understanding of customer needs, determining ways in which these needs influence attitudes toward the value equation, establishing a return on value-enhancing investments, developing different value packages for various market segment, developing a single-minded emphasis on value, and ultimately deciding whether value can be provided at a profit.

The elements of the value equation may offer so little margin for error that they represent little opportunity for making a profit. It is necessary to tie the value equation to the strategic vision. Marketing, operations, and human resource management are important operating-strategy element that leverage value to customers over costs. They are important determinants of the degree to which this effort is translated into profit for the service provider and true value for customers via decisions regarding the price charged for the

[14] Source: James L. Heskett, W. Earl Sasser, Leonard A. Schlesinger, The Service Profit Chain: How Leading Companies Link Profit and Growth to Loyalty, Satisfaction, and Value, p.40, Free Press, 1997.

service, as well as other components of the value equation. By keeping in mind both strategic service vision and the service profit chain concepts, managers can increase profitability by expanding margin potential.

Example

Sir Colin Marshall became the chief executive of British Airways in 1983, at a time when the airline was suffering from poor customer satisfaction. Marshall began to mobilize his workforce to develop of spirit that projected to its passengers that the people of British Airways cared about them and were doing something about there concerns.[15] Given the airlines high operating costs, a low-price ticket solution was not an option. Therefore, the airline sought to enhance the results provided to passengers, the quality with which they were served, and access of passengers to airline personnel before, during, and after the flight. This restructuring of their strategic service approach took on a number of dimensions, among them a massive retraining program, a reorganization of BA personnel into teams with expanded frontline latitude and responsibility, the redesign process, and a revamped information system to handle communications, including complaints.

Given the history of the office business center industry, One could expect to see the largest providers of serviced offices like Regus and HQ experiencing the same strategic image and service issues that faced BA when it incarnated and grew. In particular, it is reasonable to expect that these companies implemented similar strategic restructuring efforts to shake the low quality and poor service reputation of the industry.

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[15] Based on information presented in "Saving Customers With Service Recovery," a video prepared and distributed as part of the series, "People, Service Success," (Boston: Harvard Business School Management productions, 1994)

3.4 Rethinking marketing---Building Customer Loyalty

Traditional marketing efforts have typically centered on the four P's of product, price, promotional activity, and place (distribution channels); the primary objective of building market share.[16] This quest for market share has created mantras such as " the customer is always right," and has employed strategies relying heavily on sales and advertising directed at broadly defined market segments.

Service profit chain management adds the R's of retention, related sales, and referrals to the four P's. Market share quality, defined primarily in terms of share of loyal customers served is the primary goal. To reach this goal means abandoning the idea that customers are always right and embracing the notion that some customers are never right. "It means marketing more by listening, often by providing outstanding customer service, as well as a heavy reliance on customer-to-customer referrals." It means less reliance on "telling" through expensive sales and advertising campaigns, and more reliance on taking major cues for new products and services from customers. It means organizing in ways that make former marketing managers almost indistinguishable from their operating and human resource counterparts. Lastly, it means taking full advantage of new electronic media that are replacing traditional channels of distribution and reconsidering the validity of the four P's.

By combining measures of loyalty with data describing potential levels of usage, this new "potential-based marketing" seeks to lengthen the relationships with loyal customers,

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[16] Robert D. Buzzell and Bradley Gale, The PIMS Principles [Profit Impact of Market Share]: Linking Strategy to Performance (New York: Free Press, 1987).

extend the relationship through increased sales, and increase the profitability on each sale opportunity.

3.5 Attaining Total Customer Satisfaction---Not Whether But When

Customer satisfaction and loyalty can be tracked by means of "listening posts" such as customer surveys, feedback volunteered by customers, formal marketing research, reports filed by frontline service personnel, and actual customer involvement in certain affairs of organizations serving them.

Organizations that take the time to identify and target a specific customer base are more likely to achieve total customer satisfaction. Oftentimes, service providers attempt to please everyone, creating too many "merely satisfied" customers and too few "apostles" (those who tell others about positive service experiences) in the very core of the customer base. Further, customer satisfaction measures too often are averaged across segments and not related to other measures that could provide insights into profitable strategies.

3.6 Managing the Customer-Employee "Satisfaction Mirror"

Example

Nordstrom, the department store chain, is known for its excellent service. This leads to high customer satisfaction and almost fanatic loyalty among Nordstrom customers, which in turn, contribute to employee satisfaction with the job. These encounters tend to encourage a relationship with Nordstrom or with an individual salesperson. The company does whatever it can to encourage these relationship, most importantly rewarding results by paying salespeople a substantial commission on sales. But it also provides an attractive selling environment, a complete assortment of merchandise, and it establishes a liberal return policy that enables employees to consistently help resolve customers' problems without a lot of fuss. This provides Nordstrom employees the incentive for continuing their efforts to satisfy Nordstrom customers.

Successful service encounters, and the interactive relationships they create, are called the "satisfaction mirror effect"[17] which begins with hiring the right people and attracting the right customers.

3.7 Building a Cycle of Capability

The satisfaction mirror requires a great deal of preparation and thought---the kind that produces the type of job definition, management policies, supporting technologies, and rewards and recognition that customer-contact people describe with enthusiasm or in the authors' words "capability."

Capability is achieved through employee latitude to deliver results to customers; a clear expression of limits within which frontline service providers are permitted to act; excellent

[17] Benjamin Schneider and David E. Bowen, "new services Design, Development and Implementation and the Employee," in W.R. George and C. Marshall (ends), New Services (Chicago: The American Marketing Association, 1985), pp. 82-101.

training to perform the job well-engineered support systems, such as service facilities and information systems; recognition and rewards for doing the job well; and customer and employee selection methods and results.

3.8 Developing Processes That Deliver Value

Effective frontline service providers both value and contribute to the processes for carrying out their jobs. These contributions to quality and productivity through process redesign have resulted in some basic universal lessons, namely: The customer, not the service provider, determines and defines quality and value; moreover, these definitions are relative rather absolute. Customer evaluations of quality and value are based on what was delivered as opposed to what was expected. Customer expectations are just as important an element of perceived value as what is actually delivered. It is important to manage such expectations. Because customer perceptions of quality and value are relative, services must be adapted to individual needs. This is most effectively done through frontline employees.

Efforts to enhance processes, quality, and value should have a profound impact on the culture of an organization, forcing it to become more sensitive to the needs of customers, suppliers, and employees alike.

3.9 Designing Service Delivery Systems

Various kinds of redesign efforts, including process, quality, and productivity improvements enhance value to the customer. In a service organization, these efforts are extended to the design of service delivery systems that enhance employee satisfaction, facilitate service, and ultimately influence customer attitudes toward service. These systems are often broad ranging when implemented in a network-based service organization.

3.10 Attaining Total Customer Satisfaction---Doing Things Right the second Time

In service industries, there is ample evidence that doing it right the second time, in ways that exceed customer expectations, may produce higher satisfaction levels than services provided right the first time. The problem is that when given this second opportunity, too many service organizations perform miserably.

In order to be effective, recovery policies and procedures, must lead to service recovery that is fast, customized, and personalized, meaning it takes place at the point of contact between customer and service provider---the service encounter. However, organizations cannot rely too heavily on service recovery. They must be very good at delivering results day after day, time after time. Organizations that accomplish this and supply effective recovery as well, when things go wrong, have a particular advantage over their competitors.

The goal of any business is to provide a valuable service to their customers. This in turn will lead to customer satisfaction and loyalty, which then leads to repeat business, which then results in profit and growth for the business. The service profit chain is relevant to the serviced office industry and, therefore, provides an opportunity to assess findings.

The serviced office space industry appears to apply several of the concepts highlighted in the book. For example, an important measure for market demand can be gathered through customer feedback. Also, feedback from employees and customers about their respective satisfaction helps managers refine business policies. Other service delivery systems such training employees and giving them decision making latitude, locating the business where the clients need them, matching different categories of clients with different products and services are being implemented by the industry.

The following chapter presents some industry data, followed by an analysis of the data as it relates to the service profit chain.

4. The Supply of Serviced Office Space

Interviews were conducted over the summer of 2001. Owners or senior managers of two large providers and six small suppliers were interviewed to substantiate relevant links between the Service Profit Chain and serviced office space industry.

The interview questions were designed to gain insight about several dimensions of the industry; the changing dynamic of the industry from the advent of the big suppliers, and distinguishing characteristics between the big and small suppliers. The following insights reflect the results of these interviews.

4.1 Market Distinctions: Big vs. Small

Both big and small suppliers of serviced office space acknowledge a difference between the types of clients they serve and nature of the products and services they deliver. Typically the big suppliers provide prime space (Class A) in prime locations within the central business district of a major city. The center is usually located within a high-rise office building occupying an entire floor or approximately 20,000 to 25,000 square feet. Small suppliers tend to be located in Class B downtown office buildings or more commonly suburban office parks and occupy 10,000 to 15,000 square feet.

Clients of the big suppliers are mostly large companies with a national or multinational presence. The smaller providers serve mostly regional companies and local professional firms. The single-location supplier typically caters to the space and service needs of small local firms and entrepreneurs, particularly those stepping up from a home office.

The following issues highlight the differences that exist between the big suppliers and the small suppliers interviewed for this work. Large suppliers felt confidently that they are redefining the business.

Each of the following topics is intended to highlight a significant aspect of serviced office space in the context of service and growth of both big and small suppliers. Each topic opens with a chart that highlights the key findings.

4.2 Growth Strategy

Big Supplier	Small Supplier
• Downtown and suburban market • Increase Corporate partnerships • Economy of scale • Occupy up to 25% of all commercial real estate	• Suburban Market • Expand and contract with property owners to meet demand in existing markets

Each of the big suppliers has a different strategy for growth. One grows through agglomeration, acquiring regional and local operators, while the other plans growth organically, by building new centers in new markets. Both big suppliers interviewed have reduced their plans for aggressive growth, citing the recent downturn in the US economy. However, as expected, the big suppliers foresaw a temporary slowdown in the economy. Each believed there is plenty of room for expansion in the sector. They proposed that growth would be driven by a growing awareness of the advantages of serviced office space, and further investment from the public financial market. The demand for serviced space is seen as evolutionary, not a short-term reaction to economic cycles.

The big suppliers target the top 50 US downtown markets for new growth opportunities. Each plans on developing a high concentration of centers in the top 10 markets citing consumer demand for floor plan flexibility and location options within these markets. Both large players plan on growing their respective corporate client base.

Each of the smaller suppliers interviewed were generally content with the size of their organization and had no plans to grow their businesses. Two small suppliers interviewed plan to move from prime downtown locations due to competition from the big suppliers. Each commented on a growing saturation of service space in their respective downtown market and further felt that opportunities exist where most small providers operate currently, for example providing limited and specific services to a niche market in a suburban location.

4.3 Competitive Advantage

Big Supplier	Small Supplier
• Global Coverage	• Access to providers globally
• Full service "not the least expensive"	• Niche Provider
• Prime locations	• Local market knowledge
• Latest Technology and Equipment (Furniture and Office Equipment)	• Few standardized products and services
• Professional staff	• Owner on site "personal touch"
• Customized and Standardized Billing	• Standardized billing
	• High employee retention

The large suppliers provide office space with the latest technology, equipment and services located in prime downtown locations. The big suppliers further distinguish themselves from the competition by highlighting a few points of quality service provided. These suppliers pursue consistency in their product and services, global coverage, and the creation of integrated environments that are valuable to their clients. The large providers do not consider the small providers their direct competition. They consider the traditional space market as their direct competition. One large provider also acknowledged other large commercial real estate owners as potential competition once they begin to develop a version of serviced office space as an option for their tenants.

Big providers, realizing their large clients have varying degrees of need for products and services in different locations, are tailoring unique product and service plans to not only cater to the individual client needs but also to maintain competitive pricing.

Most small providers offer a limited menu of basic services. They argue that a limited menu of services minimizes monthly costs for tenants and allows for simpler billing.

The small suppliers sometimes cater to a specific industry. They offer very customized products and services to a unique client base. For example, one provider's client base includes several law firms. The products and services within this center include a law library and paralegal assistants. What about the standardized services offered by small providers? Needs a sentence or two to clarify what small providers offer (standardized and above).

Spillover Benefits

The small providers receive spillover benefits from the advent of large suppliers located in high profile buildings. A number of smaller providers indicated that the large providers have established a recognizable image for the industry. By providing state of the art amenities and a full range of services delivered by carefully trained personnel, the large providers project a set of standards for the serviced space industry on the general space market. Smaller providers benefit from being grouped into the serviced office space category even though the products and services they provide are more standardized than those offered by large providers. The smaller suppliers suggested that small businesses and entrepreneurs who first heard of serviced office space through large providers where then drawn to small suppliers for their less expensive pricing structure.

4.4 Client Base

Big Supplier	Small Supplier
• >60% Corporate: Finance, Insurance, Real Estate • <40% Small Firms and Start-ups • Average term of 6 months to 2 years	• <40% Corporate: Finance, Insurance, Real Estate • >60% Small Firms and Start-ups • Average lease term of 6 months to 3 years

The types of business taking place in serviced offices exemplify the distinction between the types of clients and the size of supplier. Entrepreneurs and small professional firms use serviced office space as their core business space, usually operated by a small provider in a suburban location, according to industry accounts. The lease term tends to be longer and less expensive than occupying a center run by a big supplier. There are several plausible reasons why small centers tend to be less expensive. They tend to be located in suburban locations or small cities, offer fewer services, and employ fewer staff.

Corporations and other large firms have different uses for serviced office space. Big suppliers in prime (Class A) locations provide large companies with visibility, a corporate identity plan, or simply a presence in a particular market. In some cases, a corporation may use a center as a "virtual" satellite office where no actual workers exist. The firm may use the center's conference rooms, touchdown space (a small office or workstation with complete telecommunication features), and other amenities on an as needed basis and charged for services on an "as used" basis. Serviced office centers also provide high quality space to businesses sales force evaluating a new market. In this case, the center adds services to the real estate, rather than acting as a substitute, in providing high-end "peripheral" and "virtual" space.[18]

[18] Change and Flexibilty, The role of serviced office space in office markets and corporate property portfolios, Virginia Gibson and Colin Lizieri, The University of Reading

4.5 Products and Services

Big Supplier	Small Supplier
• Located in prime Downtown and Suburban areas	• Located in Downtown or Suburban areas
• Class A office space	• Class A or B office space
• Minimum 20,000 sqft center size	• Avg. 10,000 sqft to 15,000 sqft center size
• Variety of office size and configuration	• Standard office size and configuration
• Modern workstations	• Conventional office furniture
• T-5 data cabling	• Up to T-1 data cabling
• Advanced telephone systems	• Advanced telephone systems
• Videoconferencing	
• Full-time Receptionist • Full-time Secretary	• Receptionist and secretary combined
• Customized Pricing	• Standardized Pricing
• Catering	
• Enhancements including concierge and cafe	
• Formally trained staff	• Informally trained staff

There are considerable differences in the scope and quality of services provided by large and small providers. Historically, the small suppliers tended to provide the minimum level of product and services acceptable to their clients. The emergence of larger, high quality suppliers has forced many small suppliers to emulate their competition. The small suppliers provide the basic infrastructure with furnishings, limited common space and secretarial support. Only recently have the small providers begun to add high-speed network cabling and advanced telecommunication systems. The basic package of service consists of reception, telephone and answering service, mail service, utilities and cleaning, and secretarial services at an additional charge. Beyond the basic level of service, some small providers, like the big providers, are teaming with high tech telecommunication companies to create a proprietary communication network to enable their mobile customer base by linking home, office, and personal portable devices.

Meanwhile, the big providers offer a full range of services including the fastest Internet access available, elegant public spaces, access to catering, the latest workstation designs, and highly trained staff. Videoconference service, available to clients, is also sold to the public at large. For security purposes, the videoconference room is typically located directly off the main reception area and does not have access to client spaces.

Some limited services are bundled into the monthly fee; however, most are priced separately based on a menu system. The billing system has been adapting to market demand. Customers complain about "nickel and diming" charges for every small expense. The big providers are testing a new system for billing add-on services. Instead of itemizing the bill based on each and every product or service used within a month, users will receive a single charge. This charge will provide an unlimited use of certain predetermined services for one a single monthly fee. Further, certain large clients receive special service "packages" customized to their needs for products and services.

4.6 New Industry Roles

When suppliers were asked to characterize their business within the real estate market, the majority responded that they are in the business of providing a service. Only one small provider stated that his is a business purely for providing real estate on a short-term basis. This characterization highlights an important distinction about the changing nature of the business of short-term office space. The large suppliers and most small providers view themselves as systems integrators, that is, combining real estate, office services, technology, and communication for users requiring flexible workspaces. Serviced office providers in a sense, stand between the real estate and the corporation, providing the necessary people, information and technology to ensure the efficient use of space, driving down total occupancy cost per worker or cost per unit of output. The real estate that they own or lease on a long-term basis is an essential ingredient, but it is secondary to their service delivery operation. This is important for the development of the market, since it provides a clear link between the serviced office sector of the real estate market and facilities management.

4.7 Marketing

Big Supplier	Small Supplier
Strategy • Direct Sales force to corporate community • Word of mouth • Internet sales force and exposure • Direct Mailing • Educational Seminars Outlets • Sponsored events • R.E. Brokers • Local radio • Bus ads • Subway ads • Internet search engines • Yellow Pages • Trade Journals • Newspaper Ads	Strategy • Network affiliations • Word of mouth • Educational Seminars • Internet exposure Outlets • Business publications • Classified ads • Internet search engines • Yellow pages • Trade Journals

The big suppliers cite word of mouth as a very important means for new business lead flow. The advent of big suppliers to the market, along with growing corporate outsourcing, and limited industry data about serviced office space has led to a great deal of curiosity and interest in serviced office space. Both large and small suppliers aggressively pursue clients via telephone marketing. Real estate brokers have been the weakest source of lead flow, according to the suppliers. The brokers neither provide adequate industry data to sell the product effectively (i.e. total employee costs) nor are they eager to lease small space on a short-term basis. The suppliers argue that serviced office space has the potential for high earnings for brokers because of the inherent high volume nature of the business.

Both big and small providers use the Internet for marketing. Advertisements on web-based real estate search engines and industry network WebPages target the public at large. Further, the Internet is used to market and sell video-conferencing services to the public as well. Both large and small suppliers continue to use the yellow pages, newspaper advertising, and real estate industry publications as a primary source for marketing.

As a means of educating potential clients, big suppliers host open houses for real estate brokers and corporate real estate.

4.8 Customer Feedback

Big Supplier	Small Supplier
• Formal questionnaire • Adapt services based on feedback • Survey customers at end of lease term • Survey customers at introduction of a new product or service	• Informal feedback through routine conversations • Adapt services based on feedback • Survey clients each year

The big suppliers gather customer feedback on a regular basis, twice annually, and at the end of a client's contract term. Suppliers state that clients are more candid at the exit interview than at any other period in the lease. The questionnaire is never the same and typically requests feedback only about new services being rolled out or proposed by the operator.

Small operators tend to gather feedback informally. The center owner is usually on the premises and has day-to-day contact with the staff and clients. Small operators claim that the personal interaction keeps them abreast of all issues at the center.

Both big and small providers have changed policies due to customer feedback. In several instances operators have either increased or decreased services due to customer feedback. Suppliers consider feedback critical to the success of the center because it allows the consumer to help shape the product lines and service delivery to create value for both the consumer and provider.

4.9 Employee Training

Big Supplier	Small Supplier
• Formalized Training • Annual training workshops • Management trainee programs • Office manuals and on-line real-time help line • Annual evaluations and feedback	• On the job training • Informal evaluations and feedback • Open door policy with on-site owner for questions and concerns

Large operators have sophisticated training techniques in place. Front-line employees receive extensive training in the field, attend classroom-training seminars, and have access to manuals and on-line help with other centers via the computer. Periodically all employees attend retraining events in order to maintain standards. Management receives the same training as frontline employees, yet when they reach a certain stage in their career they are pulled out of the field. Management trainees attend workshops about attracting and retaining clients (in particular, corporate clients) Further they attend team member development sessions. One large supplier stated that the administrative training is so good that their clients ask to allow their administrative support personnel to attend.

Small players tend to train their employees in the field through face-to-face on the job training. They tend not to use formalized standards and manuals. Small owners encourage their employees to communicate directly with the clients to customize work procedures around the specific needs and habits of the clients. For example, one international client was forced to relocate to his respective country. An employee of the center became so familiar with the work being performed by the client that the client asked the employee to temporarily fill-in for the relocating client. This tailored service is one reason for the "personal touch" label associated with small providers.

4.10 Company Example: Regus

The following company example is based on widely available data and is meant to provide some concrete examples of a serviced office business model.

<u>Company Strategy</u>

As one of the world's largest in providers of serviced office space, Regus has helped redefine the serviced office space business. According to Steve Dixon, President of Regus USA and Latin America, Regus is an "integrated real estate solution for corporate clients by combining people, technology and space through organization."

Regus located their centers by first researching demographics. A center was located where there is a significant correlation between office supply and existing or new job growth. They targeted office workers in categories of government, financial, investment, real estate, technology and telecommunications. They did not target retail, transportation, manufacturing, or construction. Their tenancy model was an educated office worker.

Two Regus clients used serviced office space for a combination of reasons. They both cited reasons as developing their sales force. Once the company has a certain number of sales employees in a certain region (i.e. 4 to 6 employees), it made sense to place them together to promote teamwork. They use the centers exclusively during the initial stages of the company entering a new market region. They retain a lease contract until they are confident that they will remain in the region. They both cite serviced office space as good economic sense. They can determine the potential of a market without a long-term lease commitment.

Regus' goal is to occupy 10% of office real estate in the downtown sector of the major metropolitan areas within which they have a presence. They also locate centers in sub markets of a metro region that are spread out, like southern California. They analyze commuter patterns and locate the center so potential clients won't have to travel more than fifteen miles to a center, the maximum distance that Regus believes a client should travel for alternative officing. Their target market share in those areas is 30%. Regus considers the emerging suburban market new territory for expansion and hopes that early market entry will help establish their product.

<u>Services</u>

Regus considers their competitive advantage to be their ability to act as the supplier of consistency, offering global coverage and one service contract for a global workforce. To ensure this consistent, high-quality service, the company established "135 Service Standards" that define the company's product and service delivery code.

Regus competes on the basis of value-added to customers, but must also address more traditional cost-related concerns. As Steve Dixon described this: "We are competing on price constantly and selling on value." Those customers that compare Regus' costs to total occupancy costs, including services such state-of-the-art IT systems that are always up and running, are seen as their best and most loyal clients.

Each center provides the same baseline products and services. Each center is at least 20,000 square feet. There are on average 5 to 6 people running a given center of 90 workstations in a 25,000 square foot Class A office building. They are a center manager, an assistant manager, two customer service representatives, and one receptionist. On occasion, Regus will customize the floor plan for long-term, multiple location tenants, but generally they speculate the floor plan. For example, one client was constantly reconfiguring the center's common training room, so Regus provided the tenant with their own large open room that can be reconfigured at their will.

Feedback and Training

Regus surveys their clients every six months using an outside agent. They also track retention rates but do not track the reasons why the client left (i.e. went out of business, moved to direct lease space, etc.). According to Regus, customer feedback influences their business tremendously by providing new ways to improve their services and products. For example, center staff is available to deal with issues such as temperature and customer feedback about the design of the furniture has led to improved workstation environments.

The pricing policy for secretarial and beverage service was changed due to customer feedback about the lengthy itemized bill for small individual expenses.

Regus employs 2,800 people. Hence, there are many categories of employees: sales, operations, management, and frontline service employees. Regus provides a formal training program for new employees and a variety of ongoing training programs to reinforce the company standards and to educate employees about new products, services, and delivery techniques.

The following is a list of the four basic categories of training:

a. Regus Open Learning Institute (ROLI) is an IT based week long taped instructional video training course for all new employees.
b. SMART is an online manual and procedures program that is printable and available anytime in each center.
c. Performance evaluation: After 3 months the center managers evaluate performance, and after 6 months employees are sent to the Regus Institute in London for further training on corporate issues.
d. Regus Passport is an ongoing tracking system for continuing education programs that should be accomplished at scheduled intervals.

Customer service employees are given a two-week training seminar. Additional training occurs at the center and is considered “on the job training”. Customer service representatives, Regus’ frontline employee, develop a unique relationship with the clients of the center. “Often times I feel like an employee of the client, not the center, we are concerned for each others success.”

Employees are interviewed for satisfaction every six months. For example, Regus learned from a sampling of top managers that they were uncertain if a long-term career path exists at Regus. Therefore, to accommodate growth and development in the staff, Regus enhanced the job posting system to allow managers to see job openings at centers around the world. The employees are encouraged to move from center to center. Regus considers it one of their strengths because it fosters a “consistent culture” globally.

Employees receive a performance review from their manager every 3 months. Furthermore, employees are asked to discuss their own strengths and weaknesses. At this time, it is determined if the employee should receive additional training about a specific subject such as enhancing computer program skills. This interaction between the office manager and frontline worker was characterized as “nice and caring and showed a lot of concern for employee development.” Employees are also asked to provide feedback to the company about job satisfaction and opportunities for improvement.

The frontline employees have latitude to make decisions on behalf of the company. To do so, the company ensures that employees are adequately trained to provide customers with both the baseline services they require as well as services such as travel arrangements that are not typically provided by the centers. The management structure is decentralized therefore allowing centers to self manage most billing and service matters.

Frontline employees are rewarded through base salary compensation with incentive pay based bonus and stock options. For example, a client service representative (a frontline employee) can earn up to an additional 15% of their base salary through incentive based programs such as cross-selling services.

The performance of regional managers is measured on productivity within their region. Further, regional managers help set the "tone" for the workforce by having a good and energetic disposition. Regional managers must also comply with the "135 Regus Standards" which details the company's code of conduct and operational standards. Managers are blind tested on these standards periodically.

According to senior management, the Regus employee profile is "a person willing to go the extra mile." In other words, the business is very dynamic and requires employees adapt to change quickly to respond to client needs.

4.11 Analysis

The serviced office industry has grown significantly over the past 35 years. The business of delivering space and services has become more efficient and sophisticated while attracting a wider audience. It appears that this evolution was not by accident.

Serviced office owners, especially the big suppliers, have been implementing business methods that have helped the industry grow and become more profitable.

A framework, for exploring how companies link profit and growth not only to customer and employee loyalty, satisfaction, and value but also to the human side of the business, was presented in chapter three. The findings in this chapter illustrate the relevance of the service profit chain to this rapidly changing industry. A central tenet of the service profit chain – the value equation – is particularly relevant to the serviced office industry. The value equation suggests that customers achieve value when the results produced for the customer are greater than price to the customer and the cost to acquire the service.

The big suppliers were familiar with the business model of the executive suites industry; however they recognized that a huge untapped market existed---the corporate client. By developing an environment that included the tools necessary for corporate clients to work efficiently and the flexibility to easily enter and exit a market on a multi-national scale, the big suppliers created a valuable service for corporate real estate. The big suppliers developed a service delivery process that integrates high quality office environments and services with professionally trained staff, knowledgeable frontline employees, and customer and staff feedback procedures.

However, developing a product and producing process quality is only part of the equation. In order to achieve value, serviced office owners have been addressing cost issues. By introducing new pricing strategies to meet specific customer needs, big serviced office providers deliver a customized pricing package that is more affordable or more responsive to the particular menu of the services they want. It can be either or both.

There appears to be some evidence that the clients of small providers are making a value-based decision. They compromise access to a full set of services for lower cost. The small providers achieve cost value by providing a limited set of standardized services either to the general public or by providing a set of niche services to a particular industry, such as law.

The high quality space and high quality service supplied to the marketplace has removed the stigma of second hand space. In turn, the public investment market has become more aware and interested in the industry. Large public funding in the industry of big serviced office space provided opportunities for partnerships with large-scale developers and other product and service companies.

Serviced office providers have been building customer loyalty by rethinking marketing. The executive suites era focused on the marketing efforts around the four P's of product, price, promotional activity, and place. There is evidence that serviced office providers are adding the three R's of retention, related sales, and referrals to the four P's.[19] The suppliers are listening more. They use customer and employee feedback as a tool for "listening". Also, outstanding customer service is leading to more customer-to-customer referrals.

[19] Heskett, James L., W. Earl Sasser, Leonard A. Schlesinger, The Service Profit Chain: How Leading Companies Link Profit and Growth to Loyalty, Satisfaction, and Value, Free Press, 1997.

Therefore, providers are spending less marketing effort on "telling" through expensive sales campaigns and more on taking major clues from clients.

Managing by the value equation demands an understanding of customer needs. Large and small serviced office providers determine the long-term profit potential of each new product or service introduced. The cost associated with introducing a new technology such as videoconferencing requires enormous capital expenditure. For example, one large provider discovered from a customer feedback survey that videoconferencing was not demanded by the customers. Therefore, the company plan to integrate videoconferencing into every center was put on hold. Listening to customers enabled the provider to help maintain costs that otherwise would have been increased.

Large and small providers understand the respective target audiences. Further, each tailors the products and services around the specific needs of those client groups. Large suppliers, whose client base is mostly corporate clients, seek sophisticated office environments and services. Small suppliers whose client base includes sole practitioners and small firms provide limited or niche services in adequate office environments. The clients at large providers expect to pay a premium for the products and services while the occupiers of the small centers expect to pay less and are willing to compromise product for cost. In both cases, the supplier provides a different product for different clients.

"Satisfied customers become repeat clients," said one owner. Embedded in that statement is the key element of the service value chain. It is critical for employers to emphasize the need for qualified, front-line employees who are empowered to provide the services required by customers. In large companies, this takes the form of "preferred customer" status, while in smaller companies it takes the form of the "personal touch".

It appears that suppliers, big and small, are achieving profit and growth from enabling employees, creating an environment that produces results for the customer, and developing customer loyalty.

5. Conclusions

The original supposition of this thesis was that the way in which office space is used and acquired has changed significantly during the last decade. The need for physical, functional, and financial flexibility along with rapid market entry from businesses has resulted in a growing demand for a new type of property product. This changing demand has led to the emergence and consolidation of a new commercial office sub-market: serviced office space. As the industry has changed and matured, it has exemplified characteristics described in the Service Profit Chain.

5.1 The Advent of Big Suppliers

Much of the recent growth in the industry has come from the big suppliers of serviced office space. These providers are increasing the credibility of the market by providing centers in prime locations in Class A buildings that attract corporate tenants.

Big suppliers have created a brand identity from their marketing efforts and clients' word of mouth. Further, the industry has attracted awareness interest and subsequent funding from the public investment community.

The recent consolidation and expansion of the industry could not have happened without the backing of investors who recognized the potential of the business model. Also, in order to expand rapidly into new markets, big suppliers have partnered with real estate developers and related product and service companies.

5.2 Comparison of Big and Small Suppliers: Different Clients, Different Needs

A comparison of big and small providers' service delivery techniques highlighted the differences and similarities between large and small suppliers. The majority of occupiers of big providers are large corporations while the majority of occupiers of small providers are sole practitioners and small firms. Similarly, the different sized clients have different service needs.

Big suppliers offer a sophisticated set of custom and standard products and services delivered efficiently on a multinational scale to meet the needs of the clients. Corporations are beginning to understand the product, services, and service delivery.

Meanwhile, small suppliers offer a limited number of products and services delivered on a local or regional scale. Also, clients of small firms tend not to expect the latest products and services or wish to pay less for the products and are willing to compromise. Often times, small providers offer niche products and services to suit the specific needs of a particular industry.

A commonality of the two client groups is the need for financial and lease term flexibility both in terms of speed of entry and, more importantly, speed of exit.

5.3 Current Issues

Suppliers are fine-tuning their service delivery techniques. It appears that suppliers are adopting proven service delivery methodologies to enable expansion and profitability. It is interesting to note that big suppliers introduced their products and services during a period of tremendous market expansion; the model has not been tested in a downturn economy.

However, the industry's maturation has occurred during the course of both upturns and downturns. .

Suppliers are looking for new growth opportunities in the market, such as offering a less expensive brand, opening niche centers around full-service centers in a "spoke and hub" manner that provide only those services required by a specific target audience, and bundling services to meet the individual needs of clients.

In conclusion, the serviced office industry is developing into a significant part of both the commercial property market and corporate real estate portfolios.

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