Real Estate Advisory Services

"Is Internationalization the Key for Long-term Success of Established Firms"?

by

Charles Staerkle

Grad. Real Estate Fiduciary
College for Real Estate Fiduciaries, Zurich
1992
B.S. Building Construction
Trade & Technical School, Brugg
1976

Submitted to the Department of Architecture in Partial Fulfillment of the Requirements for the Degree of

Master of Science in Real Estate Development

at the

Massachusetts Institute of Technology

August 1995

©1995 Charles Staerkle
All rights reserved

The author hereby grants to MIT permission to reproduce and to distribute publicly paper and electronic copies of this thesis document in whole or in part.

Signature of Author ____________________________

Department of Architecture
August 22, 1995

Certified by ____________________________

Henry Birdseye Weil
Senior Lecturer, Thesis Advisor

Accepted by ____________________________

William C. Wheaton
Chairman

Interdepartmental Program in Real Estate Development

SEP 28 1995

LIBRARIES
Real Estate Advisory Services
“Is Internationalization the Key for Long-term Success of Established Firms”?

by

Charles Staerkle

Submitted to the Department of Architecture on August 22, 1995 in Partial Fulfillment of the Requirements for the Degree of Master of Science in Real Estate Development at the Massachusetts Institute of Technology

ABSTRACT

Real estate service firms that operate in mature home markets are faced with complex decisions as they prepare for major changes in their industry. One such change now faced by several established real estate service firms is the question of whether to internationalize their business.

This thesis starts by stating two hypotheses about how to enter the international real estate service market as either a firm that exports its services, or as a firm that establishes a local presence in a foreign market. Thereafter, an analysis of the international real estate service industry identifies major trends and key uncertainties, and an assessment of the competition concludes that this industry offers attractive business opportunities. To identify the strategic issues related to the possibilities of going international, a case study of an established real estate service firm that operates in a saturated home market is presented. The case firm's internationalization strategies are simulated under different macroeconomic and industry scenarios, and a final assessment and discussion of strategic options lead to the following conclusions:

Established real estate service firms that have a nation-based competitive advantage in this industry and who operate in mature domestic markets can increase their overall profit margins by exporting services that abroad are at a different stage of life-cycle and where economic growth is higher than at home. A firm should not only consider the most likely scenario, but also remain flexible to exploit multiple scenarios. When considering an unstable scenario, a firm should first start by exporting its services. The timing of entry into a foreign market is crucial and very sensitive to a variety of scenarios.

The scenario planning method proved to be an extremely useful approach to gain insight into the entrepreneurial issues that arise when a real estate service firm is considering whether to go international. In practice, the application of this method is strongly recommended.

Thesis Supervisor: Henry Birdseye Weil
Title: Senior Lecturer
ACKNOWLEDGEMENTS

My deepest thanks to Henry Birdseye Weil for his guidance and contributions to my thesis. His comments not only illuminated my thesis project, but will remain a source of inspiration in my future career.

I wish to thank Professor Don Lessard, who helped me to structure my ideas for this thesis project in its early stages and whose brilliantly taught courses in international management provided me with a sound framework for the international business.

Special thanks to Christoph Ackeret, COO of Spaltenstein Immobilien AG who generously provided me with detailed information about his firm and who spontaneously agreed to simulate internationalization strategies based upon his firm.

I wish to thank several professionals in the real estate service industry with whom I had discussions and who provided me with valuable information.

Finally, I would like to thank my colleagues at M.I.T. Meizhi May Yan, Jonathan Richter, and Suon Cheng, my editor Tara Zend, and my friend Mimi Sun who supported me throughout this work.

Charles Staerkle
Cambridge, Massachusetts
August 22, 1995
TABLE OF CONTENTS

ABSTRACT 2
ACKNOWLEDGMENTS 3
TABLE OF CONTENTS 4
LIST OF FIGURES AND TABLES 6

1. INTRODUCTION 7
   1.1 Going International: A Tough Issue for Real Estate Service Firms 7
   1.2 Background 9
   1.3 Publications Review and Thesis Structure 11

2. OBJECTIVES, APPROACH AND HYPOTHESES 12
   2.1 Objectives 12
   2.2 Approach 13
      Task Accomplishment 13
      Scenario Planning Method 14
   2.3 Hypotheses about How to Go International 18
      Sources of Competitive Advantages by Going International 18
      Hypothesis about going International as an Exporter Firm 21
      Hypothesis about going International as a Multi-domestic Firm 22

3. REAL ESTATE INDUSTRY 23
   3.1 Real Estate Markets 23
   3.2 Services for Development and Operation of Real Estate 26
   3.3 International Real Estate Service Industry 26
      Demand Drivers for International Real Estate Services 32
      International Real Estate Service Competition 38

4. CASE STUDY AND ADVISORY SERVICE BUSINESS MODEL 45
   4.1 Spaltenstein Immobilien AG
      [Spaltenstein Real Estate Company] 45
      Company Background 45
      Business Scope 45
      Market and Competition Assessment 47
      Why Spaltenstein Immobilien AG? 49
   4.2 Advisory Service Business Model 54
      Model Concepts and Components 54
      Advisory Service Business Concept 57
      Financial Model 61
LIST OF FIGURES AND TABLES

Figures

Figure 3-1  Distinction of real estate markets  24
Figure 3-2  Real estate industry roles  27
Figure 3-3  Real estate drivers of value  31
Figure 3-4  Leading international real estate service firms  44
Figure 4-1  Spaltenstein Immobilien AG -- Competitive positioning  53
Figure 4-2  Overview -- Advisory service business model  56
Figure 5-1  Overview -- Possible scenarios -- strategies combinations  79
Figure 5-2  Assumptions for cases A and B  86
Figure 5-3  Assumptions for cases B, C, and D  97
Figure 5-4  Assumptions for cases C and E  104

Tables

Table 3-1  Exports-to-overseas production ratios for MNE’s  33
Table 4-1  Service areas and revenues  46
Table 4-2  Basic financial model structure  63
Table 4-3  (Investments) and estimated profit contributions  63
Table 5-1  Summary of projected operations for case -A-  81
Table 5-2  Summary of projected operations for case -B-  84
Table 5-3  Summary of projected operations for case -C-  92
Table 5-4  Summary of projected operations for case -D-  96
Table 5-5  Summary of projected operations for case -E-  101
Table 5-6  Investments and estimated profit contributions cases A and B  87
Table 5-7  Investments and estimated profit contributions cases B,C, and D  98
Table 5-8  Investments and estimated profit contributions cases C and E  105
1. INTRODUCTION

1.1 Going International: A Tough Issue for Real Estate Service Firms

Continued advances in information technology coupled with globalization and regionalization of the world economy are changing the nature of competition in the real estate industry. To survive and to succeed, a firm must be innovative and manage change effectively -- fundamental behaviors that are dynamic departures from business-as-usual. Real estate service firms that operate in saturated real estate markets are facing complex decisions as they prepare for major changes in their industry. One such change now confronted by several established real estate service firms is the question of whether to internationalize their business.

In addition to the two oldest established major global players in this sector, the British firms Jones Lang Wootton and Richard Ellis, many locally or nationally established real estate service firms, especially those in the United States, the United Kingdom and Middle European countries, are now considering international expansion. Such questions arise as:

- Where to go? -- Geographically and to reach new client segments.
- How to go? -- The nature and sequence of the internationalization process: Export one’s services or set up a foreign office? Do it alone or as a joint venture? Buy a foreign firm or access international markets through membership in a network?
- What? -- Understanding what the necessary changes in the current management processes are and how to go about implementing them.

Success in developing an international business will depend on the answers given to these questions. However, these questions cannot be answered without a clear vision of why the firm wants to go international. Simply adding incremental sales will most probably not result in an increase in profits. According to Jenster & Jarillo (1994), going international is an enormously expensive exercise, both in terms of money and, especially, the time and attention top management must give to projects. Jenster & Jarillo argue that a company has to gain a competitive advantage by going international
and must add value to the company beyond extra sales. If a firm is not well prepared for international ventures such an approach can leave it worse off than before, even in its home market, and initiate the beginning of the end!

Emerging markets around the globe now offer huge possibilities for top real estate service firms to market their know-how and managerial capabilities. Taking advantage of these opportunities can present a significant step in securing the long-term survival and success of a company. However, going international should not be seen as just an “extra” activity of marginal importance. In today’s dynamic global real estate markets, there is no room for marginal competitors. Jonas (1995) observed “life-threatening” competition to established international real estate service firms from indigenous businesses overseas, which are now beginning to provide the same or similar services offered by international real estate firms.

“The international dimension of a company, in the long run, will wither, disappear or be an essential dynamic component of its overall competitive strength” (Jenster & Jarillo, 1994, p.15). Senior managers of prospective real estate service firms face two important challenges in this regard. First, they must achieve consensus within the company to overcome the fear of the unknown that other executives may have and the feeling (possibly correct in the short-term), that profits are to be made exclusively in the home market with current clients. Managing this risk so that international operations will not be seen as marginal is important. Second, they must be prepared to adapt their strategies rapidly in a business environment that will most probably be quite unstable.

Weil (1990) suggested that several leading multinational corporations (including Shell and Airbus) are already meeting these challenges with new planning approaches that stimulate systematic consideration of the business environment and enhance management learning. Their planning involves, among others, scenario development that is recognized as a powerful means for anticipating shifts in competitive, market, technological, economic, political, and social factors. I shall discuss this planning approach in detail in chapter two.
This thesis provides the reader with a useful tool for strategy decision-making in the area of internationalizing real estate services. It attempts to shed light on the important question:

Is internationalization the key to long-term success for established real estate service firms?

1.2 Background
During the early 1990s the real estate industry in major industrialized countries saw its most dramatic changes since World War II. These changes were influenced by the massive overbuilding of the 1980s, the increase in antigrowth legislation, and the long-range lack of market justifying speculative building opportunities. Due to this situation, most development firms that survived transformed their businesses and started to offer real estate services. In addition, firms traditionally not engaged primarily in the real estate service business, but with substantial financial resources, entered the business. The resulting increase in competition and the limited growth opportunities in these saturated markets combined with the commoditization of certain real estate services, especially the agency business, and led to shrinking margins.

Margins can be viewed as proof of the value a business delivers to its clients. When businesses start to lose their margins, fail to reinvent themselves and to redefine their relationships to clients, they soon lose their ability to invest and add more value to their services in the future.

Some senior managers in the real estate service industry were aware of the changing business environment and examined their strategies. Those who had a sound financial basis invested heavily in R & D and invented new service products, built up new data bases, and retained experienced staff or hired additional professionals. With excellent firm infrastructure in place and existing superior business know-how, they were then
facing an increased intensity of rivalry in their saturated home markets. Given this situation, potential real estate service firms started to look for business opportunities abroad as an alternative to playing in niche markets, or even to considering an exit of the industry.

Major demand drivers for international real estate services are multinational corporations, investors in international real estate, and the emerging markets of formerly closed economies. Today, an increase in activities to capitalize on these opportunities can be observed. Such activities include the building of alliances and joint ventures with foreign firms, international acquisitions and mergers, and the emergence of global real estate network organizations. It seems that a majority of established real estate service firms want to climb on the bandwagon and no one wants to miss the global real estate market’s “sweet-spot.”

While spending much effort to gain new contracts and to handle problems that arise in a new business environment, firms may downplay the need for financial controls. With little understanding of their working capital requirements and cash flow management, foreign ventures may become larger while leading to poor profitability. This is because an international venture might take much longer to effect and lead to higher start-up costs. Setting objectives to focus market and service development efforts is an important early step in the process of internationalization.

Considering a global expansion of market territory means a major change in the way a firm does business. According to Weil & White (1994), changes of this magnitude can also be defined as business transformation. Transforming a firm toward internationalization of its business scope is an ongoing and complex process, leading to a more sophisticated and, eventually, more successful firm.
1.3 Publications Review and Thesis Structure

Little has been written regarding the aspects of internationalization of real estate services. The numerous articles published in newspapers and journals have primarily focused on the aspects of new international real estate developments. News about successful consulting and management performances in the real estate industry rarely find their way into the media. One prominent author is Hines (1988, 1990, 1992) who has written articles and books about international corporate real estate, international real estate investment, and marketing real estate internationally. Also, the recent masters thesis of M.I.T. graduate Michael McGoldrick (1993) has provided a framework for determining what defines a global real estate firm. However, no specific work in the field of entrepreneurial issues facing real estate advisory service firms as they internationalize their operations could be found. Therefore, this paper will close part of this existing research-gap.

This thesis is organized into six chapters, beginning with chapter one, the introduction. Chapter two states the objectives of this paper, explains important aspects of the applied methodology, and hypothesizes about the sources of competitive advantages when a firm goes international. Chapter three provides an overview of the service aspects in the real estate industry and an assessment of the international real estate service industry and its competition. Chapter four illustrates a case study of a nationally established real estate service firm, describes an advisory service business model and identifies key management decisions within this model. Chapter five describes the strategic issues facing the case firm and then formulates two strategies of entry into the international real estate service market. Thereafter, it develops three scenarios based on assumptions about different macroeconomic and industry conditions. At the end, it assesses the outcome of each of the two strategies under different scenarios and discusses strategic options, previously unconsidered. Chapter six discusses the conclusions developed by this thesis and identifies questions which might lead to further research.
2. OBJECTIVES, APPROACH AND HYPOTHESES

2.1 Objectives

The objectives of this thesis are to form a set of hypotheses about the internationalization of a real estate service company as an exporter or as a multi-domestic firm, and then to develop, first: A financial model of a service business that can show cash flows from its operations. Second: Three scenarios based on different environmental assumptions and competitive dynamics. Third: Two different strategies for entering the international real estate service market. The outcome of each entry strategy will then be assessed according to different scenarios. Also, strategic alternatives will be identified and discussed. The insights of this process will be used to address the following internationalization questions:

Questions to be Answered

- Should one gamble the future on one scenario or should one stay flexible to exploit multiple scenarios?
- What is the most suitable mode to enter into the international real estate service business arena?
- What is the international venture's risk management contribution (i.e., hedging economic exposure and the distribution of core activities)?
- How does the timing affect the success of going international (i.e., is there a "window of opportunity" for internationalization)?
- How is the success of internationalization affected by the business' financial structure (i.e., do deep pockets help, and how and where should investments be made)?

By developing an understanding of and answers to the above questions, a set of success strategies will emerge as to how one should internationalize a real estate service firm. Finally, this thesis will attempt to answer whether internationalization is the key to long term success for established real estate service firms.
2.2 Approach

Task Accomplishment
The approach was to first develop an overview of the real estate industry in general in order to identify real estate "drivers of value". A situation assessment of the international real estate service industry within the framework described by Day (1984) was the second step. The demand drivers for international real estate services were identified, followed by an analysis of the international real estate competition in order to assess the industry’s attractiveness. This step also identified the major trends and the key uncertainties that may shape this industry.

A third step was to analyze the situation of an established real estate service firm that operates in a mature home market. The domestic market as well as the “case-firm's” competitive position were assessed to identify the strategic issues related to the possibility of going international by this firm. This analysis used frameworks as provided by Aaker (1984) and Porter (1985 and 1990).

Hypotheses about how to enter into the international real estate service market as an exporter firm as well as how to enter as a multi-domestic firm were then developed. These two strategies basically followed arguments of Jenster & Jarillo (1994) regarding competitive advantages, examples provided by Randall & Telesio (1995) about risk considerations when investing in emerging markets, and the ideas put forth by Lessard (1995) as well as suggestions by Weil (1995).

An advisory service business model was then conceptualized and the parameters of “key management decisions” within this model were identified. These parameters were then used as input variables for a subsequently developed financial model. With this model, cash flows resulting from projected operations under each strategy, as described later, could then be illustrated.
A sixth step was the creation of three scenarios based on different assumptions about the economical, political, technological, and industrial environment. These forced scenarios had to describe completely different worlds. However, they had to be internally consistent, i.e., they had to address the in step two identified trends and uncertainties (the scenario planning method will be explained after the end of this section).

A next step was the formulation of the case-firm's basic strategic considerations of going international while taking into account the selection of a target market plus assumptions about the behavior of competitors. Then, two strategies of entry into the international real estate service market were formulated. These strategies follow the earlier stated hypotheses about how to go international and are also based on the firm's strategic issues arising from the competitive assessment performed in step three.

With all factors in place, the proper modeling process could then begin. The outcome of each of the two strategies under different scenarios was qualitatively and quantitatively assessed. Finally, strategic options, previously unconsidered were then generated and briefly discussed.

**Scenario Planning Method**

The reason for having selected scenario planning as the basic methodology and major component of this thesis are the benefits it provides to real estate service firms who are usually facing the following conditions:

- Uncertainty in the real estate service industry is relatively high in relationship to a manager's ability to predict or to adjust for it.
- Too many costly surprises have occurred in the past.
- The industry is experiencing significant changes.
- There are strong differences in opinion, with multiple opinions having merit.
Scenario planning is also an ideal tool in order to provide different environments in which the outcome of a strategy can be simulated. Because the approach taken in this paper to investigate research questions is to project a firm's future performance rather than to infer from past examples of firms that successfully internationalized, scenario planning which "bounds" the future's uncertainty was found to be the most suitable method.

The term scenario has many meanings ranging from movie scripts and loose projections to statistical combinations of uncertainties. Among the multitude of definitions about what, exactly, a scenario should be, I found the definition suggested by Foster (1993) best captures its essence: "A scenario is a description of a possible future based on a set of mutually consistent elements, within a framework of specified assumptions. It will typically encompass both quantitative and qualitative elements" (p. 124). Following is a brief explanation about how this method evolved.

The formal process of scenario planning and use is closely associated with the Royal Dutch/Shell Group. Pierre Wack, an economist, developed with Edward Newland the Shell system of scenario planning. Wack (1985a, 1985b) described this system that was a part of a process for generating and evaluating strategic options in two articles in the Harvard Business Review. It has to be mentioned that Shell has been consistently more accurate in its oil forecasts than other major oil companies, and was the first to project the overcapacity in the oil tanker business and European petrochemicals (Schoemaker, 1995). Originally, the motivation for developing this system came from a study of a range of businesses that survived and prospered over very long periods of time. The common feature of their longevity was their ability to adapt to changes in their environments (Weil & White, 1994).

The insights from the practical benefits that have been achieved with this method were also overtaken by Porter (1985) in his famous book *Competitive Advantage*. In Chapter 13 "Industry scenarios and competitive strategy under uncertainty" Porter advocates that macro-scenarios which consider global macroeconomics and political events are
important for an international oil or natural resource company. However, despite their relevance, he argues, they are too general to be sufficient for developing a strategy in a particular industry. Therefore, he recommends the application of industry scenarios that consider uncertainties that macro-scenarios omit such as technological change and competitor behavior. Porter (1985) suggested the following ten-step process for constructing industry scenarios:

1. Analyze the structure of the industry.
2. Identify uncertainties that may influence this structure.
3. Determine the causes of these uncertainties.
4. Establish hypotheses for each important cause.
5. Combine the hypotheses into coherent scenarios.
6. Analyze the structure of the industry that would prevail under each scenario.
7. Determine sources of competitive advantage under each scenario.
8. Project the competitive situation under each scenario.
9. Choose a strategy.
10. Monitor key factors to anticipate changes in the industry.

Weil (1990) emphasizes the significance of the first three steps because they involve a systematic microeconomic analysis of the industry in question. What is its structure? How does it function? What are the major uncertainties that might affect the industry? What are the sources of these uncertainties? Porter (1985) explained that: “Industry scenarios are fundamentally a tool to improve the creativity of strategic planning. They cannot insure creativity, but they significantly raise the odds” (p.481).

A variation of the ideas for industry scenarios is presented by Schoemaker (1993) in conjunction with his concept of multiple scenario development. Schoemaker stated that: “The importance of this new tool is to examine fundamental uncertainties and to expand manager’s thinking” (p.194). His generic method for scenario construction focuses on learning and exploring interrelationships among trends and key uncertainties. In a recent article, Schoemaker (1995) described ten steps for developing scenarios in general terms:
1. **Define the scope** (Time frame and scope of analysis in terms of products, markets, geographic areas, and technologies. Also, what have been the past sources of uncertainty and volatility)

2. **Identify the major stakeholders** (Who will have an interest in these issues? Who will be affected by them? Who could influence them?)

3. **Identify basic trends** (In industry, and those that are political, economic, societal, technological, and legal that are sure to affect the issues identified in step one)

4. **Identify key uncertainties** (What events whose outcomes are uncertain will significantly affect the issues in question? Also, what will consumers value in the future, for instance, for this product will they value service or price?)

5. **Construct initial scenario themes** (The ingredients for the scenarios are the trends and uncertainties identified in steps three and four. One approach is to identify extreme worlds by putting all positive elements in one and all negative in another)

6. **Check for consistency and plausibility** (Are the trends compatible within the chosen time frame? Do scenarios combine outcomes of uncertainties that indeed go together? Are the major stakeholders in positions they do not like and can change?)

7. **Develop learning scenarios** (Identify themes that are strategically relevant and then organize the possible outcomes and trends around them. The trends should appear in all scenarios, however, they can be given more or less weight or attention in different scenarios)

8. **Identify research needs** (Further research to flesh out one’s understanding of uncertainties and trends may be necessary. E.g., understanding of how a key stakeholder such as a regulator or a competitor will behave in a given scenario)

9. **Develop quantitative models** (Managers can use formal models to keep from straying into implausible scenarios. The models can also help to quantify the consequences of various scenarios such as price behavior, growth rates, or market shares)

10. **Evolve toward decision scenarios** (Finally, in an iterative process, one has to converge toward scenarios that will test one’s strategies and generate new ideas. One may retrace steps one through eight to check if the learning scenarios address the real issues one’s company is facing)
To assess the quality of scenarios, the same author states four criteria: The first is relevance, i.e., the scenarios should connect directly with the mental maps and concerns of senior managers. Second, to be effective they should be internally consistent. Third, they should describe generically different futures rather than variations on one theme. Fourth, each scenario should describe a stage in with the system might exist for some length of time. Wack (1985b) also mentioned the importance of option generation. He argues that: “If the scenario process does not bring out strategic options previously unconsidered by managers, then it has been sterile” (p.147). In this sense, scenarios may hold the seeds of new business and unrecognized opportunities.

The approach taken in Chapter five for constructing three different scenarios, considers elements taken from both Porter's method of industry scenarios as well as Schoemaker's concept of multiple scenario development.

### 2.3 Hypotheses about How to Go International

**Sources of Competitive Advantages by Going International**

Jenster & Jarillo (1994) stated four sources of competitive advantage that may provide the right reasons for a company to consider going international. The same authors argued that without one or more of these reasons in place, internationalization would probably not work well. The first three sources of competitive advantage that are applicable to real estate service firms are explained below.

The first reason is to follow customers. As many industries internationalize, they demand international service from their suppliers. Audit and management consulting firms experienced this phenomenon many years ago, but it is now underway in industries as diverse as real estate advisory services. As we will see in Chapter 3 [Demand drivers for international real estate services], some customers prefer international suppliers for logistical simplicity and service consistency. Therefore, firms
that can coordinate their activities across national markets will have an edge over purely local competitors.

The second reason to go international is to gain efficiency -- through economies of scale, or by taking advantage of country-specific conditions. Following the argument of Bhide (1994) that in the consulting industry there are few natural economies of scale, I would argue that real estate advisory firms are, instead, seeking economies of scope. Goshal (1987) explained that “the strategic importance of scope economies arises from a diversified firm’s ability to share investments and costs across the same or different value chains that competitors, not possessing such internal and external diversity, cannot” (p. 162). [The relevant real estate value chain will be explained in Chapter 3.] For real estate advisory firms such sharing can take place across segments and markets. Examples are: Market diversification of shared physical assets, which can include an international brand name; market diversification of shared external relations, which can include the servicing of multinational clients worldwide; market diversification of shared learning, which can include the pooling of knowledge developed in different markets.

The third way a company may gain by internationalizing is by exploiting superior business know-how abroad. If a real estate advisory firm can find a better way to deliver a service, and can develop a complete management technology around it, their services will clearly be superior to anything being done in other countries. In this case, it would make sense for the company to move abroad and try to replicate its success, particularly in the absence of strong competition.

Besides the above stated somewhat sophisticated sources of competitive advantage, there are simply offensive or defensive reasons for going international. Defensive reasons include slow growth and saturation of services in the home market, or the local market is attracting too many players resulting in excess capacity or commoditization of certain service products. Offensive reasons to go international are to seek faster
growth, higher profitability, and less intense competition. This, particularly in markets that are in an earlier stage of development of the real estate service industry.

Let us now assume that a company is clear on the advantages to be gained by going international. If the company knows where\(^1\) to go, what\(^2\) market segments to target, and believes the potential opportunities outweigh the risks there are two basic first time entry strategies to follow: Export one's services from the home base, i.e., be an exporter firm, or set up a foreign office, i.e., become a multi-domestic firm.

---

\(^1\) It is assumed that the company enters into a region, which is in a life cycle stage of its real estate service market somewhere between the stage of emerging demand conditions and the stage of growing demand conditions.

\(^2\) It is assumed that the company targets clients with a specific need for foreign real estate expertise. A detailed description will be provided in Chapter 5 [Basic strategic considerations].
Hypothesis about Going International as an Exporter Firm

By restricting the size of investment to an amount a firm can afford to lose, the risk of betting on the wrong place and the wrong future is clearly minimized. By “testing the waters” with a conservative investment, a firm stands to gain a great deal of experience from a foreign experiment. The commitment of resources can occur in many stages with minimal exposure at each stage. Entrepreneurs who favor foreign ventures that are not capital intensive but have enough profit margins, can sustain rapid growth with internally generated funds.

With incremental internationalization, independent options of doing business abroad can easily be judged on stand-alone net present values. A company who has relevant business experience, that is transferable and appropriable can pursue an opportunistic entry strategy. Maintaining a high degree of responsiveness without doing too much analysis of broad market trends and strategies of industry leaders can increase the ability to take advantage of opportunities that, by the time a full investigation is completed, may no longer exist.

Also, an exporter firm can better exploit niche-market opportunities (e.g., mature foreign markets). Jenster & Jarillo (1994) explained how a combination of high domestic R & D investment and vigorous internationalization gives so many medium-sized Swiss or German firms an impregnable position in world markets. The incremental costs of serving a niche, however, have to be carefully analyzed by taking into account their lack of scale economies and the difficulty of marketing to a small, diffused segment.

The greatest risk with the “testing the water” approach is that a company may miss the most lucrative opportunities. These may be snapped up by more courageous competitors who fearlessly entered the new market by establishing a local presence. Setting up a full-scale operation will teach one a great deal about doing business in a particular country; however, a small-scale export venture can still provide valuable lessons and give a company a solid track record. Several pro-active, low investment actions such as launching public relations campaigns extolling a company’s virtues over their competitors can be used as a pre-emptive strike in order to defend a particular market.
Hypothesis about Going International as a Multi-domestic Firm

A systematic entry strategy will have options which may not be profitable on a stand alone basis. Making a major commitment to an emerging market by establishing a local presence with an office, however, has several advantages. Firms with local presence have the greatest potential for future growth because they can grow as different services develop and they have an opportunity to select which segments of the market offer them the best profitability. They have a wide choice of marketing strategies open to them and can build learning curve advantages over later entrants. However, timing is crucial and too early an entry can produce prolonged negative cash flows.

"Diving in" means to obtain better locational benefits for core activities such as reduced costs because of less travel or lower local wages. Also, building relationships with local governments, local clients, and related local industries such as banks is facilitated when a firm operates locally. A firm, having a clear competitive advantage in organizing, performing, and presenting its service can keep the core of the management factor outside the host country and only transfer the systems necessary to provide the service on the foreign market. By an advanced positioning in a new market, a service firm may also lead its clients rather than follow them, i.e., anticipating competitive factors for a client rather than react to a given demand situation.

Being on-site facilitates watching key competitors as well as disciplining them. According to Bhide (1994) emerging markets are often characterized through rough-around-the-edge rivals, clients who may tolerate imperfect services, and opportunities to profit from shortages. Local insights and marginal innovations, not-so-sophisticated expertise, and the willingness to act quickly from the local base can go a long way toward being successful.

A constant monitoring of the environment is the most important risk management tool for the “diving in” strategy. If one really made the wrong bet, it is much better to be the first, not the last to know.
3. REAL ESTATE INDUSTRY

Following is a general overview of the basic principles of real estate markets, and the characteristics of the development and operation of real estate. This overview is given to provide an orientation about the need for real estate services and their points of delivery. In addition, current international trends in these markets will also be highlighted.

The principles of supply and demand for real estate do not differ very much among free market economies and are almost universally applicable. The characteristics and structures of the development and operation of real estate, however, usually differ considerably among nations. Because this thesis emphasizes the international aspects of real estate, the structures presented here of the development and operation of real estate are widely adopted from the business systems of the leading nations in this industry, the US, the UK and The Netherlands. Whitley (1992) observed that where firms from particular countries establish the rules of the game and play the dominant role in international markets, effective patterns of firm behavior and industry standards in these markets are likely to follow the logic established in that business system. This statement is also correct regarding the international aspects of real estate development and operation.

3.1 Real Estate Markets

In the market economy system one can distinguish between the market for real estate use (where space is rented or purchased for occupancy) and the market for real estate assets (where buildings are bought and sold as investments). Schütz (1991) noted this double function of real estate and segmented the real estate market according to a different need structure:

- The first function of real estate is the satisfaction of space needs. This part of the market is defined as the real estate property market.
If the primary purpose is the use of real estate as a financial investment, then the market is defined as a real estate asset or capital market. Figure 3-1 illustrates this distinction of the two markets. Owner-occupied real estate where the user of space is also the investor in the asset presents a case with a simultaneous participation in both markets. An additional differentiation by the two criteria of use and substitution show the multitude of special cases that can arise in these markets.¹

<table>
<thead>
<tr>
<th>Use</th>
<th>Substitution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use as pure financial investment</td>
<td>Possible substitution through securities, etc.</td>
</tr>
<tr>
<td>Use of space as basis for economic or social activities</td>
<td>No realistic substitution possibility</td>
</tr>
</tbody>
</table>

The above distinction can best be observed in the urban areas of industrialized countries. The city as a marketplace with many participants offers an opportunity for specialization. This specialization also occurs in the real estate market, where the real estate specialist puts space at the disposal of other market participants. The section "services for development, operation and investment of real estate" which follows in this chapter will show what services in which markets are needed.

Real estate markets function primarily on a local or regional level or as defined by Wheaton (1995): "The geographic definition of a real estate market encompasses real estate parcels that are influenced by the same economic conditions." It has to be emphasized, that in-depth knowledge of local conditions is crucial for almost any kind of real estate services. Another important characteristic of the real estate market, that has

¹ Examples include: Single family homes, firm owned industrial buildings for production purposes, indirect investments in real estate (e.g., through participations in real estate investment trusts) or public buildings.
a major impact on the real estate service business, is its strong cyclical nature, exposing the service sector instantaneously to the fluctuations of this market. Wheaton (1995) advocated that markets for both real estate property and assets operate within a global economy, influenced by endogenous economic variables and exogenous economic forces.\(^1\) It has to be added, however, that economies around the world are usually at different stages of the cycle. Richard Ellis (1995) observed that: "Property trends in each country differ dramatically, reflecting the economic and market conditions and the point that each has reached in its own respective cycle" (p. 3). This implies, that geographically diversified real estate service firms may reduce their economic exposure by operating in countries whose economic cycles are not very correlated.

The following two international trends that influence a large number of real estate markets, can be observed: The first trend was observed by the international accountant firm Ernst & Young, in its study showing that real power in new developments has shifted from property developers to institutional investors such as pension funds (Evers & de Jonge, 1995). Some pension funds have in-house real estate specialists, but in most cases, these institutions also need additional expertise from the outside. This creates demand for a broad range of real estate services, in some cases even cross-border consulting services.

The second trend concerns demand for industrial and office space. Since the 1960s, the average size of the workplace has been falling steadily throughout the industrialized world as large organizations try to break themselves into smaller parts (Multinationals, 1995). An example of space rationalization is given by the multinational corporation ABB (Asea Brown Boveri) who during the last five years cut space by 1/2 and at the same time doubled its sales (Lessard, 1995a). These dynamics also create additional demand for real estate services. Such services may include relocation services and tenant representation for large companies or real estate advisory services for the re-use

\(^1\) Exogenous forces such as world trade, interest rates or even climate are factors that have profound impact on real estate markets. Endogenous variables such as prices, sales and output are determined by the real estate market itself.
of obsolete industrial parcels. A detailed description of these opportunities is provided in the section "demand drivers for international real estate services" in this chapter.

3.2 Services for Development, Operation and Investment of Real Estate

The multitude of real estate services can best be explained by examining the different real estate industry roles. Leinberger (1993) provided a useful division into two major categories based on the risk that the player assumes: Capital risk and operating risk. Figure 3-2 outlines these roles and the subcategories within them.

The player that assumes capital risk has equity ownership in the project. This particular role will not be explained further, because the focus of this paper is on the player that assumes operating risk, or more familiarly, service businesses. Leinberger (1993) explained that the major risk that service businesses assume is the risk associated with collecting the fees for performing services or working capital risks. Leinberger also mentioned that the only other major risk of a service business is a lawsuit for faulty advice. While this risk has increased over the past 20 years -- particularly for general contractors, design professionals, and accountants -- it is manageable for most other service providers.

Of course, many industry players perform both capital risk and operating risk roles within their firms. Playing both roles can create considerable effects of synergy for each business activity performed. The capability to assume an equity position in a project, for instance, can be the key to getting a service contract. This paper will not explore this combined industry role in detail. Rather it will focus on the role of independent real estate advisory services.
The various service businesses available to the property industry are outlined below emphasizing explanations for "traditional" real estate services.

**Land speculation phase**
- *Land brokerage* -- Land brokers typically represent landowners and bring buyer and seller together in a land sales transaction. As a seller’s agent, brokers naturally try to maximize the value of the property they represent. This is a business that
requires strong local knowledge and is exclusively performed by “locals.”
Compensation is primarily based on a commission.

**Land development phase**

- *Land development management and Consulting* -- These managers and consultants are responsible for the improvement of raw land to the point that the land is suitably prepared to accommodate building construction. They shepherd projects through local jurisdictions, usually complex entitlement and approval processes. In very complicated cases, these professionals need to be supported by special *legal advice*, given by a lawyer or a notary public. This is also an extremely local business.

**Building development phase and operation phase**

Due to the very long life of a building with its repeated cycles of renovation and repositioning, the services listed below are in demand in both the real estate development and the operating phases.

- *Market and Feasibility studies* -- These studies, usually elaborated by real estate consultant teams, aim at the determination of the optimum type and mix of uses, market opportunities, competitive positioning, product definition, market depth, potential absorption, cash flow projections, leasing terms, and advertising required to market a project. This business also requires extensive local information. Product knowledge and know-how of advertising practices as well as principles of financial projections, however, are areas that can easily be “exported” by leading firms.

- *Appraisal and Financial consulting* -- Appraisal determines the value of an asset either in its current condition or upon improvement. This business requires strong local experience. Financial consultants provide financial feasibility studies and advice in debt / equity structuring.

- *Building development consulting and management* -- These professionals provide development services similar to those provided by a developer, but for a fee. These services require a comprehensive understanding of all aspects of real estate by its performers. This is the key position in the creation of real estate. Knowledge about
how to identify and acquiring development opportunities and capabilities to manage the specific processes necessary to create value can well be “exported,” especially to countries where this service has not yet been introduced.

- **Initial leasing** -- The leasing agent is either a tenant or landlord representative, who formulates and executes the leasing process. The landlord representative’s function comprises primarily canvassing tenants. Tenant representation is a relatively new service that provides advice to large-scale tenants on how to find new space and negotiate a favorable lease. Both are usually strictly locally performed businesses, although more and more national or cross-border businesses are arranged within network organizations where members recommend each another to clients who need services outside their home base.

- **Building brokerage** -- The building broker represents both buyers and sellers in the acquisition or sale of real estate. This is usually a commission-based service, that requires in-depth knowledge of the respective markets. Access to market data is crucial for this business with a strong local focus. This business is increasingly performed within national, international or even global network organizations. To be successful in competitive markets, a firm has to be a member of such a network organization or possess its own comprehensive market database.

- **Debt and equity brokerage** -- Debt brokers, sometimes referred to as mortgage brokers, find debt capital for their clients. Equity brokers find equity sources and usually provide investment analysis and equity financing sources for both existing and proposed properties. Compensation of these lucrative businesses are based on a percentage of the money raised or on a fee. Only in the past 20 years have real estate companies entered into this traditional merchant bank function. Today, there are increasingly international opportunities for these services, in particular for finding equity sources.

- **Technical professionals, planners and managers** -- These services include architects, engineers, construction managers, construction consultants, project managers, planning consultants, cost estimators, general contractors, plus many others. These are usually services that are not traditionally offered by real estate firms. However, some vertically integrated full service real estate companies that
perform both capital risk and operating risk roles within their firms have gained enough expertise in one or more of these special disciplines to compete successfully with the planning professions. These services have a long tradition of being internationally offered and are increasingly becoming a cross-border activity of established players.

Ownership of a stabilized asset (Operation phase)

- **Portfolio management** -- Portfolio managers take responsibility for an owner’s real estate portfolio, particularly its long-term value and ongoing bottom line performance. Some firms have specialized to advise institutional investors, in particular pension funds. These firms may acquire and manage real estate assets or analyze optimum geographic and product type investments on behalf of pension funds. Fee structures in this business are not customized, but most compensation entails a flat fee based on asset value under management. This business also offers global opportunities as clients may internationally diversify their portfolios.

- **Asset management** -- Asset managers assume responsibility for the financial performance and operation of a particular asset and periodically report the results to the portfolio manager or directly to the owner. Asset management can also include asset repositioning such as the renovation of a building to ensure its competitiveness. Fees can be based on a percentage of asset value. This is a very local business that requires anticipation of local market trends.

- **Property management** -- Property managers take responsibility for the day-to-day operations of a building, including tenant relations and retention, and the financial management of the operational part. These services need local presence and are increasingly important in today’s tenant-driven markets. Compensation is usually based on a percentage of the property’s annual revenues.

- **Maintenance services** -- Property managers oversee a wide variety of exclusively locally performed maintenance services such as cleaning, minor repairs, etc.
- **Property marketing** -- Marketing consultants identify the market and possible financial problems of an asset. They provide the owner with an understanding of all the property’s operational aspects so that practical steps can be taken to resolve the identified problems within current market conditions. This function can also serve to prevent problems. Knowledge of all local aspects are necessary to provide this kind of service.

The above list represents most usual real estate services offered in highly competitive property markets. Some of these services such as land brokerage, appraisal, initial leasing, building brokerage, and management services for stabilized assets now have a high degree of commoditization.

During approximately the past five years, however, a rapid increase in variety of services offered by real estate companies has been observed. Some companies have developed their range of services further to meet the demand for enhanced property-related expertise, including services such as design and use advice, development funding, environmental consultancy, facilities management, property taxation advice, relocation advice, space audit and planning, urban regeneration and economic development advice, or specialized product consulting and management for shopping-centers, hotels and other specific real estate. The impacts of this trend on the real estate service industry will be discussed in chapter 3.3 "International real estate service industry."

Figure 3-3 summarizes the above sections with a simple chain illustration, showing how raw material, product, and real estate services ultimately create utility value, i.e., value for the user and value for the owner/investor.

**Figure 3-3 Real Estate Drivers of Value**

![Diagram of real estate drivers of value]

---

31
3.3 International Real Estate Service Industry

The following sections analyze the international real estate service industry. Hines (1992) concluded, that real estate services are important to international production, distribution and trade. Hines also defined an international real estate company as a firm that adds value by producing/servicing in more than one national economy. The scope of this analysis is on those firms that compete within the international arena of the real estate industry.

Demand Drivers for International Real Estate Advisory Services

Although real estate as a product is fixed in location, local supply and demand factors are in some cases considerably influenced from abroad. The driving forces can be categorized as:

- Increases in international trade, and continuous expansion and re-organization of multinational enterprises.
- Emergence of foreign direct investment in different local property markets together with treatment of investment objects as money commodities.
- Opening of huge markets of once closed economies and, in some cases, the demand from governments in these emerging markets for advice in real estate specific issues.

International Trade and Multinational Enterprises

It is not only the specialization within an economy that enhances services, it is also the international division of labor which demands new services. International trade with the exception of a few years has throughout the post-war period increased more than global production which explains why services are growing so fast. International trade requires not only transport services but also other complementary financial services such as insurance and marketing. (Schaumburg-Müller, 1993). Part of these complementary services also include international real estate agents or international real estate consultancies as mentioned by Thrift (1987).
The major driving force of the demand for international real estate advisory services are the multinational enterprises (MNEs). Assessing the importance of these firms, Dunning (1993) reckoned that the largest 500 MNEs account for roughly 25% of the world gross domestic product, and over 50% of world trade (p. 28). A closer look at the changing balance between international trade and direct foreign investment as presented by Stopford (1993) confirms the increasing internationalization of production by the MNEs (see Table 3-1). Low ratios mean a high share of foreign production.

Table 3-1 Exports-to-overseas production ratios for MNE’s

<table>
<thead>
<tr>
<th>MNEs from:</th>
<th>1977</th>
<th>1981</th>
<th>1990</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>0.17</td>
<td>0.16</td>
<td>0.15</td>
</tr>
<tr>
<td>Europe (a)</td>
<td>0.50</td>
<td>0.44</td>
<td>0.44</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0.32</td>
<td>0.24</td>
<td>0.17</td>
</tr>
<tr>
<td>France</td>
<td>0.58</td>
<td>0.63</td>
<td>0.57</td>
</tr>
<tr>
<td>Germany</td>
<td>1.76</td>
<td>1.38</td>
<td>1.09</td>
</tr>
<tr>
<td>Japan</td>
<td>4.30</td>
<td>3.76</td>
<td>1.64 (b)</td>
</tr>
</tbody>
</table>

Note: (a) Europe includes MNEs from Austria, Belgium, Finland, France, Germany, Italy, Netherlands, Sweden, Switzerland and the UK.
(b) The ratio for 1994 for Japanese MNEs is 1.03 (Lessard, 1994).
For 1977 and 1981 based on sales of 500 industrial multinationals; for 1990 based on sample of United States multinationals by Wells (1992), European industrial MNEs by Stopford (1992), and Japanese multinationals by MITI.

The multinational corporations also require more property as they expand into new markets and maintain, reorganize, or contract their businesses in existing locations. These corporations are continually acquiring, divesting, and renovating real property (Hines, 1990). The dynamics of growth and relocations are further enhanced with the current tendency of many companies, in particular US based MNEs, to outsource real estate related service functions. This creates additional opportunities for real estate advisory service firms. Hines (1992) suggested that a MNE has several reasons to use outside real estate services to complement in-house corporate real estate service:
Local estate managers with locally based firms and international real estate firms know: available sites; zoning, building, and tax laws; government programs for economic and
land development; building owners and their agents; and, the local system for title assurance and transfer as well as for real estate valuation.

Walton (1993) reported that a survey of corporate real estate executives found that 54% of those surveyed already outsourced real estate services and half of the remaining respondents were exploring outsourcing options. Another report, released by the International Facility Management Association conducted in 1993, looking at the advantages of outsourcing stated that 75% of the managers in the survey confirmed that their companies realized lower personnel costs and improved access to specialty skills as a result of outsourcing (Bergsman, 1995).

Examples of MNEs that are served by international real estate advisors include Hewlett Packard SA of Geneva whose advisor for their new headquarters in Poland was London based Fuller Peiser (“Office building,” 1992). Or Ford (US) which plans to build a new factory near Warsaw. The purchase of the land was arranged by Healey & Baker (UK) and Cushman & Wakefield (US) (“What’s New,” 1992). These examples show a contracting out of specific tasks. As corporate property decisions continue to be increasingly complex, with corporations expecting more than just a quick fix from their real estate consultants, more frequently the focus is on a long-term strategic approaches to asset management (“Jones Lang Wootton,” 1995). This trend gives real estate advisory firms the opportunity to provide more comprehensive services to corporate clients. Examples include Baxter Healthcare International (US) which has given Trammell Crow Corporate Services of Stamford, Conn. the responsibility for the management of its portfolio of 6 million square feet (Deutsch, 1993). Or, the huge outsourcing assignment for the management of Ameritech’s (US) 3,600 nationwide facilities to LaSalle Partners and Johnson Control (both in the US).

One can see that the MNEs increasingly generate opportunities for established real estate advisory firms to provide advice based on local understanding but overlaid with national or international knowledge.
Investment in International Property

There is ample evidence of foreign real estate investment by financial institutions, industry corporations, real estate companies, individuals, families and other types of investors. The real estate investment funds move toward both developed and newly industrialized countries. Owing to the long reign of the British Empire, British investors and financial institutions are accustomed to investing abroad, previously moving monies freely into foreign real estate to support colonization plans (Hines, 1988).

In recent times, direct international property investment emerged in the early 1970s when British investors moved into the Continental European market and in the late 1970s when they moved into North America (“Following the global property,” 1988). At the same time, British international real estate consultancies have grown rapidly under the impetus provided by this market. These consultancies are essentially commodity brokers, dealing in the same four commodities--office buildings, retail buildings, industrial buildings, and expensive residential real estate. Over the last 15 years, the market for commodities of this kind has become truly international under pressure from institutional investors wanting to internationalize their property portfolios. The net result is that the international property market is a market in which buildings are increasingly treated as money commodities (Thrift, 1987).

According to Hines (1988), the large British, Dutch and German international real estate investors have continued their international investment practices over a long period owing to their conclusion that real estate portfolio yields and their variability can be improved in this manner.

As a result of the increasing demand to view real estate as an investment, real estate advisory firms were led into new trends. Thrift (1987) observed two significant trends that are still thriving today. The first was computerization. In particular, the building up of computer data banks of properties allows clients to select international property portfolios more easily. The second trend was diversification. Besides their traditional functions, real estate advisory firms have increasingly moved into services with which
they have not been traditionally associated. These include advice on and management of property portfolios, location consultancy and, taking over more of the functions of merchant banks, arrangement of financing.

Today, an increasing activity in this field and a broader base of participants on both sides -- clients and servers -- can be observed. Recent examples include the approval by the Mexican government to allow a US real estate investment trust to invest $250 million in Mexican real estate. Or LaSalle Partners, a Chicago based real estate advisory firm that opened a London office in 1990 and a Paris office in 1994 to meet the growing demand for real estate investment advisory services. On one side, this firm got the contract for investing $100 million in property in the UK committed to US pension funds, and on the other side they were appointed by London based Prudential Portfolio Managers as one of its advisors to invest approximately $400 million in US property. Other examples, in particular of the increasing activity by US investors, present the raising of $240 million by Auburndale Properties Inc. of Wellesley, Mass. to develop industrial properties in Central Europe. This fund is targeting MNEs as users and yet received letters of interest from Apple Computer Inc., Kmart Corp., IBM, and Levi Strauss & Co., among others (Pacelle, 1995a). Or, Prudential Insurance Co. of America which has raised $200 million to form a real estate fund together with the London-based global real estate advisory firm of Jones Lang Wootton to invest in Southeast Asian countries (Pacelle, 1995b).

The above activities represent only a part of what is going on in the international real investment community today and in the recent past. It can be inferred, however, that most of these investments generate business opportunities for real estate advisory firms able to perform the required services.

**Emerging Markets and Local Governments**

The opening of the once closed economies of China, Russia and the former communist countries in Central Europe together with other emerging markets represent unprecedented opportunities for the real estate business. Recent examples include
ambitious plans to expand commercial buildings and even to build an entire town in Israel, requiring real estate expertise from outside sources (Sandler, 1994). Furthermore, the Vietnamese economy is now growing steadily and moving toward free market principles, which offers promising fields for US enterprises in the real estate industry (Linuma, 1994). Or, China, where the number of real estate companies rose from several hundred by 1991 to over 10,000 by 1993 with approximately one-sixth of them having foreign investment (Miles & Mei, 1994).

Although political and economic liberalization, growth rates, per capita income, direct foreign investment, and the state of economic and industrial development differ considerably among these emerging markets, they have something common: A huge need for new real estate. In almost all of these markets, “western-style” commercial buildings are preferred. At the same time, most of the countries in these markets do not have a traditional, real estate service industry. The introduction of economic market principles and its resulting freewheeling entrepreneurship are now requiring modern, sophisticated real estate services such as market and feasibility studies, project development consulting, and asset management, all of which are services that experienced real estate advisory firms from abroad can offer.

Not only these emerging markets, but also the European Union (EU) through the creation of the free trade zone and the reconstruction of former Eastern Germany is an additional demand driver for real estate. Cheeseright (1990) observed that the increasing interests of Japanese, Swedish and US investors in the EU property market clearly shows that the European property market has rapidly become an international market. At the recent world property fair MIPIM in Cannes/France, Jonas (1995b), a prominent real estate consultant stated that “Europe is at the beginning of an exciting period of change and opportunity with the property professions having the greatest period of growth still ahead” (p. 22).

Not surprisingly, also the public sector, driven by the dynamic growth of private industries, has to build new necessary facilities. Governments, in some cases, need
advice about how to build, for example, specialized buildings for commercial administration or they may need special expertise in financial real estate matters that cannot be offered by domestic advisory firms. Examples of consulting services for local governments by foreign advisory firms include the city of Berlin which hired Hanscomb, an Atlanta based project management firm to value engineering for the $2.2 billion Messe Berlin project (Inklebarger, 1995), and Moscow’s main administration for services to the diplomatic corps who in 1991 hired Hines Interests, a US developer and full service real estate service firm to provide construction advice, property management, and leasing services for a new 40,000 square meter mixed-use complex in Moscow.

These examples show that renowned real estate advisory firms with specific product knowledge, management skills, or financial engineering capabilities are hired by public authorities for neutral advice on real estate problems.

**International Real Estate Service Competition**

The following section analyzes the international real estate service industry, utilizing Porter’s (1985) five forces framework for assessing the relative attractiveness of different industry structures. Basically, an industry is attractive if the intensity of competition is relatively low, because competitive intensity acts to drive down average profitability. The five forces that determine an industry’s profitability are: The threat of new entrants in the industry (entry barriers); the bargaining power of buyers; the bargaining power of suppliers; the threat of substitute services; and the degree of rivalry among competitors in the industry (industry competitors). Major trends in this industry will additionally be highlighted or identified within the five forces framework.

---

1 This market and competition assessment is primarily based upon numerous interviews with executives from leading international real estate service firms such as Richard Ellis, DTZ, and Binswanger, and a poll by mailed questionnaire to 20 renowned real estate service firms with international experience, both conducted by the thesis author. It has to be mentioned, however, that the amount and quality of information received was not sufficient to provide a complete picture of this industry. This result was eventually due to the fact that almost all real estate service firms are closely held private partnerships or companies (the thesis author encountered an unintelligible level of secrecy by these firms).
Entry barriers: The real estate advisory service business has low economies of scale, because each contract is usually unique, i.e., tailor-made for a specific client and often short-term. In addition, the services offered are, with the exception of market databases, not proprietary and can easily be imitated by competitors. Capital requirements for this business can be moderate to quite high. Moderate investments are needed when servicing clients abroad from a firm’s home base. Higher investments are needed when one’s own databases have to be built and local offices will be established. Costs from access to market data can be reduced through membership to one of the big real estate networks such as Colliers or ONCOR. A record of success and reputation play the major role in attracting clients. Building “brand identity” from scratch is a long process that requires considerable investment in advertising. Also, the reputation power of a long-term, established player on a market place can be a significant barrier to new competition. This industry has also seen new entrants from related industries. Since 1988, nearly every Big Six accounting firm has entered into the real estate consulting business and some international investment banks also increasingly offer real estate services (Bergsman, 1992; Leinberger, 1993; Frantz, 1994; Scott 1995).

Bargaining power of buyers and suppliers: Supplier power is not relevant because the inputs necessary for the service business such as hardware and software are usually commodities. A threat of forward integration, i.e., shifting activities from producing to servicing by related firms in the industry exists. A prominent example is the once largest US real estate developer Trammell Crow, who now offers a variety of real estate services because of the lack of development opportunities (Pinder, 1993).

The buyer’s power for real estate agency services such as different forms of brokerage or appraisal is high because these services are practical commodities. Real estate firms compete primarily on price and, to a certain degree, on the quality of their data sources for these services. These businesses contain some possibilities for achieving economies of scale by exploiting standardized processes and quality of market data. Clients purchase real estate advisory and management services based on the
reputation of, or the existing relation to a particular firm. The service price is usually not of first importance and there are few firms that are capable of providing these services internationally. However, a trend toward a squeeze on fees was observed over the past few years, indicating that the buyer’s power has also increased with regard to these services (Parsley, 1995).

Substitute services: The threat that clients substitute high level real estate expertise is not extensive, especially when complex problems have to be solved or high management capability is needed for project success. Also, for consulting services that are usually based on trust and long-standing relationships, the propensity to switch to another firm is quite low. The threat that clients may substitute a renowned international firm with a local firm is biggest in the agency business. MNEs may replace some services that international real estate firms offer with services performed by in-house staff, if outsourcing tendencies are reversed. Institutions with large investments in property sometimes build up their own departments to manage their property portfolios.

Intensity of rivalry: It is very difficult to estimate the actual degree of rivalry among the international real estate service firms. No numbers about the magnitude of commissions and fees resulting from these cross-border services could be found and no standardized price structure exists. Therefore, it was not possible to estimate the size of this business.

Few global firms are well established and have reached a degree of “brand identity.” Their strengths are an extraordinary relationship base, sophisticated market databases and high quality staff people. However, it can be noted that the absence of a clear market leader causes intense jockeying for position in the different international markets. Networks have emerged and have gained meaningful positions in this international business environment. Figure 3-4 summarizes the leading international

---

1 From the few international real estate service firms that reported revenue numbers, a range of $80,000 to $100,000 revenues per employee p.a. could be identified. (As a comparison: The 100 leading US real estate service companies averaged revenues of $130,000 per employee p.a.. Source: Ward's Business Directory, 1994)
firms and their characteristics. Besides these major players, there is a multitude of nationally established real estate service firms, in particular US based firms, that are now pressing toward the international arena. This is primarily because they have run out of growth opportunities in their mature home markets.

A common way to get access to international business is through membership in one of the international networks. In addition, some networks form alliances with major independent firms. An example is ONCOR International Inc. which has formed an alliance with London based Hillier Parker and Paris based Bourdais SA, doubling the group’s size to 6,000 professionals in 29 countries (Gibbs, 1994).

Other ways to expand are the building of alliances or joint ventures and through acquisitions and mergers. Examples include the two largest US real estate service providers: New York based Cushman & Wakefield who recently formed alliances in Asia, Europe and Latin America, and CB Commercial from Los Angeles which has forged alliances with over 160 offices in 23 countries worldwide and has a partnership with London based DTZ (Stephens, 1995). International property advisers DTZ have become the largest real estate service firm in Central and Eastern Europe through aggressive acquisition of leading local firms (DTZ, 1995). The above examples show strong competition activity that may lead to further consolidation into a few big groups.

Looking at how these firms compete, one can observe that competition is primarily based on a firm’s reputation and quality of services, and secondly on service price. A general trend in the compensation structure that was observed by Hines (1992) continues today. Contracts for international real estate services have become more short-term and are more split with each function billed separately. This trend is partly due to an increase in demand for new, more specialized services and partly to the fact that real estate service firms increasingly seem to pursue a strategy of service product

---

1 The two biggest international networks are: Boston based Colliers International with approx. 113 offices and 37 firms with strong presence in the US and the Pacific-Rim and, Houston based ONCOR with approx. 112 offices and 30 firms with strong presence in North America and Europe. Source: Commercial Property News, January 1992.
differentiation. This implies a shorter life cycle of service products with an increase in investments by the real estate service firms for the development of new services.

Two other trends in strategy pursued by international real estate service firms can be observed. The first is the targeting of the client segment "large multinational corporations" because these client groups offer a major opportunity for real estate service firms to do international business. The second trend is the attempt to gain dominance in a specific geographic area. US based firms are primarily looking to Latin America and Southeast Asia whereas firms from the European Union are focusing on Central and Eastern Europe, but also on Southeast Asia (Deutsch, 1993; Levin, 1995; Stephens, 1995).

The major factors of competitive advantage for an international operating real estate service firm are good relationships, highly developed business know-how, and experienced, well-trained and "internationally minded" staff people. In addition, an excellent market database is indispensable in this increasingly information technology driven business.

Summary Assessment of the International Real Estate Service Industry

This industry shows symptoms of growth. At the same time, it is an industry that is very fragmented with little common price structure and a low level of standardization of services offered. Strategy planning is extremely difficult due to the lack of sufficient information and rapid change, i.e., the entry of new players together with the emergence of new client segments and new markets. An assessment within the “five forces” is as follows:

Barriers to entry (Mildly unattractive)

- No economies of scale and no proprietary service products..
- Reputation and database building require larger investments.
- Increased threat of new entrants from related industries.
Bargaining power of buyers and suppliers (attractive)

- Agency services are usually highly commoditized and price sensitive.
- Possibility of leveraging proprietary market databases to increase the attractiveness of one's agency services.
- Advisory services are purchased based on reputation with low price sensitivity.

Threat of substitute services (attractive)

- Threat that commercial clients substitute real estate expertise is low.
- Low probability of substitution through in-house services by MNEs.

Intensity of rivalry (attractive)

- Global competition is concentrated among relatively few big players and networks.
- Strategic alliances may consolidate the competition structure in the near future.
- Competition is primarily based on reputation and quality of the services.
- Still profitable industry, but with declining margins.

Summary assessment of industry attractiveness: Attractive.

Of course, the attractiveness of the real estate service industry depends additionally on the respective conditions in a market. In markets with a high growth potential, few capable competitors, and little existing business know-how, this industry might even be very attractive.
### Figure 3-4  Leading International Real Estate Service Firms

<table>
<thead>
<tr>
<th>Firm</th>
<th>Market scope</th>
<th>Special characteristics</th>
</tr>
</thead>
</table>
| **Richard Ellis** (1)  
Founded 1773 in London.  
Neutral private company.  
Approx. 1600 employees.  
Services: Investment advice and management; agency; property management; valuation; development consulting.  
Approx. 53 offices in Europe, The Americas, Asia-Pacific, Australia.  
Major clients: Private investors; multinational corporations; public and private funds. | Leading global company.  
All offices fully owned by one holding company.  
Global proprietary database with historic rent/yields for top 40-50 cities worldwide.  
Separate corporate consulting group. | |
| **Jones Lang Wootton** (2)  
Founded 1783 in London.  
Neutral private company.  
Approx. 3500 employees.  
Services: Investment advice and management; agency; property mgmt.; valuation; project mgmt.; hotel real estate mgmt.; market research; asset management.  
Approx. 60 offices in Europe, North America, Asia-Pacific, Australia.  
Major clients: Private investors; commercial investors; multinational corporations; public and private funds. | Leading global company.  
Partnership structure.  
Decentralized decision making.  
Special corporate real estate services.  
Sophisticated worldwide database with information about major metropolitan property markets.  
Strategic alliance with A.D. Little management consultants for leisure and hotel industries. | |
| **DTZ**  
Debenham Thouard Zadelhoff (3)  
Founded 1784 in Birmingham as Cheshıre Gibson.  
DTZ formed 1988; JV with Thouard (F) and Zadelhoff (D,NL).  
International private held umbrella company (LLP) with minor ownership in affiliates by parent company.  
Approx. 1900 employees.  
Services: Investment advice; agency; portfolio/asset management; valuation; planning advice; property management.  
Approx. 70 offices in EU; strongest player in Central Europe; Offices in Australia, South Africa, Asia-Pacific.  
Alliance with CB Commercial (US) and CY Leung (HK) covers 170 offices worldwide with 7000 employees.  
Institutional, private and commercial investors; local authorities; public companies. | Market leader in Central Europe.  
Biggest market coverage through alliances with strong partners.  
International umbrella company controls business standards of affiliates.  
Parent company has partial equity or direct financial interest in affiliate companies. Parent does not have majority stakes in affiliate companies. | |
| **Chesterton Binswanger** (4)  
Founded 1805 in London (Chesterton), 1931 in Philadelphia (Binswanger), and an alliance formed in 1993.  
Approx. 4300 employees.  
Services: Corporate asset management; location consulting; development consulting; valuation; agency; marketing.  
Approx. 120 offices in Europe, the Americas, the Middle East, Asia-Pacific, South Africa, Australia.  
Unique degree of interconnectedness.  
Marketing activities centralized for worldwide operations.  
Mostly joint ventures with established local firms overseas. | |
| **Healey & Baker** (5)  
Founded 1820 in London.  
Neutral international partnership  
More than 100 partners and approx. 650 staff  
Services: Estate agency; corporate services; investment and financial services; research & consultancy; development consulting; property valuation; professional services.  
Approx. 20 offices in Europe.  
Association in the Middle East and South Africa.  
Alliance with Cushman & Wakefield (C&W) of the US with 39 offices and 1000 staff, covering the Americas.  
Major shareholder (with C&W) of Marlin Land, Hong Kong.  
Local entrepreneurs, multinational corporations, clients from private and public sectors. | Leading international commercial real estate consultant.  
Partnership structure.  
Founder member of Cushman & Wakefield International.  
Europe-wide research service with proprietary econometric forecasting model.  
Several on-line databases. Alliance with strong partners gives global coverage. | |

(1) Source: Company brochure 1995, interview with Mr. F. Wehrli.  
(3) Source: Company brochure 1995, International Cities Mgmt. Review Jan./95, Interview with Mr. T. Plumbe  
(4) Source: Company brochure 1995, interview with Mr. T. Prince.  
(5) Source: Company brochure 1995
4. CASE STUDY AND ADVISORY SERVICE BUSINESS MODEL

The following case study was developed with the purpose of having a realistic example of an established real estate service firm that may consider to internationalize its business. An assessment of the domestic real estate service industry and the case firm's competitive position will finally lead to the definition of strategic issues.

4.1 Spaltenstein Immobilien AG [Spaltenstein Real Estate Company]

Company Background
Spaltenstein Immobilien AG (SPIM) was formed in Zürich in 1969 as an autonomous, privately held company with the initial purpose of managing all properties of the Spaltenstein Group, a large group of building contractors. Starting with a few staff people and representing mainly the parent company’s real estate interests, SPIM grew steadily during the 80s in terms of personnel capacity, a variety of service products, and increasingly offered its services to third party clients. Today, SPIM is a full service real estate firm with 55 employees, operating primarily in the eastern and central parts of Switzerland. The organizational structure of the company emphasizes flexible and market oriented groupings of individuals as well as interrelationships across departments. All activities are guided and performed under the umbrella of a rigorous, publicly certified quality assurance system.

Business Scope
The firm operates in three business fields: Real estate advisory services for third parties and their own projects; development of their own projects; and, portfolio management of their own properties. The focus of this study is exclusively on the real estate advisory services business of SPIM; the company had a total revenue for 1994 of CHF10 million.
and earnings before taxes of CHF0.75 million.¹ SPIM offers a wide array of real estate services, basically in three service areas, as described below:

Table 4-1 Service areas and revenues

<table>
<thead>
<tr>
<th>Service area</th>
<th>Services offered</th>
<th>Revenues 1994 (a)</th>
<th>Revenues per consult. hour</th>
</tr>
</thead>
</table>
| Project development| • Development consulting  
|                    |  • Project management  
|                    |  • Design management  
|                    |  • Owner’s fiduciary  
|                    |  • Feasibility studies  | 3,700,000        | 120                        |
| Asset management   | • Asset management  
|                    |  • Property management  
|                    |  • Maintenance services  
|                    |  • Property marketing  
|                    |  • Initial leasing  | 3,300,000        | 105                        |
| Sales and acquisition|  • Land / building brokerage  
|                    |  • Market studies  
|                    |  • Financial consulting  
|                    |  • Appraisal  
|                    |  • Legal advice  | 2,000,000        | 110                        |
| Supporting services|  • Quality assurance  
|                    |  • Accounting  
|                    |  • Financial controlling  | 1,000,000        | —                          |

(a) Past annual revenues are not listed because of the difficulty of drawing comparisons with results achieved within different real estate cycles. It can be mentioned, however, that despite the past three year downturn phase, revenues and number of employees remained roughly the same.

Services are sold to a broad client base consisting of private persons / investors, small to mid-sized private or public corporations, local governments and public institutions with no client generating more than 20% of total revenues. The method of compensation differs considerably among the services. Sales, acquisitions, and asset management are priced at usual market commissions as percentages of value or as a fixed fee based on a percentage of income of the properties. Advisory services are usually compensated for on a fee basis per hour or, in some cases, on a fixed fee basis.

¹ All financial data was reported by Mr. Christoph Ackeret, COO of SPIM. All amounts are in Swiss francs (FX rate at the end of 1994: CHF1.26 / US$) and heavily rounded by the thesis author for reasons of confidentiality. All financial data are therefore approximations for the purpose of this thesis project and do not represent the exact financial statements of SPIM.
Market and Competition Assessment

The stock of Swiss real estate is of extremely high value, estimated at over $2 trillion1 and mostly owned by private individuals. During the past five years, a major structural change in the national real estate industry occurred: More and more investments are now in the building renovation sector with decreasing investment in new buildings. It is predicted that this trend will continue. Aggregate investments in real estate also declined during the last five years (Wüest, 1993). Due to the fact that real estate has a very prominent position within the Swiss economy2 with a variety of players earning their income through real estate, the shift in allocation of investment together with decreasing contract volume has created a highly competitive and dynamic environment for all kinds of real estate services. This industry is now more fragmented than ever with a multitude of new competitors, a low level of standardization of service products, and only a mediocre level of market transparency.

Traditional real estate services such as brokerage and property management are practically traded as commodities with a high degree of rivalry competing on service price. Entry barriers for new competitors are relatively low and the propensity of the buyer to substitute a management firm or a broker is high. This market segment is very crowded with predominantly small firms where no competitor has a market-share of more than 1%3. A trend toward increasing localization and smaller size of firms can be observed. Firms which are operating from a greater distance or are not familiar with very local market conditions are experiencing shrinking margins. SPIM is a well positioned player in these market segments. The company concentrates on deepening its client relations by enhancing contracts with additional value-creating services instead of increasing the quantity of clients through geographic expansion.

---

1 With a per capita property value of $290,000 probably the highest in the world. As a comparison: The US property value was estimated in 1991 by the IREM Foundation and Andersen Consulting at $8.8 trillion or of $34,000 per capita.
2 During the last two decades, the construction industry alone accounted for 17% of GDP (source: Wüest & Partner, 1993).
3 Estimated by the thesis author. Due to the fact that almost all real estate service firms are private companies, no financial information on a broad basis about revenues was available. Therefore, it was not possible to elaborate an industry ranking by companies.
For the relatively new area of project development services, the situation is quite different. In this business field, reputation, proven record of success, and relationships are the major sources of competitive advantage. SPIM is the market leader and trend setter. These services are also the facilitators for the cross-selling of other service products that SPIM is offering. However, new entrants, partly from related industries such as banking, fiduciary services, general contracting or planning are now offering similar services. It has been argued that these competitors, in some cases, act as price dampers for purposes of building up or fostering client relationships in order to sell services from their core business. Such behavior certainly dilutes the true price based on the performance relation of these specialized services. In addition, the perception of the buyer of value for services such as feasibility and market studies, development consulting or owner’s fiduciary is still relatively low in Switzerland and noone can estimate when demand will increase.

Summarizing the above, the domestic real estate service industry can still be attractive for established firms who possess a high degree of efficiency, responsiveness, and a good relationship base. However, the increasing localization of activities together with the fact that contracts for real estate services have become more short-term with each function billed separately has led to a new tendency: The emergence of very small firms and niche players who assert they are able to perform the same real estate services for a lower price than their larger and more diversified competitors. These new rivals pose a serious threat to the larger, established full service real estate companies.
Why Spaltenstein Immobilien AG?

There are several reasons for choosing SPIM as an example of a firm that might consider internationalizing its operations or seeking contracts from abroad.

The first reason is the firm’s home base. According to Porter (1990), Switzerland together with the US and the UK is one of the nations with the greatest number of international positions in service industries. Although there is a strong international Swiss presence of real estate relating to and supporting industries such as banking, construction, general contracting and planning professions, there is surprisingly no Swiss real estate service company with an international reputation. There are opportunities to exploit domestic relationships to these related and supporting industries in order to gain access to international business. Examining the demand side, one can observe that the nation’s buyers for real estate products and services are known to be extremely demanding (probably the world’s most demanding customers). International sales for real estate services could be facilitated if this high quality culture can be exported. Another national competitive advantage is the high level of domestic rivalry in the real estate service industry. Firms are used to doing business in a highly competitive environment. Porter (1990) also mentioned that: “Swiss service firms do well where trust, discretion, and personalized attention are important or complex negotiation among parties is essential” (p. 264). Real estate businesses are usually based on trust and almost always include complex negotiations and decision-making processes. These capabilities are increasingly sought in the international real estate industry.

However, different macro-economic and political conditions are confronting the above mentioned national competitive advantage in services. Switzerland has the second slowest GDP growth and at the same time it has the second highest trade-weighted exchange rate. These facts imply both slow growth for new real estate and a high cost

---

1 Thesis author’s speculation.
2 GDP growth on an annual basis was reported of +2.1% (compared to Japan +0.1%; US +4.0%; Germany +3.3%; UK +3.7%). The trade-weighted exchange rate, that shows how expensive a currency is, had an index value of 113.3 (compared to Japan 169.5; US 88.3; Germany 112.6; UK 84.3). Source: Economic and financial indicators. The Economist, June 24th 1995.
disadvantage for exporting services. Also, due to a long existing law that prohibits foreign ownership in Swiss property for investment purposes, a lack of international demand for domestic real estate services results and therefore excludes national firms from competition based on international standards.

With regard to the above described situation, the following questions may arise for established national real estate service firms: Is the time right to seek contracts from abroad or to internationalize one’s operations? Which foreign markets present growth opportunities without too much risk? Where can one best sell the capabilities that arose from the national competitive advantage?

The second reason why SPIM is an interesting example are current dynamics in the domestic real estate industry. The increasing segmentation and localization, and the fierce competition for real estate services inhibit a fast and cost efficient penetration of new regional markets and customer segments. The structural change in the industry from producing primarily new buildings toward increasing investing in renovation of buildings results in an increase in demand for real estate services, especially by private owners. Space reduction by industrial corporations and the tendency to outsource functions that are not core competencies create additional demand for real estate services by this customer segment. SPIM’s core competency has primarily been the development of top quality, large-scale projects. Projects that are now in very scarce demand. SPIM’s management anticipated early the above mentioned trends in the industry and the firm has developed new service products, tailored to the new market conditions. However, the buyer's perception of value for these new services is still low. One could argue, that the market is not yet ready for these services and achieving economies of scale with these services will not be in the immediate future.
Due to this domestic industry environment, SPIM is confronted with the following set of questions: Will the investments made in R & D and spending in advertising pay off in this slow moving and fragmented domestic market? Where could the firm eventually export its core competence of managing large scale high-end projects? Are there any real estate markets abroad that are in a similar stage of maturity where the firm could sell its advanced advisory and management services in this kind of real estate environment? Can the firm acquire additional business know-how by going international that could later be applied in its home markets?

The third reason why SPIM is a firm that may consider going international is its competitive position within the domestic real estate industry. A summary assessment within the value chain concept of Porter (1985) is provided by Figure 4-1. The firm is also interesting because it is successfully transforming its way of doing business from developing and managing, or selling its own real estate projects to a primary orientation toward a third-party client business. Today, this business is generating approximately 50% of revenues. The medium-term goal is an ambitious increase of up to 75% of revenues from outside\(^1\). In addition, it should be noted that SPIM has built a sophisticated accounting and reporting system, and is also the first real estate service firm in Switzerland that has an acknowledged European-wide quality assurance system. Due to its heavy investments in firm infrastructure and technological development together with current and past market conditions, its profit margins have been shrinking during the past few years. Earnings before taxes were only 7.5% for 1994 and well below the target level of 10%. Finally, the firm provides important key assets such as human assets; a highly motivated, well educated, and experienced workforce with special real estate product know-how. Looking at financial assets, it can be observed that the company can still generate a considerable amount of cash flow out of the business from servicing its own properties. The firm is also able, when necessary, to take capital risks in connection with its service business.

At the firm level, SPIM is concerned with questions such as: How can the firm increase its profit margin? Will the firm’s future earning power secured by competing in the home market? Will SPIM be able to increase market share in order to fully take advantage of its sophisticated and expensive supporting services? Can the firm increase its attractiveness to high value clients such as institutional investors? Will SPIM maintain its domestic leadership by staying exclusively at home?

The set of questions arising for SPIM from the three factors macroeconomic environment, industry structure, and firm competitiveness form the basis of the definition of the strategic issues and the scenario building process, discussed in chapter 5.
<table>
<thead>
<tr>
<th>Spaltenstein Immobilien AG Competitive Positioning</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Firm infrastructure</strong></td>
</tr>
<tr>
<td>Very strong corporate culture</td>
</tr>
<tr>
<td>Superb financial management and management control capabilities</td>
</tr>
<tr>
<td>Lean structure, flat organization</td>
</tr>
<tr>
<td>Excellent quality management system</td>
</tr>
<tr>
<td>Capital risk taking possibilities</td>
</tr>
<tr>
<td><strong>Human resources management</strong></td>
</tr>
<tr>
<td>Friendly, personality emphasizing labor relations</td>
</tr>
<tr>
<td>Strong recruiting channels</td>
</tr>
<tr>
<td>Excellent training and development</td>
</tr>
<tr>
<td>Top compensation level, reward systems and pension-plans</td>
</tr>
<tr>
<td><strong>Technology development</strong></td>
</tr>
<tr>
<td>Leader in developing new service products</td>
</tr>
<tr>
<td>Large investments in quality assurance and information systems</td>
</tr>
<tr>
<td>Intensive spending in advertisement and market research</td>
</tr>
<tr>
<td>Highly standardized work processes</td>
</tr>
<tr>
<td><strong>Procurement</strong></td>
</tr>
<tr>
<td>Independent annual quality audits</td>
</tr>
<tr>
<td>Standardized evaluation system for the purchase of all inputs</td>
</tr>
<tr>
<td>Sophisticated supplier database</td>
</tr>
<tr>
<td><strong>Operations</strong></td>
</tr>
<tr>
<td>Full responsibility on business-area level increases responsiveness</td>
</tr>
<tr>
<td>Firm-wide commitment to quality assurance system</td>
</tr>
<tr>
<td>First movers of investments in market information and quality assurance systems</td>
</tr>
<tr>
<td>Client-server relations emphasizing one responsible person and guaranteeing representation</td>
</tr>
<tr>
<td>Attractiveness through very well educated and experienced work force</td>
</tr>
<tr>
<td>Institutionalized internal knowledge and information exchange</td>
</tr>
<tr>
<td><strong>Marketing and sales</strong></td>
</tr>
<tr>
<td>Marketing leader, aggressively advertises its services and capabilities</td>
</tr>
<tr>
<td>Cross-selling of broad service line</td>
</tr>
<tr>
<td>Leverage through other Spaltenstein Group firms</td>
</tr>
<tr>
<td>Leverage through own projects from capital risk business</td>
</tr>
<tr>
<td>Efficient sales channel relations through own independent search organization</td>
</tr>
<tr>
<td>Effective standardized packaging and pricing of consulting services</td>
</tr>
<tr>
<td>High-level relationship network</td>
</tr>
</tbody>
</table>
4.3 Advisory Service Business Model

Model Concepts and Components
The purpose of this model is to create a framework for making quantitative statements when exploring growth options for SPIM's real estate advisory service business. In particular, growth opportunities in emerging markets abroad. The model will be used to project future patterns of demand, prices, and profitability in the following markets:

- Domestic market (SPIM's home market)
- New domestic market ((New target market at home)
- Foreign markets (New target market abroad)

The model should assist SPIM's senior management in making decisions about investments in foreign ventures; pricing of services; and modes of entry into foreign markets. The primary objective is to project mid-term (Five years) earnings, profit margins, and profit contributions. Questions such as: What will happen to our revenues? What will happen to our costs? should be answered within the model structure.

Other objectives are:

- Increasing understanding of the causal structure and the dynamics that generate profitability
- Exploring robust policy decisions when making a commitment to operate in a foreign market

The model will also be used to investigate risk related questions when considering entering a foreign market such as what if:

- The target market doesn’t grow at the projected rate?
- The entry takes longer and cost more than projected?
- It takes longer to build-up revenue?
- The profit margins deteriorate faster than anticipated?
- The company does not pursue business opportunities abroad?
The model consists of the following three components that form a system which generates behaviors of interest by receiving inputs:

- A domestic and foreign market that is characterized by the size of the market and the demand for real estate advisory services. This component receives inputs from scenarios based on assumptions of changes in macroeconomic and industry factors.

- A firm that is characterized by its attractiveness to clients and the real estate advisory services it provides. This part receives inputs from management decisions about marketing strategies and investment allocations.

- A financial model that is characterized by receiving inputs from domestic and foreign markets as well as from a firm which affects revenues and expenses, and then projects earnings and profit margins as well as profit contributions.

Figure 4-2 on the following page provides an overview of the system boundaries.

In Chapter 5 [Scenario Building and Strategy Analysis], two different internationalization strategies and one alternative strategy that considers only a domestic market run through the model under three different macroeconomic and industry scenarios. An overview of the assessed strategy - scenario combinations, is provided with Figure 5-1 in Chapter 5.2 [Summary of Assessed Outcome Combinations].
Advisory Service Business Concept

In general, real estate advisory services share the characteristics of professional service businesses. The following concept captures the most important aspects when SPIM decides to explore foreign business opportunities:

- A service business seeks profits from opportunities in which it offers professional time.
- A distinguishing feature is that the output of a service cannot be stored as inventory. The product is intangible and cannot easily be specified nor can it be demonstrated before purchase. Clients therefore make choices about which services to buy based upon the reputation of a service firm.
- An advantage is that the service business can show great flexibility in response to changing client demands.
- A disadvantage is that each opportunity is short-lived.
- Profits are determined by the cost of providing a given service capacity (e.g., personnel hours), price of service, and client utilization of that capacity.

A service firm’s attractiveness is its major feature for success. Key determinants of its attractiveness are: Relationships that provide access to potential assignments; the reputation of the firm; and the quality of services that a firm provides. Relationships are primarily based on professional and private contacts of the firm’s staff and owners. The reputation of the firm has to be build-up over a long period of time by providing high quality service. Following is a brief discussion about the most important factors that shape a real estate service firm.

Service Quality

Service quality and perceived service quality are vital to a service organization. Quality can be viewed in relative terms -- relative to client expectations or relative to competition. This concept is important because the firm not only enters into a market, where basic services exist, but also a market in which certain services are new. Service quality is subjectively perceived and firms have to be careful before increasing the
quality level. It is easy to raise expectations, but it is difficult to reduce them. It is also important, that a firm is certain it can manage a level of increased quality with consistency and cost efficiency.

Skills match, i.e., hiring the right people, maintaining a pool of experience and continuous training to increase staff productivity are key. Workload and work environment such as an appropriate number of assignments, and frequency of travel are other important aspects. These considerations are particularly relevant when starting foreign ventures.

Service Staff
The service delivery system is very important for a service business. The staff of a service organization represents the most important asset. The management of these “assets” make or brake the profitability potential of a service firm. It has to be mentioned, that it is especially difficult to separate the service itself from other components that are necessary to produce the service. Therefore, clients will evaluate the entire delivery system such as methodologies, quality control, and support staff.

Service Price
Another important element in the service concept is the pricing of a service. Several factors render the pricing of a service more complicated than the pricing of products. The intangible character of a service makes it harder to understand how the service should be determined. Naturally, the price is less influenced by the cost than it is by the client’s perceived value. One way a company may optimize its pricing may be to use cost generators to determine the price floor. This is, however, difficult in a consulting firm because of the different levels of professional performance.

Entering a new foreign market makes pricing even more difficult, especially when the service offered is relatively new. Nontheless, it is important to make explicit judgements about the elasticity of one’s service demand schedule in a foreign market.
In the advisory service business concept, service quality can be seen as the major component of a firm's attractiveness and service price plays a minor part. The drivers of service quality are capacity adequacy, skills and experience of the staff, R & D investments made in increasing the quality of the service provided, and investments made in increasing staff productivity.

Key Management Decisions
Following are the key decisions of the firm’s management within the advisory service business model.

Service Price:
This decision is determined by calculating a price based on the firm's cost structure and the desired profit margin.

Desired Service Price = Unit Cost *(1+Desired Profit Margin)

SPIM's desired profit margin for domestic operations is 10% and for foreign operations 15%. The unit costs of foreign operations are expected to be 30% over the unit costs of domestic operations. The average cost per capacity unit for domestic operations is CHF109 / hour + 10% margin = CHF 120. The cost for foreign operations is CHF142 / hour + 15% margin = CHF163. Saleable on the market are 84% of the consulting hours1. Billings to clients per domestic consulting hour are therefore CHF 143 / h (CHF120 divided by 0.84), and per foreign consulting hour CHF194 / hour (CHF163 divided by 0.84)2.

---

1 This means that the rest of the time, or 16%, a consultant typically provides services to the firm such as developing standards for quality systems, or organizing training programs for company staff.
2 CHF = Swiss francs (FX rate on June 24, 1995: CHF1.16 / US$ or US$ 0.86 / CHF)
**Investments in R & D, Quality and Training:**  
The basic decision as to how much to invest is determined as a percentage of anticipated revenues. Management decides what fixed percentage to dedicate to each budget (foreign and domestic operations). These investments are included in the overhead expenses within the financial model.

**Investments in Start-up Costs for Foreign Business:**  
This decision is determined by estimating additional costs to get the foreign business started. These investments are not reflected in the overhead expenses since they are regarded as one time allocations of company resources that are intended to generate income over a lengthy future period. These investments will be considered within the financial model when profit contributions from the different foreign entry modes are estimated.

**Spending on Marketing:**  
These expenses are determined by annual budgets made by the marketing department for advertisements, special events, and other representations of the firm. Management decides how much to spend after a review of the projected budgets.

**Targets of Service Assignment Volume and Service Market Share:**  
The decision regarding service assignment volume is determined by an optimal capacity utilization of consultants generating foreign business, i.e., each foreign assignment should maximize the consultant's capacity. Service market share is determined by the respective pricing policy, i.e., by demand elasticity as well as by competitor behavior.
Financial Model

The financial model basically summarizes SPIM’s projected operations. This financial model (spreadsheet) receives inputs from the assumed scenarios and from the key management decisions according to the advisory service business model as presented in Figure 4-2. Table 4-2 on the next page shows the basic spreadsheet structure. Initial projections (Year 1) of domestic operations are based on SPIM’s past (1994) performance of the advisory service business plus apportioned support services. Revenues were CHF4 million. These projections do not include the agency and asset management business. Therefore, the term “contribution to the overall firm's margin” is related to SPIM’s advisory service business. The projections of foreign operations consider assumed first assignments under the respective strategy. It is assumed that the projected operations are based on the following financial management policy:

- Investments are financed from internal sources (No debt financing).
- Working capital requirements of the foreign operations are covered by the parent company.
- Depreciation and costs of hedging currency exposure through forward contracts or put/call options are included in the overhead expenses.

The basic financial model structure is intentionally kept very simple for the purpose of this exercise because all projected revenues and expenses rely on assumptions. It would therefore not have been useful to explore further international corporate finance topics that consider international valuations of the cost of equity. In practice, however, currency factors such as inflation, real exchange rates, and transfer risks; tax factors such as host country taxes, taxes due to remittance (Withholding taxes, taxes on royalties); leverage effects on cost of capital; and effects of volatility of foreign cash-flows on the shareholder’s portfolio should also be considered. Works of scholars such as Lessard (1995a), Eiteman, Stonehill & Moffet (1988), and Sercu & Upal (1995) provide comprehensive literature related to these issues.
### Table 4-2  Basic financial model structure

<table>
<thead>
<tr>
<th>Figures in thousands of CHF</th>
<th>year 1-5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SUMMARY OF PROJECTED OPERATIONS</strong></td>
<td></td>
</tr>
<tr>
<td>A) Domestic sales</td>
<td>0</td>
</tr>
<tr>
<td>B) Export or Foreign sales</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total revenue</strong></td>
<td>0</td>
</tr>
<tr>
<td>C) Domestic direct service costs</td>
<td>0</td>
</tr>
<tr>
<td>D) Export or Foreign direct service costs</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total operation expenditure</strong></td>
<td>0</td>
</tr>
<tr>
<td>Domestic net operating income</td>
<td>0</td>
</tr>
<tr>
<td>Export or Foreign net operating income</td>
<td>0</td>
</tr>
<tr>
<td>E) Domestic overhead expenses</td>
<td>0</td>
</tr>
<tr>
<td>F) Export or Foreign overhead expenses</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total other expenses</strong></td>
<td>0</td>
</tr>
<tr>
<td><strong>Earnings before interest &amp; taxes</strong></td>
<td>0</td>
</tr>
<tr>
<td><strong>Total margin</strong></td>
<td>%</td>
</tr>
<tr>
<td>Domestic earnings b. interest &amp; taxes</td>
<td>0</td>
</tr>
<tr>
<td><strong>Domestic margin contribution</strong></td>
<td>%</td>
</tr>
<tr>
<td>Export or Foreign earnings b. int. &amp; taxes</td>
<td>0</td>
</tr>
<tr>
<td><strong>Export or Foreign margin contribution</strong></td>
<td>%</td>
</tr>
</tbody>
</table>

Model inputs: \( f = \text{function}, \ SC = \text{scenario}, \ ST = \text{strategy}, \ MD = \text{management decision}, \ F = \text{factor} \)

[A] **Domestic sales**: \( f_{ST} \) (market size; consulting hours) \( \times f_{SC} \) (GDP growth; \( \% \times F \) growth in service demand) \( \times f_{MD} \) (market share; \( \% \times F \) demand elasticity \( f_{SC} \) \( \times \) price; CHF/h)

[B] **Export or Foreign sales**: \( f_{ST} \) (market size; consulting hours) \( \times f_{SC} \) (F GDP growth \( \times \) growth in demand; \( \% \) \( \times \) \( f_{MD} \) (market share; \( \% \times F \) demand elasticity \( f_{SC} \) \( \times \) price; CHF/h)

[C] **Domestic direct service costs**: \( f_{MD} \) (business unit cost; CHF \( \times F \) productivity) \( \times f_{SC} \) (F intensity of rivalry)

[D] **Export or Foreign direct service costs**: \( f_{MD} \) (business unit cost; CHF \( \times F \) productivity) \( \times f_{SC} \) (F time to entry \( \times F \) intensity of rivalry)

[E] **Domestic overhead expenses**: \( f_{MD} \) (general & administrative expenses; CHF = \( F \times \) sales) \( \times f_{MD} \) (investments in R&D, quality, training; CHF = \( F \times \) sales) \( \times f_{MD} \) (marketing expenses; CHF).

[F] **Export or Foreign overhead expenses**: \( f_{MD} \) (general & administrative expenses; CHF = \( F \times \) sales) \( \times f_{MD} \) (marketing expenses; CHF) \( \times \) additional G & A costs of headquarters because of foreign operations; CHF, 8% of [E] for export services, CHF, 10% of [E] for foreign subsidiary.
To compare different strategies of entry into foreign markets under different scenarios, Table 4-3 shows the investments made for each entry strategy and the cumulative profit contribution, discounted at the company's desired rate of 8%. The discount rate for both foreign entry strategies remains the same, because they share the same currency risks and have essentially the same diversification effect on the company's operations.

According to Lessard (1994), exposure to risks such as unfamiliarity with the foreign country should be factored into the revenue and cost projections and will therefore have a direct impact on earnings. Lessard also suggests that although risks clearly reduce the attractiveness of a given investment, they have to be weighed against other factors such as the growth potential and competitive advantages in the country in question. For the purpose of this exercise, I assumed that the potential risks are balanced by the potential opportunities of achieving greater margins, of faster growth, and of acquiring new business know-how. In this sense, the applied discount rate for making comparisons with alternative strategies that would target new domestic markets would also be 8%.

Table 4-3  (Investments) and estimated profit contribution

<table>
<thead>
<tr>
<th>(INVESTMENTS) AND ESTIMATED PROFIT CONTRIBUTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>figures in thousands of CHF discounted @ 8%</td>
</tr>
<tr>
<td>Year 0</td>
</tr>
</tbody>
</table>

[A] ST: Testing the Water; SC: Muddling Through (1) 0 0
[B] ST: Diving In; SC: Muddling Through (1) 0 0
[C] ST: New Domestic; SC: Muddling Through (1) 0 0

Model inputs: f = function, SC = scenario, ST = strategy, MD = management decision

[A], [B], [C]: fST (investments); fMD (strategy choice); fSC (respective scenario assumptions).

Export or Foreign earnings, or New Domestic Market earnings before interest and taxes will be taken from Table 4-3.
5. SCENARIO BUILDING AND STRATEGY ANALYSIS

In the first part of this chapter, three scenarios based on different macroeconomic and industry factors will be developed. The following part states the strategic vision, i.e., the assumptions made of why the case firm wants to go international. Thereafter, two different entry strategies are formulated. Before starting with the proper modeling process, an overview of all possible scenario -- strategy combinations is provided and the assessed combinations within this paper are indicated in Figure 5-1. In the last part of this chapter, five different cases are presented. The assumptions for each case are stated and the results of the outcomes are discussed. Three different case combinations are assessed and compared, and strategic options for each case are generated.

5.1 Scenario Building

Scope of Analysis

Time frame: For this exercise, a five-year time frame is considered. The once static nature of the real estate service industry during the past two decades has changed in recent years to a more dynamic one. Therefore, anything beyond five years is quite uncertain and difficult to project.

Service products: Of the two major business segment agency services (e.g., brokerage, appraisal, or initial leasing) and advisory services (e.g., development consulting and management, or asset management), emphasis is given to advisory services. In this business, where firms compete on reputation and service quality, expertise and management capability can quickly be exported from the home base.

Geographic area: Domestic and international. International with focus on countries within the European Union and newly independent countries in Central and Eastern Europe. SPIM would most probably start with foreign ventures in one of these markets with a focus on markets in Central Europe.
Major Stakeholders

Powerful stakeholders that can act as regulators or can also be clients are local and national governments, and trade organizations. Financial institutions such as the European Bank for Reconstruction and Development (EBRD) or the World Bank which allocate resources in real estate projects also act as regulators or as mediators. Another important group is formed by multinational corporations and institutions that invest in foreign properties, both acting as demand drivers for international real estate services. International and local competitors are other stakeholders. Finally, there are SPIM’s private shareholders who have to approve proposed internationalization strategies and SPIM’s staff who will be affected directly by each implemented strategy from the internal stakeholders.

Some Past Changes in the International Real Estate Service Industry

1970s
- Rapid increase in international trade and increasing importance of multinationals
- Direct investment in foreign property increases
- British international real estate service firms’ fast expansion worldwide
- Computer databanks of commercial property emerge

1980s
- Most industrialized countries ventured into unprecedented overbuilding
- Savings & Loans crisis in the US, and credit crunch in other industrialized countries
- General increase in government regulations in all areas of real estate
- Established real estate service firms increasingly diversify their business scope
- Buildings in international property markets are treated as money commodities
- Global real estate network organizations emerge
Early 1990s

- Lack of speculative building opportunities shifts industry focus on property services
- Pension funds gain greater importance as investors in real estate
- Industrial corporations increasingly start to outsource real estate service functions
- Emergence of a multitude of new real estate related financial instruments
- Increase in splitting traditional real estate services into specialized segments
- New, huge real estate markets in European and Asian countries emerging
- US developers and real estate service firms start to internationalize their businesses

Perceived Trends and Predetermined Elements

The perceived trends represent the essence of the real estate industry analysis from Chapter 3: The predetermined elements were identified in recent press articles.

T₁: Intense jockeying for positions in most international markets through building of alliances, joint ventures, acquisitions and mergers, and partnerships among firms.
T₂: Maturing real estate markets in Switzerland and countries of actual members of the European Union.
T₃: Increased opportunities for real estate services in former Eastern Germany, Central Europe, and Russia.
T₄: Switzerland continues to be a high-cost country in absolute terms.
T₅: Increasing government regulations affecting all aspects of the real estate industry in mature and in emerging markets.
T₆: The real estate service industry remains fragmented with low standardization of services and no common price structure.
T₇: Industrial and commercial business organizations continue to outsource real estate services as they increasingly concentrate on and invest in their core businesses.
T₈: Fast changing conditions for use and ownership of real estate demand for additional services and an increased degree of specialization.
T₉: Exclusively commission based real estate agency services such as brokerage are increasingly offered as consulting services based on a fee.
T10: Property decisions become increasingly complex and clients emphasize comprehensive high quality advisory services.

T11: Large international network organizations gain greater importance for small firms to gain access to international businesses.

Key Uncertainties
The critical uncertainties were identified by the author's analysis of looking at which outcomes would significantly affect SPIM's internationalization strategy.

U1: Will the evolution toward a completely integrated European community continue?
U2: Will the GDP in the emerging markets of Central Europe (CEU) steadily grow at approximately + 5% p.a.?
U3: Will Switzerland join the European Union in the near future?
U4: Will the Swiss GDP continue to grow at approximately + 2% p.a.?
U5: Will the Swiss franc remain extremely strong against other relevant currencies?
U6: Will international real estate service competition consolidate into a few mega-players who will increasingly provide standardized services?
U7: How strong will the demand for real estate advisory services in the emerging CEU countries grow, in size and in scope?
U8: Can smaller “boutique” real estate service providers compete with the established international players?
U9: How fast will the established international real estate service firms increase their efficiency and then start to compete on quality and price?
U10: Will clients continue to desire primarily a high level of service quality and to remain price insensitive?
U11: Will the information technology industry advance to provide widespread and commonly available property market data?

The following three scenarios address the above stated trends and uncertainties. In addition, quantitative data about growth rates in the selected target markets as formulated in the strategic vision [see Chapter 5.2 Strategies], are incorporated.
Scenario “Muddling Through”

Political, economic, and market instability create an unpredictable business environment. Russia remains a notorious uncontrolled high risk marketplace growing on average at + 3.5% p.a.. The integration of prospective countries into the EU proceeds slowly and Switzerland remains indecisive about whether to join the EU. Instability favors a high Swiss franc and creates a continuous high cost and slow growth climate in Switzerland. Gross domestic product (GDP) grows at + 2% p.a. for the first two years, but then declines to + 1.5% p.a. during the subsequent three years.

Emerging European markets still offer opportunities in real estate although the lack of progress in property rights slows the dynamics. GDP growth in Central Europe (CEU) varies considerably with the Visegrád countries having growth rates still well above those of the European Union (EU) member countries. Average growth in these countries is at + 5% p.a.. During the first three years, “western” construction firms and developers remain the major sources of equity investment in the emerging CEU markets. In some Visegrád countries, however, signs of a soon emerging secondary market for mortgages can be observed and pension funds start to invest in property, although at a modest scale.

The demand for real estate services is growing faster than the GDP in the emerging markets and the scope of services is slowly increasing. This is not only influenced by increasing regulations, but also by an industry demand structure that is steadily shifting from basic real estate service needs toward the need for more sophisticated real estate services. The growth rate for real estate advisory services in the CEU countries is at + 6% p.a. for the first two years and then at + 8% p.a. for the subsequent three years.

The real estate industry remains fragmented with room for niche-players. There are no signs of industry consolidation into a few mega-players. However, the four leading international players in the CEU market, Debenham Thouard Zadelhoff (DTZ), Richard Ellis, Jones Lang Wootton, and Healey & Baker steadily build their positions and it is expected that they will share about 30% of the market for real estate advisory services by the fifth year. Service differentiation continues with more firms becoming specialized in particular fields. Competition among real estate service firms is high and
new entrants from related industries who offer real estate services consolidate into special service segments such as portfolio management and financial consulting. In these market segments, these players are extremely cost efficient and have an almost unchallenged position.

Information technology increasingly shapes the real estate industry as renowned research institutions discover markets for selling property data that will be commonly available. Competition among multinational corporations is stiff and optimizations of corporate real estate portfolios call for comprehensive advisory services with clients becoming more price sensitive. The tenure form for industrial facilities shifts from owning to renting.

International real estate service players sustain their competitive advantage and small “boutiques” cannot compete with the established firms. The early entrants in the emerging markets are rapidly acquiring learning advantages, and after three years, they are able to serve new and existing clients far more cost effectively. These firms now start to aggressively play this card when competing for new assignments. Personalized high quality service and service with a high degree of involvement of the real estate consultant are in demand. Real estate advisory services remain throughout a relationship and reputation based business with no sign of commoditization.

Clients do not perceive network member firms or alliances without a clear corporate identity as trustworthy. This gives the “brand-names” and other long established real estate service firms a competitive edge. A proven track record as well as a certain level of perception as “national” is important in this unstable environment.
Scenario “Global Powerhouse”
The European market shows signs of homogenization together with political stability. Emerging markets in Central Europe adapt gradually to free market economy principles and their highly educated and low cost workforce attract investments in production facilities, offices, and residential buildings. An unexpected long lasting economic boom and supportive governments create a highly competitive business environment. Switzerland joins the EU by the fourth year and the value of the Swiss franc is heading toward purchasing power parity. GDP grows at +2% p.a. for the first four years, and then increases to +3% p.a. during the subsequent year.

The political and economical success of the EU stimulates growth in the former communist countries who now want to become members of the EU. GDP growth in CEU grows at a constant pace with the Visegrad countries having the highest growth rates, well above those of EU member countries. Average growth in these countries is at +7% p.a.. Construction firms and developers from abroad are increasingly replaced in their role of equity providers in real estate projects in the emerging CEU markets by nationally operating banks. These institutions fast acquire mortgage business knowledge and signs of a starting secondary market for mortgages can be observed. Pension funds of “western” industrial corporations start to invest in property, especially in the metropolitan areas of the Visegrád countries.

Confidence in this mega-market leads to increasing investments of leading real estate service firms in managerial training and development which give them a strong edge. Although there is no clear consolidation into few big real estate service firms, the market leaders increasingly gain market share and offer more standardized and profitably priced services. The four biggest international players in the CEU market, DTZ, Richard Ellis, Jones Lang Wootton, and Healey & Baker will share about 40% of the market for real estate advisory services by the fifth year. Clients require efficient, high quality service within comprehensive consulting and management packages. The demand for real estate services is fast growing together with the scope of services. The industry demand structure is shifting fast from basic real estate service needs toward the need for sophisticated real estate services based on international standards. The growth rate for real estate advisory services in the CEU countries is at +7% p.a. for the
first two years and then at + 10% p.a. for the subsequent three years. Real estate advisory services remain a business, where competition is based on reputation. However, because of standardization efforts by the leading firms, signs of commoditization for certain kinds of consulting, such as new project development consulting and management, can be observed after the third year. Niche-players and small "boutiques" can only compete on a very local level and within a limited business scope. The early into the CEU markets entered international real estate service firms learn very fast. Together with their advantage of having access to "pooled" knowledge from throughout the world in their headquarters, these firms have unchallenged attractiveness for providing sophisticated services.

The fast changing real estate business environment postpones the entry of market research firms into the property data business and firms with existing proprietary property data bases have a competitive advantage. Loose alliances among real estate service firms erode and real estate agencies who are members of well organized network organizations prosper. National and regional industrial companies follow the example of the multinational corporations and outsource real estate management functions. Governments also increasingly optimize their use and management of property and start to outsource some real estate functions.
Scenario "Fragmentation"

The integration efforts of the European community start to wither as more and more national governments have problems financing their budgets and are less willing to make contributions to the EU. Localization flourishes and regional governments of the non EU members impose conflicting demands on foreign companies. Trade conflicts arise and segment Europe into prosperous, stagnating, or declining regions. Russia and Southeastern Europe remain exposed to potential military conflicts. Switzerland again decides not to join the EU. The Swiss franc remains relatively high with increased volatility. GDP grows at an average rate of +2% p.a. during this five year period.

Regionalization weakens the way toward an efficient continental marketplace. Emerging CEU markets still offer opportunities in real estate although the lack of progress in property rights and extreme differences in taste and uses for real estate among regions slows the dynamics. GDP growth in Central Europe (CEU) varies considerably with the Visegrad countries still having high growth rates. Average growth in these countries is at +5% p.a., however, with increasing volatility each year and lack of correlation among CEU countries as well as in relation to EU member countries. Some financial institutions start to offer mortgages, but only on a modest scale, i.e., still with equity requirements in the range of 30% to 50% and only in the most advanced countries in the Visegrad. “Western” pension funds remain reluctant to invest in CEU property markets and return to their former policy of almost exclusively investing at home. The growth rate for real estate advisory services in the CEU countries is at an average rate of +6% p.a. during this five year period.

The big real estate service firms who aggressively expanded throughout Europe increasingly face cost problems in this inefficient market environment. The fragmentation in the real estate service industry is increasing and standardization of services is far from reaching realization. Localized, specialized, or small “boutique” real estate service firms flourish as the big players cannot maintain profitable relationships with their long-term clients. Some big clients become disillusioned because their service providers start to cut quality. As a result, many clients turn to alternative sources of real estate services and become more price sensitive or look for service providers who maintain a high level of quality. The four leading international players in the CEU
market, DTZ, Richard Ellis, Jones Lang Wootton, and Healey & Baker reduce their engagement in these markets, start to lose position and it is expected their share will decrease to approximately 25% of the market for real estate advisory services by the fifth year.

Regional property data bases become very valuable to real estate service providers and market research firms now start to cover all important regions and offer information as a commoditized service. The complexity of property decisions increases as regional or local regulations and tastes shape ownership and use conditions of real estate. Network organizations lose attractiveness for real estate service firms because contracts are increasingly traded on an arm’s length basis.
5.2 Strategies

Basic Strategic Considerations

Real estate advisory services are characterized by ease of entry, fast action, and service intensity and may therefore more be like poker rather than chess. One could also follow the arguments of Bhide (1986; 1994) who mentioned that in ventures based on hustle rather than proprietary advantages, the ability to seize short-lived opportunities and execute them brilliantly is more important than strategic considerations. I would argue, however, that strategy planning as performed within this paper also has its practical merits as far as they can be achieved cost and time effectively. Analysis of specific clients and relationships would in practice probably be of most value. This, however, was not within the reach of this thesis.

Following is a brief summary of the most important strategic issues SPIM is facing in its mature home market:

- **SPIM** is a de facto quality leader of real estate services.
- **Key assets** are: An experienced workforce; a strong firm infrastructure and financial basis; and good regional and national relationships.
- **In the real estate advisory service business**, SPIM is one of the market leaders and a trendsetter for new services. Recent innovations of services were aimed at existing buildings, i.e., renovations, re-use, and repositioning of real estate.
- **Buyer perception** of value of these new services is developing only slowly.
- **SPIM faces** a fragmented, highly competitive market that is increasingly heading toward localization of activities.
- **A core competency** of SPIM, the development management of large scale high end projects is now and probably for the near future completely not in demand.

---

1 The strategic considerations and the strategic vision, and the following two strategies do not represent the opinions or intentions of SPIM's shareholders and management. Rather, they are assumed by the thesis author for the purpose of this paper. The assumptions are based on the analyses made in Chapters three and four.
• Contracts have become smaller in size and more short-term (Typical assignments were in the range of CHF100,000 to 200,000 and higher, and are now more in the range of CHF10,000 to 50,000).
• SPIM’s services are of high quality but are also relatively high priced. The firm needs a “critical mass” for the profitable execution of assignments.
• The firm is increasingly forced to pursue niche-market opportunities. These markets are not cost effective because of their small size.
• SPIM seeks to increase its revenue share from third-party clients from 50% to medium-term clients equaling 75%.
• Profit margins were recently shrinking due to heavy investments in the firm’s infrastructure and, at the same time, unfavorable market conditions.

Facing the above issues, I assumed that SPIM would decide not only to defend today’s businesses but also to create new competitive space by pursuing ventures abroad. In particular, the company is seeking new markets with faster growth, higher profit margins, and less intense competition. In a later stage, the company would also seek strategic assets such as new business know-how including learning from competitors, and risk management contributions such as hedging economic exposure and distributing core activities. Although the company at the present time is not generating earnings at the target level of 10% (earnings before taxes were 7,5% for 1994), starting a foreign venture now, with stable earnings perspectives and backed by a sound financial base, seems opportune. SPIM will limit its engagement in the first stage to an operating risk business and will offer exclusively neutral consulting services on a fee basis.

SPIM is convinced that its core competences, broad real estate business know-how, and real estate management capabilities are in high demand in the emerging markets of the Visegrád countries, Russia, and the former Eastern Germany¹. Most of these markets are located within two hours of air travel distance from SPIM’s homebase.

¹ The Visegrád countries include the Czech Republic, Hungary, Poland, and Slovakia with a total population of 65 million. Russia has a population of 149 million. GDP growth forecasts for 1996 for these countries range from +3% (Russia) to +5% (Czech Republic, Poland).
Target clients at whom SPIM will offer its real estate advisory services are international investors, multinational corporations, and local governments or local investors who might be involved in joint ventures with “western” investors. The services are aimed at the following property types: New medium to large scale projects which need a high level of know-how and managerial skills, and larger, multi-faceted renovation projects in the many historic towns that require special expertise for their successful repositioning and future operation. By targeting these property segments where competition for advisory services is based on reputation and quality, SPIM will have the best chance to initiate a successful pricing-for-profit policy. The total size for fees of real estate consulting services in these market segments is estimated at CHF30 million per annum (e.g., for 1996)\(^1\).

Major competitors in these service segments are the well represented big international players, especially DTZ but also Richard Ellis, Jones Lang Wootton, and Healey & Baker among others. It is assumed, that all the big international firms together have a market share for this particular market segment of about 50\%\(^2\). The rest of the competition is probably composed of medium-sized planning firms and other professionals, particularly from Germany and other EU member countries as well as several from the US.

SPIM sees clear advantages to be gained by going international and believes that the potential opportunities outweigh the risks. The firm may follow at first one of the two basic entry strategies as described below.

---

\(^1\) Estimated by the thesis author after studying project financing commitments of the European Bank for Reconstruction and Development (EBRD) and the additional equity sponsors, mostly private construction companies and developers. Assumed annual property investment volume is CHF 1,500 million, @ 2\% = CHF30 million of fees (without agency services and asset management services).

\(^2\) Estimated by the thesis author after evaluating the presence of the major players in these markets. Of course, this number is very speculative because of the limited underlying research data!
Strategy “Testing the Water”

With this strategy, the firm wants to restrict the size of investment to an amount it can afford to lose. SPIM makes an up-front commitment of resources for the start-up, allocating CHF50,000 for special overhead costs and later decides, in stages, future further investments. The idea is to sustain growth in medium-terms by using internally generated funds, i.e., the export of services should at least cover the costs plus necessary investments. With an opportunistic entry strategy, the firm wants to keep a high degree of flexibility in order to exploit opportunities in different countries. Niche-markets that are big enough (on an international scale), where SPIM has a clear competitive advantage, are estimated to offer promising business fields. Advisory services as described in the strategic considerations form the business arena in which to begin.

As a starting point, it is assumed that after a successful bidding, SPIM was assigned by an international investor group for managing the development of a major commercial building in one of the Visegrád countries. The service in this case is priced to cover costs (including travel costs). The fee is CHF600,000 and the planned length of this assignment is three years. It is planned, that the firm manages this project with its existing staff. Maintaining the high standard of service quality for this assignment is emphasized. Increased capacity utilization and also learning are further objectives of this venture. SPIM wants to follow through and decides to invest CHF50,000 in international marketing efforts for the next year. The experience and reputation gained should immediately be exploited and new assignments should aggressively be pursued.

The company sees itself as a portfolio of core competences and foreign investments aimed to shape the target market for consulting services five years hence. SPIM wants to gain a medium-term market share for advisory services that is in the range of the market share of the major competitors, i.e., approximately 5% to 10%.
**Strategy “Diving In”**

With this strategy, the firm makes a major commitment to an emerging market in which it sees great potential for future growth. SPIM wants to be an early player and build learning curve advantages over later entrants (or, exporter firms). Building relationships in a new market and showing presence is another important aspect. SPIM sees growth opportunities in the whole region and is convinced that by having a regional beach-head, adjacent countries could be served more easily. SPIM decides to enter this foreign market through a “greenfield” investment rather than acquire a local firm or enter through a joint venture. The intention is to effect a long-term commitment with a centralized organization structure. The core management factor will be kept at headquarters and only the systems necessary to provide services will be transferred initially. SPIM decides to make a start-up investment of CHF200,000 for local office supplies and lease commitment.

As a starting point, it is assumed that after successful bidding, SPIM was assigned by an investor group composed of international and local firms to manage the development of a major commercial building in one of the Visegrád countries. The service in this case is priced to cover costs (not including capital costs for office investments). The fee is CHF600,000 and the planned length of this assignment is three years. The firm will manage this project under the responsibility of expatriate staff and hire necessary support staff locally. Emphasis is on providing high quality service and gaining reputation. Cost reductions through less travel and savings in marketing expenses are further objectives. Strategic assets such as new business know-how including learning from key competitors as well as risk management contributions such as the distribution of the company’s core activities are considerations made for a later stage. Marketing spending for the next year is budgeted at CHF 30,000. The medium-term goal is to provide services that require local presence such as asset management and, eventually, agency services.

SPIM seeks a medium-term dominant position as a diversified real estate service provider in this market. Market share should be comparable to those of its major international competitors.
5.3 Summary of Assessed Outcome Combinations
Figure 5-1 provides an overview of all possible scenario-strategy combinations. The shaded boxes indicate the assessed combinations within this paper. The selection was based on the assumption that these combinations would show the largest contrasts among strategies. Of course, other combinations would also be meaningful. They offer opportunities for further investigation outside the work of this thesis.

**Figure 5-1**

**Overview:** Possible Scenarios - Strategies Combinations

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Strategy &quot;Testing Water&quot;</th>
<th>Strategy &quot;Diving In&quot;</th>
<th>Strategy &quot;New Domestic&quot;</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Muddling Trough&quot;</td>
<td></td>
<td>Case A</td>
<td></td>
</tr>
<tr>
<td>&quot;Global Powerhouse&quot;</td>
<td>Case C</td>
<td>Case B</td>
<td>Case D</td>
</tr>
<tr>
<td>&quot;Fragmentation&quot;</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Assessment and Options # 1:** Case A -- Case B  
**Assessment and Options # 2:** Case C -- Case B -- Case D  
**Assessment and Options # 3:** Case C -- Case E
5.4 Assessment of Strategies and Discussion of Strategic Options

Assessment and Options # 1: Case A -- Case B

Case -A- : Strategy “Diving In” in Scenario “Muddling Through”

Assumptions
The domestic real estate service market grows at the rate of GDP increase (+2%, and +1.5%) and SPIM maintains a market share of 0.5% during the period. Clients became to be more price sensitive after year 3 and SPIM lowers its service price from CHF143/h to CHF 140/h. Direct service costs grow basically at the rate of GDP. These costs can be reduced after year 3 because of better productivity (+5%, and +6%), but then, additional costs (+7%) are incurred due to increased rivalry, i.e., the firm has to make more proposals and needs more time to get new assignments. Overhead expenses are 18% of revenues plus 2% of revenues for investment in quality and training, and an additional CHF140,000 for marketing.

The foreign real estate service market grows faster than the foreign GDP and SPIM increases its market share steadily from 1% to 3.5% over this period. This large market share is possible because the aggregate market size for real estate advisory services is assumed to be only about CHF30 million in year 1 (See also “Strategic Vision” in this Chapter) Clients start to be more price sensitive after year 3 and SPIM lowers its service price from CHF194/h to CHF 190/h. Direct service costs reflect staff employment of one full time staff in year 1, an additional staff assistant in year 2, two staff and one assistant in year 3, three staff and one assistant in year 4, and four staff and two assistants in year 5. Personnel costs are increased (+8%, and +4%) during the first 2 years due to unfamiliarity with the business environment, neutral in year 3, and reduced (-5%) after year 3 due to the positive effects of learning. These costs are additional to those already included of 30% higher costs of staff working abroad (e.g., expatriate staff) as compared to costs of domestic staff. Entry time is longer than projected bringing additional costs (+10%,+8%, and +4%) during the first 3 years. Other additional costs (+2%) are incurred due to increased rivalry in year 3 after which the
subsidiary needs to accelerate its efforts to get new assignments. Overhead expenses are 10% of foreign revenues plus 10% of the domestic (headquarters) overhead because of increased administrative expenses in connection with the foreign subsidiary. In year 2, additional CHF30,000 are spent for marketing. Table 5-1 summarizes the projected operations in Case -A-.

### Table 5-1  Case -A-

<table>
<thead>
<tr>
<th>figures in thousands of CHF</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>A] Domestic sales</td>
<td>4,084</td>
<td>4,166</td>
<td>4,228</td>
<td>4,370</td>
<td>4,435</td>
</tr>
<tr>
<td>B] Export or Foreign sales</td>
<td>301</td>
<td>478</td>
<td>688</td>
<td>956</td>
<td>1,445</td>
</tr>
<tr>
<td>Total revenue</td>
<td>4,385</td>
<td>4,644</td>
<td>4,917</td>
<td>5,326</td>
<td>5,880</td>
</tr>
<tr>
<td>C] Domestic direct service costs</td>
<td>2,825</td>
<td>2,882</td>
<td>2,939</td>
<td>3,047</td>
<td>3,126</td>
</tr>
<tr>
<td>D] Export or Foreign direct service costs</td>
<td>238</td>
<td>337</td>
<td>520</td>
<td>678</td>
<td>969</td>
</tr>
<tr>
<td>Total operation expenditure</td>
<td>3,063</td>
<td>3,218</td>
<td>3,459</td>
<td>3,726</td>
<td>4,095</td>
</tr>
<tr>
<td>Domestic net operating income</td>
<td>1,322</td>
<td>1,425</td>
<td>1,458</td>
<td>1,600</td>
<td>1,785</td>
</tr>
<tr>
<td>Export or Foreign net operating income</td>
<td>1,259</td>
<td>1,284</td>
<td>1,289</td>
<td>1,322</td>
<td>1,309</td>
</tr>
<tr>
<td>Total other expenses</td>
<td>1,083</td>
<td>1,148</td>
<td>1,153</td>
<td>1,222</td>
<td>1,274</td>
</tr>
<tr>
<td>Earnings before interest &amp; taxes</td>
<td>240</td>
<td>277</td>
<td>305</td>
<td>378</td>
<td>511</td>
</tr>
<tr>
<td>Total margin</td>
<td>5.5%</td>
<td>6.0%</td>
<td>6.2%</td>
<td>7.1%</td>
<td>8.7%</td>
</tr>
<tr>
<td>Domestic earnings b. interest &amp; taxes</td>
<td>302</td>
<td>311</td>
<td>303</td>
<td>298</td>
<td>282</td>
</tr>
<tr>
<td>Domestic margin contribution</td>
<td>7.4%</td>
<td>7.5%</td>
<td>7.2%</td>
<td>6.8%</td>
<td>6.4%</td>
</tr>
<tr>
<td>Export or Foreign earnings b. int. &amp; taxes</td>
<td>-53</td>
<td>-34</td>
<td>1</td>
<td>80</td>
<td>229</td>
</tr>
<tr>
<td>Export or Foreign margin contribution</td>
<td>-20.8%</td>
<td>-7.1%</td>
<td>0.2%</td>
<td>8.3%</td>
<td>15.8%</td>
</tr>
</tbody>
</table>

**Discussion of Results**

The margins of the domestic business deteriorate steadily after an initial slight increase in year 2. This is partly due to an increased price sensitivity by the clients starting in year 4, when SPIM has to lower its service price to stay competitive. Another reason is the over proportional increase of the direct service cost relative to revenues. Although

1 Formulas (for detailed identification see Table 4-3): [A] (5600000) * (+1.02y1,2;+1.015y3,4,5) * (.005* 1y1,2,3;1.04y4,5,*143y1,2,3;140y4,5). [C] (2825y1;C1;+1.02y2,3,4,5, +1y1,2,3;95y4; .94y5) * (1y1,2,3,1.07y4,5). [E] (A1-5*.18) + (A1-5*.02) + (A4y1,2,3,5; 150y4). [B] (155000) * (1* +1.06y2;+1.08y3,4,5) * (.01y1;015y2,02y3;025y4;035y5,*1y1,2,3;1.05y4,5,*194y1,2,3; 190y4,5). [D] (200y1;300y2;500y3;700y4;1000y5,+1.06y1;1.08y2;1y3;95y4,5) * (1.1y1;1.06y2; 1.04y3;1y4,5,*1y1,2,3;1.02y4,5). [F] (B1-5*.1) + (E1-5*.1) + (30y2).
productivity because of earlier investments made in R & D (Training and quality), considerably increases after year 3, the simultaneous increase in rivalry among competitors which results in increased expenses, more than offsets the gained advantage. Also, overhead expenses remain at a high level due to continuous high spending on marketing. The steady decrease in margins clearly shows that the service products offered do not provide the necessary value to clients. Another interpretation may lead to the conclusion that the increase in efficiency is not enough to face competitors with a better cost structure.

The foreign operations break-even in year 3 after an unprofitable start-up phase of 2 years. Considering the “muddling-through” scenario, this is a quite optimistic projection. In year 5, foreign operations finally reach the target margins of 15%. The profitability is primarily determined by the capacity utilization of the staff employed. This can best be seen in the starting year, when staff capacity cannot be ideally allocated because of the unfavorable volume of the first assignment. The following years, staff utilization is better managed by assigning staff from headquarters part-time to the foreign office. An ideal level of business would be annual assignments of about CHF350,000 per senior staff member. The fast build-up of market share reflects SPIM’s gained reputation as well as the increasing demand for high quality real estate advisory services. Spending CHF30,000 for marketing in year 2 may be sufficient to introduce the firm to the new market place, provided that the right “word of mouth” effect is instituted early.

The overall picture looks fair and clearly shows the contribution of the foreign operations to increasing margins of the whole company. Also, a quarter of total revenue in year 5 is generated through the foreign subsidiary. This means that the firm at that time is on its way to diversifying in the sense of risk management contributions of the foreign venture to economic exposure and distribution of core activities of the whole firm. The level of business of CHF1.5 million p.a. allows the foreign subsidiary to have a permanent presence of four senior staff on site, a good basis for efficient future operations and growth. The still dominant and for the foreign venture important (R & D activities) domestic business, however, needs to improve its cost structure or to redesign its relationships to clients to reach a healthy margin level of 10%.
Case -B- : Strategy “Diving In” in Scenario “Global Powerhouse”

Assumptions
The domestic real estate service market grows at the rate of GDP increase (+2%, and +3% in year 5) and SPIM maintains a market share of 0.5% over the period. Clients remain price insensitive and SPIM increases its service price from CHF143/h to CHF 150/h in year 5. Direct service costs grow basically at the rate of GDP. These costs can be reduced after year 3 due to better productivity (+5%, and +6%), but then, additional costs (+5%, and +9% in year 5) are incurred due to increased rivalry, i.e., the firm has to make more proposals and needs more time in order to get new assignments. Overhead expenses remain at 18% of revenues plus 2% of revenues for investments in quality and training which are increased to 3% in year 4 and 5 in order to increase efficiency. Annual marketing expenses are increased from CHF140,000 during year 1 to 3 to CHF150,000 in years 4 and 5 in reaction to increased competition.

The foreign real estate service market grows faster than the foreign GDP and SPIM increases its market share steadily from 1% to 4% over the period. This strong increase in market share is possible because the aggregate market size for real estate advisory services is assumed to be only about CHF30 million in year 1. In addition, the dynamic demand for specialized real estate advisory services facilitates a fast revenue build-up. Price sensitivity for these kinds of services remain unchanged over the period. SPIM’s service price increases in terms of Swiss francs, however, not in terms of local currency from CHF194/h in years 1 to 3 to CHF202/h, and CHF205/h in subsequent years. This action is taken because the foreign currency appreciates relative to SPIM’s home currency. Direct service costs reflect staff employment of one staff in year 1, one staff and one assistant in year 2, two staff and one assistant in year 3, four staff and one assistant in year 4, and five staff and two assistants in year 5. Personnel costs are increased (+8%, and +4%) during the first 2 years due to unfamiliarity with the business environment, neutral in year 3, and reduced (-5%) after year 3 due to the positive effects of learning. These costs are additional to the already included 30% higher costs of staff working abroad (e.g., expatriate staff) as compared to costs of domestic staff. Entry time is longer than projected bringing additional costs (+10%,+8%, and +4%) during the
first 3 years. Other additional costs (+2%, and +3%) would be incurred due to increased rivalry in year 3 after which the subsidiary needs to increase its effort to get new assignments. Overhead expenses are 10% of foreign revenues plus 10% of the domestic (headquarters) overhead because of increased administrative expenses in connection with the foreign subsidiary. In year 2, additional CHF30,000 are spent for marketing. Table 5-2 summarizes the projected operations of Case -B-

Table 5-2 Case -B-

<table>
<thead>
<tr>
<th>figures in thousands of CHF</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SUMMARY OF PROJECTED OPERATIONS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A] Domestic sales</td>
<td>4,084</td>
<td>4,166</td>
<td>4,249</td>
<td>4,334</td>
<td>4,683</td>
</tr>
<tr>
<td>B] Export or Foreign sales</td>
<td>301</td>
<td>483</td>
<td>708</td>
<td>1,216</td>
<td>1,810</td>
</tr>
<tr>
<td><strong>Total revenue</strong></td>
<td>4,385</td>
<td>4,648</td>
<td>4,957</td>
<td>5,550</td>
<td>6,493</td>
</tr>
<tr>
<td>C] Domestic direct service costs</td>
<td>2,825</td>
<td>2,882</td>
<td>2,939</td>
<td>2,990</td>
<td>3,156</td>
</tr>
<tr>
<td>D] Export or Foreign direct service costs</td>
<td>238</td>
<td>337</td>
<td>530</td>
<td>872</td>
<td>1,223</td>
</tr>
<tr>
<td><strong>Total operation expenditure</strong></td>
<td>3,063</td>
<td>3,218</td>
<td>3,470</td>
<td>3,863</td>
<td>4,379</td>
</tr>
<tr>
<td>E] Domestic net operating income</td>
<td>1,322</td>
<td>1,430</td>
<td>1,487</td>
<td>1,688</td>
<td>2,114</td>
</tr>
<tr>
<td>F] Export or Foreign net operating income</td>
<td>1,259</td>
<td>1,284</td>
<td>1,310</td>
<td>1,344</td>
<td>1,527</td>
</tr>
<tr>
<td>Domestic overhead expenses</td>
<td>63</td>
<td>146</td>
<td>177</td>
<td>344</td>
<td>587</td>
</tr>
<tr>
<td>Export or Foreign overhead expenses</td>
<td>957</td>
<td>973</td>
<td>990</td>
<td>1,007</td>
<td>1,143</td>
</tr>
<tr>
<td><strong>Total other expenses</strong></td>
<td>1083</td>
<td>1,149</td>
<td>1,160</td>
<td>1,229</td>
<td>1,439</td>
</tr>
<tr>
<td><strong>Earnings before interest &amp; taxes</strong></td>
<td>240</td>
<td>281</td>
<td>328</td>
<td>459</td>
<td>675</td>
</tr>
<tr>
<td><strong>Total margin</strong></td>
<td>5.5%</td>
<td>6.0%</td>
<td>6.6%</td>
<td>8.3%</td>
<td>10.4%</td>
</tr>
<tr>
<td>Domestic earnings b. interest &amp; taxes</td>
<td>302</td>
<td>311</td>
<td>320</td>
<td>337</td>
<td>383</td>
</tr>
<tr>
<td>Domestic margin contribution</td>
<td>7.4%</td>
<td>7.5%</td>
<td>7.5%</td>
<td>7.8%</td>
<td>8.2%</td>
</tr>
<tr>
<td>Export or Foreign earnings b. int. &amp; taxes</td>
<td>-63</td>
<td>-30</td>
<td>8</td>
<td>122</td>
<td>292</td>
</tr>
<tr>
<td>Export or Foreign margin contribution</td>
<td>-20.8%</td>
<td>-6.2%</td>
<td>1.1%</td>
<td>10.0%</td>
<td>16.1%</td>
</tr>
</tbody>
</table>

Discussion of Results
The margins of the domestic business remain more or less stable with a slight increase in year 5. The success of the EU also stimulates growth in Switzerland. Clients ask for high quality real estate services and SPIM’s reputation allows the firm to increase its

---

1. Formulas (for detailed identification see Table 4-3): [A] \((5600000) \times (+1.02y1-4;+1.03y5)\) * (.005* 1*143y1,2,3,4;150y5). [C] \((2825y1;C1*+1.02y2,3,4;+1.03y5, *1y1,2,3;95y4; .94y5)\) * (1y1,2,3;1.05y4; 1.09y5). [E] \((A1-5+.18) + (A1-4+.02;A5+.03) + (140y1-4:160y5)\). [B] \((155000) * (1+1.07y2; +1.1y3,4,5) * (.01y1; 0.015y2; 0.02y3; 0.03y4; 0.04y5, *1y1-5;+194y1,2,3,202y4,205y5). [D] \((200y1;300y2;500y3;900y4;1250y5, *1.08y1;1.04y2;1.02y3;95y4,5) * (1.10y1;1.08y2; 1.04y3;1y4,5, * 1y1,2,3;1.02y4;1.03y5)\). [F] \((B1-5+.1) + (E1-5*.1) + (30y2)\).
service price + 5% in year 5. At the same time, SPIM starts to increase spending in marketing and also in R & D (Training and quality) in order to respond to the behavior of the competition, who then aggressively starts to attack SPIM's lead position. This results in greater direct service costs and overhead expenses that possibly have an impact on margins in subsequent years. It has to be mentioned, that a remarkable increase in productivity (up to +7% at year 5) was necessary to sustain, i.e., slightly increase the margins. The stagnating margins (they never reach the target level of 10%) may be caused by service products that cannot be effectively priced because of the small size of the average assignment. Another reason may be that clients perceive the value of the services provided as not high enough.

The foreign operations start to be profitable in year 3 after a short unprofitable start-up phase of 2 years. This fast revenue build-up is realistic, considering the “global powerhouse” scenario. In year 5, foreign operations finally achieve more than the required margin of 15%. The profitability is primarily determined by the capacity utilization of the staff employed. This can best be seen in the starting year, when staff capacity cannot be ideally allocated because of the unfavorable volume of the first assignment. An ideal level of business would be annual assignments of about CHF350,000 per senior staff member. The loss in the second year is primarily due to spending CHF30,000 for marketing. 6% of the increase in revenue over the period is due to an appreciation of the foreign currency relative to the Swiss franc. The fast build-up of market share reflects SPIM's gained reputation as well as the dynamic demand for high quality real estate advisory services. In this environment, spending CHF 30,000 on marketing in year 2 may be enough to introduce the firm to the new market, provided that the right “word of mouth” effect is instituted early.

The overall picture looks promising and clearly shows the contribution of the foreign operations to increasing margins of the whole firm in years 4 and 5. Also, almost a third of total revenue in year 5 are generated through the foreign subsidiary. This means that the firm at that time is considerably diversified and the foreign operations contribute to hedge the firm's overall economic exposure. The level of business of approximately CHF1.8 million p.a. allows the subsidiary to have a permanent presence of five senior staff on site. This can be a good basis for developing
the subsidiary toward a serious player in the new market not only for real estate advisory
services, but also for asset management and agency businesses. The domestic
business needs to maintain at least its actual profitability or better, to reach its target
level of 10%. This is also important for the long-term success of the foreign venture,
because this business benefits from synergies that result from a centralized firm
structure, where headquarters can supply efficient support services and pooled
knowledge to the subsidiary.

Assessment and Comparison of Case -A- and Case -B-
This assessment contrasts an identical strategy of entry into a foreign market by direct
investment, i.e, opening an office abroad under two different macro economic and
industry scenarios. The company’s overall performance with the foreign venture will
also be considered in the assessment. Figure 5-2 summarizes the assumptions made
for the “diving in” strategy and the prevailing conditions of each of the two scenarios,
before continuing with the actual assessment.

Figure 5-2 Assumptions for case A and case B

<table>
<thead>
<tr>
<th>Strategy “diving in”</th>
<th>Scenario “muddling through”</th>
<th>Scenario “global powerhouse”</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Greenfield investment in subsidiary CHF 200,000</td>
<td>- High valued domestic currency persists</td>
<td>- Domestic currency adapts toward ECU value</td>
</tr>
<tr>
<td>- First assignment CHF 600,000 for 3 years</td>
<td>- Domestic GDP grows + 2% p.a. yr. 1-2, + 1.5% yr. 3-5</td>
<td>- Switzerland joins EU in yr. 5</td>
</tr>
<tr>
<td>- Marketing spending CHF 30,000 in year 2</td>
<td>- Real estate service demand in CEU markets grows at + 6% p.a. yr. 1-2, + 8% yr. 3-5</td>
<td>- Domestic GDP grows + 2% p.a. yr. 1-4, + 3% yr. 5</td>
</tr>
<tr>
<td>- Mid-term strategic vision: Dominant position in target market as full service real estate firm. Serious competitor to leading firms</td>
<td>- Leading firms share 30% of real estate services in target market by yr. 5</td>
<td>- Real estate service demand in CEU markets grows at + 7% p.a. yr. 1-2, +10% yr. 3-5</td>
</tr>
<tr>
<td></td>
<td>- Increased competition after yr. 3</td>
<td>- Leading firms share 40% of real estate services in target market by yr. 5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Very strong rivalry after yr. 3</td>
</tr>
</tbody>
</table>

Root (1994) suggested three kinds of comparative analyses to make to use to decide
the best entry mode: Profit contribution, risk, and nonprofit objectives. For the purpose
of this assessment, the profit contribution comparison is emphasized. Table 5-6
illustrates the estimated profit contributions of the “diving in” strategy under each
scenario.
Table 5-6 Investments and estimated Profit Contributions

<table>
<thead>
<tr>
<th>(INVESTMENTS) AND ESTIMATED PROFIT CONTRIBUTIONS</th>
<th>Year 0</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Cumulative</th>
</tr>
</thead>
<tbody>
<tr>
<td>[A] ST: Diving In; SC: Muddling Through</td>
<td>(200)</td>
<td>(58)</td>
<td>(29)</td>
<td>1</td>
<td>58</td>
<td>156</td>
<td>(72)</td>
</tr>
<tr>
<td>[B] ST: Diving In; SC: Global Powerhouse</td>
<td>(200)</td>
<td>(58)</td>
<td>(26)</td>
<td>6</td>
<td>89</td>
<td>199</td>
<td>10</td>
</tr>
</tbody>
</table>

The above table clearly shows that opening an office in the new foreign market to start doing business abroad is only successful under the optimistic “global powerhouse” scenario. In the unstable business environment of the “muddling through” scenario, a high negative net present value over the 5 year period results. Under the unpredictable scenario it would therefore be too early to “dive in”. The risks, such as the market and political risks as well as nonprofit objectives, such as growth, control, reversibility of the venture, and establishment of reputation are identical in both cases. Under both scenarios, the “diving in” strategy contributes considerably to an increase in profit margins of the whole firm. It would therefore clearly be wrong not to seek foreign business. The up-front investment with the resulting negative net present value under the unstable scenario could be justified when taking into account the possible benefits gained by being an early entrant in order to avoid “costs of lost opportunity”. Early local presence in the foreign market under the optimistic scenario would bring the most benefit for the whole firm. However, it has to be remarked that the results are based on expected revenues and costs. Also, only considering the optimistic scenario is too risky. The above assessment and comparison therefore call for strategic alternatives to reduce risks while still maintaining the most important opportunities.
Strategic Options

**Case -A- : Domestic Business**

- One option is to continue the drive for higher quality and for innovative services until a very significant leadership is achieved. This leadership would give SPIM greater pricing flexibility for holding marketshare with eventually somewhat higher prices. However, a substantial margin above the quality provided by the competition is necessary to be recognized by the market. Pursuing this option would mean to increase the amount of investments of 2% of revenues p.a. in quality and development of new service products. A reduction in marketing spending could help to finance these investments. However, the quality increase has to be perceived as such on the market and SPIM has therefore to be very careful in cutting marketing expenses. It has also to be mentioned that this option would imply a long lead-time and therefore include larger investments.

- Another option is to increase efficiency, i.e., to reduce costs. This could be achieved by investing more into training programs and eventually at the same time by downsizing. Downsizing, however, is problematic because it usually, at least temporarily, adversely impacts productivity. A major risk is to overestimate the expected growth in productivity and cut staff too much. SPIM would have to be careful in pursuing this option because it may result in insufficient service capacity together with an erosion in quality.

Pursuing both options at the same time is not recomended because self-defeating staff dynamics might result and thus make the efforts ineffective.
Case -A- : International Business ("Diving in")

- The most obvious option is to start with exporting services, i.e., following the “testing the water” strategy. Taking into account the unpredictable business environment, it would be unwise for SPIM to make the first entry without prior penetration of the target market through exports. This option would facilitate pursuing opportunities in different markets (or, niche-markets). A "cherry-picking" strategy may be opportune in the first stage. The biggest advantage of this option is that it can be enhanced with different alternatives.

- One alternative would be to look for a partnership with a renowned firm in a complementary industry such as advertising or architecture. Such a coordinated strategy with a marketing partner abroad could be very effective and would not require large investments.

- Another alternative would be to hire local individuals who would represent the firm's interests and exclusively promote SPIM’s name in a promising marketplace. This would provide a strong advantage over, for instance, seeking alliances because it creates from the beginning a single “brand-name” which is not the case in alliances where different names appear without a specific identity. Hiring a local individual on a commission basis does not require up-front investments. In addition, providing incentives for the representative could have a “turbo-charger” effect that results in a faster introduction of the firm in the new market without having local presence.

- Another option would be to postpone the entry into the foreign market. This, however, is not recommended because the results have shown that it takes time until any foreign venture becomes profitable. Therefore, an entry as early as possible, even on a small scale would at least yield experience in doing international business.
Case -B- : Domestic Business
For domestic business opportunities in scenario “global powerhouse”, please see assessment and options #2.

Case -B- : International Business (“Diving in”)
The question in this prosperous business environment is how better to take advantage of the presented growth opportunities without taking too many risks. The following options can be considered:

- One option would be to acquire a foreign real estate service company rather than found a new firm. One advantage would be a faster start. Also, such an entry can provide pre-existing relationships with clients and the expertise of existing personnel familiar with local market conditions. However, difficulties of integrating the acquisition into the parent system because of different corporate cultures, organizational structures, and business approaches may result. This may ultimately lead to poor performance and the subsequent failure of the acquired subsidiary.

- Another option is a joint-venture entry, i.e., sharing the ownership of the local firm in the target country with local private interests. Management tasks can be assigned to local partners who are better qualified to manage local relationships with buyers, related industries, and government. Maintaining control over critical know-how would be important in this case. However, joint-ventures may be troubled not only by cultural differences, but also by difficulties in sharing proprietary assets such as special databases or newly developed marketing tools.

- By pursuing the strategy of a wholly owned “greenfield investment,” SPIM could position itself early as a full-service real estate firm and take advantage of synergies that would result from performing other services such as property management or brokerage. This strategy would facilitate the way to become a principal in this new emerging market. Since SPIM possesses financial resources to take equity position, property acquisition for its own interests would clearly leverage the risk-return situation of the foreign venture.
Assessment and Options # 2: Case C -- Case B --Case D

Case -C- : Strategy “Testing the Water” in Scenario “Global Powerhouse”

Assumptions

In this case, the projections for the domestic real estate service market remain unchanged, i.e., they are the same as in case -B-. For reference, please see description case -B- [Strategy “diving in” in scenario “global powerhouse”].

The foreign real estate service market grows faster than foreign GDP and by exporting its services, SPIM can double its market share from 1% to 2% over the five year period. This increase in market share is possible because the aggregate market size for real estate advisory services is with approximately CHF30 million in year 1 not very large. In addition, the dynamic demand for specialized real estate advisory services facilitates steady revenue accumulation. Price sensitivity for these kinds of services remains unchanged over the period. SPIM’s service price increases in terms of Swiss francs, however, not in terms of local currency, from CHF194/h in years 1 to 3, to CHF202/h, and CHF205/h in subsequent years because the foreign currency appreciates relative to SPIM’s home currency. Direct service costs reflect staff employment of one staff working 80% of the time on foreign assignments in year 1, and then one full time staff and one assistant in year 2, one staff and two assistants in year 3, two staff and one assistant in year 4, and two staff and two assistants in year 5. Personnel costs are increased (+8%, and +4%) during the first 2 years due to unfamiliarity with the business environment, neutral in year 3, and reduced (-5%) after year 3 because of the positive effects of learning. It has to be mentioned, that these costs are additional to those already included of 30% higher costs of staff doing foreign assignments (e.g., higher salaried people, travel expenses) as compared to costs of domestic staff. Entry time is longer than projected bringing additional costs (+10%,+8%, and +4%) during the first 3 years. Other additional costs (+2%, and +3%) are incurred due to increased rivalry in year 3 after which the foreign “task-force” needs to work harder to get new assignments.
Overhead expenses are 10% of foreign revenues plus 8% of the domestic
(headquarters) overhead because of increased administrative expenses in connection
with foreign business activities. In the first year, an additional CHF50,000 is spent for
marketing. Table 5-3 summarizes the projected operations of Case -C-.

Table 5-3  Case -C-

<table>
<thead>
<tr>
<th>figures in thousands of CHF</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SUMMARY OF PROJECTED OPERATIONS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>A</strong> Domestic sales</td>
<td>4,084</td>
<td>4,166</td>
<td>4,249</td>
<td>4,334</td>
<td>4,683</td>
</tr>
<tr>
<td><strong>B</strong> Export or Foreign sales</td>
<td>301</td>
<td>402</td>
<td>531</td>
<td>709</td>
<td>905</td>
</tr>
<tr>
<td><strong>Total revenue</strong></td>
<td>4,385</td>
<td>4,568</td>
<td>4,780</td>
<td>5,043</td>
<td>5,588</td>
</tr>
<tr>
<td><strong>C</strong> Domestic direct service costs</td>
<td>2,825</td>
<td>2,882</td>
<td>2,939</td>
<td>2,990</td>
<td>3,156</td>
</tr>
<tr>
<td><strong>D</strong> Export or Foreign direct service costs</td>
<td>202</td>
<td>303</td>
<td>398</td>
<td>494</td>
<td>587</td>
</tr>
<tr>
<td><strong>Total operation expenditure</strong></td>
<td>3,027</td>
<td>3,185</td>
<td>3,337</td>
<td>3,485</td>
<td>3,743</td>
</tr>
<tr>
<td><strong>Total net operating income</strong></td>
<td>1,358</td>
<td>1,383</td>
<td>1,443</td>
<td>1,559</td>
<td>1,845</td>
</tr>
<tr>
<td><strong>Domestic net operating income</strong></td>
<td>1,259</td>
<td>1,284</td>
<td>1,310</td>
<td>1,344</td>
<td>1,527</td>
</tr>
<tr>
<td><strong>Export or Foreign net operating income</strong></td>
<td>99</td>
<td>99</td>
<td>133</td>
<td>215</td>
<td>318</td>
</tr>
<tr>
<td><strong>Total overhead expenses</strong></td>
<td>957</td>
<td>973</td>
<td>990</td>
<td>1,007</td>
<td>1,143</td>
</tr>
<tr>
<td><strong>Total other expenses</strong></td>
<td>157</td>
<td>118</td>
<td>132</td>
<td>151</td>
<td>182</td>
</tr>
<tr>
<td><strong>Total other expenses</strong></td>
<td>1,113</td>
<td>1,091</td>
<td>1,122</td>
<td>1,158</td>
<td>1,325</td>
</tr>
<tr>
<td><strong>Earnings before interest &amp; taxes</strong></td>
<td>244</td>
<td>292</td>
<td>321</td>
<td>401</td>
<td>519</td>
</tr>
<tr>
<td><strong>Total margin</strong></td>
<td>5.6%</td>
<td>6.4%</td>
<td>6.7%</td>
<td>7.9%</td>
<td>9.3%</td>
</tr>
<tr>
<td><strong>Domestic earnings b. interest &amp; taxes</strong></td>
<td>302</td>
<td>311</td>
<td>320</td>
<td>337</td>
<td>383</td>
</tr>
<tr>
<td><strong>Domestic margin contribution</strong></td>
<td>7.4%</td>
<td>7.5%</td>
<td>7.5%</td>
<td>7.8%</td>
<td>8.2%</td>
</tr>
<tr>
<td><strong>Export or Foreign earnings b. int. &amp; taxes</strong></td>
<td>-58</td>
<td>-19</td>
<td>1</td>
<td>64</td>
<td>136</td>
</tr>
<tr>
<td><strong>Export or Foreign margin contribution</strong></td>
<td>-19.2%</td>
<td>-4.6%</td>
<td>0.2%</td>
<td>9.0%</td>
<td>15.0%</td>
</tr>
</tbody>
</table>

Discussion of Results

The results of the domestic business are the same as in case -B-. For reference,
please see description case -B- [Strategy "diving in" in scenario "global powerhouse"].

---

1 Formulas (for detailed identification see Table 4-3): [A] (5600000) * (+1.02y1-4;+1.03y5) * (.005+ 1*143y1,2,3,4;150y5). [C] (2825y1;C1++1.02y2,3,4;+1.03y5, *1y1,2,3,.95y4; .94y5) * (1y1,2,3; 1.05y4; 1.09y5). [E] (A1-5*.18) + (A1-4+.02;A5+.03) + (140y1-4;160y5). [B] (155000) * (1+1.07y2; 1.03y4,5) * (.01y1;0125y2;015y3;0175y4;02y5,*1y1-5; *194y1,2,3;202y4;205y5). [D] (170y1;270y2;375y3;510y4;600y5,1.08y1;1.04y2;1.02y3,.95y4,5) * (1.10y1;1.08y2; 1.04y3,1y4,5, * 1y1,2,3;1.02y4;1.03y5). [F] (B1-5*.1) + (E1-5*.08) + (50y1).
The foreign operations break-even in year 3 after a short unprofitable start-up phase of 2 years. The loss in the first year is partially due to CHF50,000 spent on marketing. Moreover, 6% of the increase in revenue over the period is due to an appreciation of foreign currency relative to the Swiss franc. The revenue build-up is not very impressive, considering the “global powerhouse” scenario. The target market share of approximately 5%, or one that is within reach of major competitors is not achieved (only 2% at year 5). This might be attributable to lack of local presence, i.e., client’s perception of the firm as foreign. However, the business finally achieves the required margins of 15% at year 5. The profitability is primarily determined by the capacity utilization of the staff employed. By exporting services from the home base, staff capacity, to a certain degree, can be allocated to assignments according to their volume. An ideal level of business would be annual assignments of about CHF350,000 per senior staff member. By providing services from the home base, the CHF50,000 spent on marketing during the first year is eventually not enough to introduce the firm to the new market. Doing business on a bigger scale would eventually institute the right “word of mouth” effect earlier. The steady build-up of market share, however, reflects SPIM’s gain in reputation as well as a dynamic demand for high quality real estate advisory services.

The overall picture looks good and clearly shows the contribution of the foreign operations to a slight increase in margins of the whole firm in year 4 and a remarkable increase in year 5. About 15% of total revenues in year 5 are generated through foreign business. Considering the small investment of CHF50,000, this can be seen as a valid success. The foreign business level of approximately CHF1 million in revenues p.a. allows SPIM to employ two senior staff members and two assistants for this task. Regarding the the high profitability, the share of foreign business should be increased to a level that would take immediate advantage of the experience and reputation gained. The domestic business needs to maintain at least the actual profitability or better, to reach the target level of 10%. This is, of course, also important for the longer-term success of the foreign venture, considering that competitiveness abroad can only be maintained if headquarters provides a “healthy” base.
Case -B- : Strategy “Diving In” in Scenario “Global Powerhouse”
Description: Please see assessment and options #1.

Case -D- : Strategy “New Domestic” in Scenario “Global Powerhouse”
This alternative strategy assumes that SPIM invests in a new domestic service product market instead of looking for business opportunities abroad. The “global powerhouse” scenario assumes that national and even regional industrial companies increasingly start to outsource real estate functions. It is assumed, that this creates an initial annual market size of approximately CHF10 million for real estate advisory service fees. The strategy aims at getting assignments from industrial corporations for comprehensive real estate advisory services. SPIM invests CHF50,000 for costs within the context of business plan elaboration and offering proposals during the start-up phase. Another CHF50,000 are planned to be spent on marketing during the first 2 years. The purpose of this aggressive market entry is to give the company a dominant position in this market segment within 5 years.

Assumptions

In this case, the projections for the ordinary domestic real estate service market remain unchanged, i.e., they are the same as in case -B-. For reference, please see description case -B- [Strategy “diving in” in scenario “global powerhouse”].

The “new domestic” real estate service market grows faster than the domestic GDP. Whereas GDP grows at 2% and 3%, the demand for corporate real estate services grow additionally +2% during the first 3 years and +1% during subsequent years. SPIM increases its market share from 2% in the first year to 6% in years 4 and 5. This steep increase in market share is possible because the firm has a strong reputation in the national market and the aggregate market size for these services is only about CHF10 million in year 1. Price sensitivity for this kind of services remains low as clients demand primarily high quality consulting services and service price plays a minor part. SPIM can rise its service price from CHF143/h in years 1 and 2, to CHF152/h, CHF155/h, and
CHF 158/h in subsequent years. This is a 10% increase in price over this period. Direct service costs are 70% of revenues. This percentage is identical to the domestic direct service costs relative to revenues. These costs can be reduced after year 3 due to better productivity (+5%, and +7%), but then, additional costs (+1%, and +2%) are incurred due to increased rivalry, i.e., the firm has spent more time to get new assignments. To account for the time of becoming familiar with the new clientele, the direct service costs are increased in years 1 to 3 (+8%, +5%, and +2%). Overhead expenses are 18% of revenues plus 3% of the overhead expenses of the headquarters in order to account for R & D expenses related to the new business as well as for investment in quality and training. Additional CHF 30,000 in year 1 and CHF 20,000 in year 2 are spent for marketing. Table 5-4 summarizes the projected operations of Case -D-.  

---

1 Formulas (for detailed identification see Table 4-3):  

[A] (5600000) * (+1.02y1-4;+1.03y5) * (.05* 1*143y1,2,3,4;150y5).  

[C] (2825y1+C1++1.02y2,3,4;+1.03y5, +1y1,2,3;95y4; .94y5) * (1y1,2,3; 1.05y4; 1.09y5).  


[B] (70000) * (1y1; +1.02y2-4;+1.03y5,* 1y1:+1.02y2,3;+1.01y4,5) * (.02y1; .03y2; .04y3; .06y4,5,*1y1,2; .95y3-5,*143y1,2;152y3;155y4;158y5).  

[D] (B1-5 *.7) *(1y1-3; .95y4; .93y5) * (1.08y1;1.05y2;1.02y3; 1y4,5,*1y1-3;1.01y4;1.02y5).  

[F] (B1-5*.18) + (E1-5*.03) + (30y1;20y2).
Table 5-4  Case -D-

<table>
<thead>
<tr>
<th>Figures in thousands of CHF</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SUMMARY OF PROJECTED OPERATIONS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A] Domestic sales</td>
<td>4,084</td>
<td>4,166</td>
<td>4,249</td>
<td>4,334</td>
<td>4,683</td>
</tr>
<tr>
<td>B] New Domestic sales</td>
<td>200</td>
<td>312</td>
<td>438</td>
<td>690</td>
<td>731</td>
</tr>
<tr>
<td>Total revenue</td>
<td>4,284</td>
<td>4,478</td>
<td>4,687</td>
<td>5,024</td>
<td>5,414</td>
</tr>
<tr>
<td>C] Domestic direct service costs</td>
<td>2,825</td>
<td>2,882</td>
<td>2,939</td>
<td>2,990</td>
<td>3,156</td>
</tr>
<tr>
<td>D] New Domestic direct service costs</td>
<td>151</td>
<td>230</td>
<td>312</td>
<td>463</td>
<td>486</td>
</tr>
<tr>
<td>Total operation expenditure</td>
<td>2,976</td>
<td>3,111</td>
<td>3,252</td>
<td>3,454</td>
<td>3,642</td>
</tr>
<tr>
<td>Total net operating income</td>
<td>1,308</td>
<td>1,367</td>
<td>1,435</td>
<td>1,570</td>
<td>1,772</td>
</tr>
<tr>
<td>Domestic net operating income</td>
<td>1,259</td>
<td>1,284</td>
<td>1,310</td>
<td>1,344</td>
<td>1,527</td>
</tr>
<tr>
<td>New Domestic net operating income</td>
<td>49</td>
<td>83</td>
<td>125</td>
<td>226</td>
<td>246</td>
</tr>
<tr>
<td>Total other expenses</td>
<td>957</td>
<td>973</td>
<td>990</td>
<td>1,007</td>
<td>1,143</td>
</tr>
<tr>
<td>New Domestic overhead expenses</td>
<td>95</td>
<td>105</td>
<td>108</td>
<td>154</td>
<td>166</td>
</tr>
<tr>
<td>Total other expenses</td>
<td>1,052</td>
<td>1,079</td>
<td>1,098</td>
<td>1,161</td>
<td>1,309</td>
</tr>
<tr>
<td><strong>Earnings before interest &amp; taxes</strong></td>
<td>256</td>
<td>288</td>
<td>337</td>
<td>409</td>
<td>463</td>
</tr>
<tr>
<td>Total margin</td>
<td>6.0%</td>
<td>6.4%</td>
<td>7.2%</td>
<td>8.1%</td>
<td>8.6%</td>
</tr>
<tr>
<td>Domestic earnings b. interest &amp; taxes</td>
<td>302</td>
<td>311</td>
<td>320</td>
<td>337</td>
<td>383</td>
</tr>
<tr>
<td>Domestic margin contribution</td>
<td>7.4%</td>
<td>7.5%</td>
<td>7.5%</td>
<td>7.8%</td>
<td>8.2%</td>
</tr>
<tr>
<td>New Domestic earnings b. int. &amp; taxes</td>
<td>-46</td>
<td>-23</td>
<td>17</td>
<td>72</td>
<td>80</td>
</tr>
<tr>
<td>New Domestic margin contribution</td>
<td>-22.9%</td>
<td>-7.2%</td>
<td>3.8%</td>
<td>10.5%</td>
<td>10.9%</td>
</tr>
</tbody>
</table>

Discussion of Results

The results of the domestic business are the same as in case -B-. For reference, please see description under case -B- [Strategy “diving in” in scenario “global powerhouse”].

The new domestic operations become profitable in year 3. This, after a start-up phase of 2 years during which losses, primarily due to heavy spending on marketing, occurred. The revenue build-up is impressive. However, the market share expansion is stopped in year 4 because of increased rivalry in the market place. Other renowned firms have also discovered this business and its relatively high margins. The new domestic business achieves margins slightly over the target level of 10% and clearly contributes to the increase in the firm’s overall margins. The increase in margins also shows that the new services provide the necessary value to the clients. Another interpretation may lead to the conclusion that the remarkable increase in efficiency of +7% during the last 2 years may be the reason for this success.
The firm’s overall margins are, with 8.6%, still well below the required 10% because the new higher margin business represents only 14% of the firm’s total revenues and therefore does not provide the necessary boost. However, taking into account the small investment of CHF50,000, the success of the new domestic business is quite remarkable and shows, what service product differentiation can yield, provided the right clients are targeted. The main domestic business needs to improve its cost structure or to redesign its relationship to clients to reach a margin of 10% as well.

**Assessment and Comparison of Case -C-, Case -B-, and Case -D-**

This assessment contrasts two different strategies of entry into a foreign market and one strategy that focuses exclusively on the home market under the same macro-economic and industry scenario. Figure 5-3 summarizes the assumptions made for the “diving in”, the “testing the water”, and the “new domestic” strategy and the prevailing conditions under the scenario “global powerhouse” before continuing with the actual assessment.

**Figure 5-3 Assumptions for case C, case B, and case D**

<table>
<thead>
<tr>
<th>Scenario “global powerhouse”</th>
<th>Strategy “diving in”</th>
<th>Strategy “testing the waters”</th>
<th>Alternative strategy “new domestic”</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Domestic currency adapts toward ECU value; - Switzerland joins the EU in year 5; - Domestic GDP grows at + 2% p.a. yr. 1-4, + 3% yr. 5; - Real estate service demand in CEU markets grow at + 7% p.a. yr. 1-2, + 10% yr. 3-5; - Leading firms share 40% of real estate services in target market by yr. 5; - Strong rivalry after yr. 3</td>
<td>- Greenfield investment in subsidiary CHF 200,000 - First assignment CHF 600,000 for 3 years - Marketing spending CHF 30,000 in year 2 - Mid-term strategic vision: Dominant position in target market as full service real estate firm. Serious competitor to leading firms</td>
<td>- Start-up allocation of resources CHF50,000 - First assignment CHF600,000 for 3 years - Marketing spending CHF50,000 in yr. 2 - Mid-term strategic vision: 5-10% market-share for advisory services in the target market, i.e., in the range of major competitors.</td>
<td>- Start-up allocation of resources CHF50,000 - New domestic market for real estate services grows at + 4% p.a. yr. 1-3, + 3% yr. 4, + 4% yr. 5 - Market-share increases to 6% in yr. 5 - Increased rivalry after yr. 3 - Marketing spending CHF30,000 yr. 1, CHF20,000 yr. 2 - Mid-term strategic vision: Dominant player in targeted market segment</td>
</tr>
</tbody>
</table>
Following the framework from assessment and options #1, Table 5-7 illustrates the estimated profit contributions under each strategy.

Table 5-7 Investments and estimated Profit Contributions

<table>
<thead>
<tr>
<th></th>
<th>Year 0</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Cumulative</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ST: Diving In; SC: Global Powerhouse</strong></td>
<td>(200)</td>
<td>(58)</td>
<td>(26)</td>
<td>6</td>
<td>89</td>
<td>199</td>
<td>10</td>
</tr>
<tr>
<td><strong>ST: Testing Water; SC: Global Powerhouse</strong></td>
<td>(50)</td>
<td>(54)</td>
<td>(16)</td>
<td>1</td>
<td>47</td>
<td>93</td>
<td>20</td>
</tr>
<tr>
<td><strong>ST: New Domestic; SC: Global Powerhouse</strong></td>
<td>(50)</td>
<td>(42)</td>
<td>(19)</td>
<td>13</td>
<td>53</td>
<td>54</td>
<td>9</td>
</tr>
</tbody>
</table>

The above table shows positive results for all strategies. The results, that favor the “testing the water” strategy may be misleading because they do not reflect the contribution of this strategy to the whole firm. “Diving in” clearly contributes the most toward boosting SPIM’s overall margins that reach more than the desired 10%. Taking into account the different risk profiles of each strategy, one could easily favor the “testing the water” strategy, that yields the largest net present value with the lowest investment. The “new domestic” strategy also produces a positive result, and this, in the “risk-free” domestic market but without the growth opportunities of the emerging foreign markets. Also, this strategy cannot boost the firm’s overall margin to the desired 10% because of its small share of only 14% of the firm’s entire revenues. The above situation, in which all strategies succeed raises the question of how this scenario can be better exploited. Some of the following options will improve the above strategies or will direct toward a mix of strategies and options.
Strategic Options

Case -B- : International Business ("Diving in")
For “diving in” strategy options in scenario “global powerhouse”, please see assessment and options #1.

Case -C- : International Business ("Testing the water")
Although the “diving in” strategy provides the best overall results, SPIM might decide to first pursue a low risk strategy by exporting services. For the time being, the firm could carefully monitor the real estate market cycle in the targeted foreign country and decide to “dive in” when the cycle is either on an ending downturn or at the beginning of an upswing. The following options present variations of this strategy.

- One option is to concentrate more on promising client segments such as foreign governments or national pension funds with intentions to invest abroad than focusing on geographic areas. In the “European powerhouse” one has to stay flexible exploit opportunities not only in emerging markets, but also in mature markets. There, lucrative market-niches such as consulting and management services for re-development of former industrial sites might offer opportunities to get assignments. A disadvantage, especially in the start-up phase, might be the lack of credibility by the market, i.e., clients may be suspicious of firms that do not have a local presence.

- Another option is to put more effort and investment into aggressively marketing the company to selected client segments abroad. Direct marketing by building up personal contacts instead of direct foreign investments into office infrastructure may present a suitable alternative. It would be very helpful, if SPIM is well known in a marketplace that would bring synergies after Switzerland joins the EU in the fourth year. However, a disadvantage with this option may be the difficulty of estimating the true cost -- benefit relation. In addition, it has to be mentioned that the most valuable marketing tool, the “word of mouth effect” only occurs when high quality consulting or management work has been accomplished.
Case -D- : New Domestic Business

- One option could be to target exclusively industrial corporations that have foreign operations such as Swiss multinational enterprises or prospective internationalization candidates such as numerous medium-sized national companies. In this case, SPIM would greatly leverage its export strategy or the foreign subsidiary into getting a competitive advantage at home against purely domestic real estate service firms that cannot offer these industrial corporations representation abroad. If SPIM could gain a reputation as the foremost Swiss corporate real estate advisor, it may even lead the firm to other emerging markets in the Middle-East or Southeast Asia.

Case -D- : Domestic Business

- Not as a proper option, but rather as preparation for getting domestic business from abroad (especially once the Swiss property market would be more liberalized after having joined the EU), SPIM could seek membership in a well-organized and renowned real estate network (e.g., Colliers International, or ONCOR). This may not at first bring very much to the advisory service business. However, new assignments for the domestic agency business and new relationships with real estate service firms abroad as well as certain international real estate know-how could result. This represents a low-risk option with low barriers to exit.

Summarizing the above options under the scenario “global powerhouse” it clearly shows that SPIM may play various instruments to get the most out of this scenario. Pursuing different strategies simultaneously would make extremely good co-ordination necessary. However, pursuing too many opportunities is not recommendable because it implies allocating a lot of resources that may put constraints on the necessary flexibility for adapting the internationalization strategy.
Assessment and Options # 3: Case C -- Case E

Case -C- : Strategy “Testing the Water” in Scenario “Global Powerhouse”
Description: Please see assessment and options #2.

Case -E- : Strategy “Testing the Water” in Scenario “Fragmentation”

Assumptions
The domestic real estate service market grows at the rate of GDP increase (+2%) and SPIM maintains a market share of 0.5% during the period. Clients remain price insensitive and SPIM increases its service price from CHF143/h to CHF150/h in year 5. Direct service costs grow basically at the rate of GDP. These costs can be reduced after year 3 due to better productivity (+5%, and +6%), but then, additional costs (+6%, and +9%) are incurred due to increased rivalry, i.e., the firm has to make more proposals and needs more time to get new assignments. Overhead expenses are 18% of revenues plus 2% in year 1 to 4, and 3% in year 5 of revenues for investment in quality and training. In addition, CHF140,000 in year 1 to 4, and CHF160,000 in year 5 in reaction to increased competition are spent for marketing.

The foreign real estate service market grows faster than the foreign GDP. The service growth rate is a steady 6% p.a.. By exporting its services, SPIM can double its market share from 1% to 2% over the five year period. This increase in market share is possible because the aggregate market size for real estate advisory services is with approximately CHF30 million in year 1 not very large. In addition, the demand for high quality real estate advisory services is increasing. This facilitates revenue accumulation for firms that can provide a steady level of quality. Price sensitivity for these kinds of services remains unchanged over the period. SPIM prices its services at CHF194/h in years 1 through 5. Direct service costs reflect staff employment of one staff working 80% of the time on foreign assignments in year 1, and then one full-time staff and one assistant in year 2, one staff and two assistants in year 3, two staff in year 4, and two staff and one assistant in year 5. Personnel costs are increased (+8%, and +4%) during the first 2 years due to unfamiliarity with the business environment, neutral in year 3,
and reduced (-5%) after year 3 because of the positive effects of learning. It has to be mentioned, that these costs are additional to those already included of 30% higher costs of staff doing foreign assignments (e.g., higher salaried people, and travel expenses) as compared to costs of domestic staff. Entry time is longer than projected bringing additional costs (+10%, +8%, and +4%) during the first 3 years. Other additional costs (+2%, and +3%) are incurred due to increased rivalry in year 3 after which staff who is doing foreign business needs to put more effort to get new assignments. Overhead expenses are 10% of foreign revenues plus 8% of the domestic (headquarters) overhead because of increased administrative expenses in connection with foreign business activities. In the first year, an additional CHF50,000 are spent for marketing. Table 5-5 summarizes the projected operations of Case -E-.

Table 5-5  Case -E-

<table>
<thead>
<tr>
<th>figures in thousands of CHF</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>A] Domestic sales</td>
<td>4,084</td>
<td>4,166</td>
<td>4,249</td>
<td>4,334</td>
<td>4,637</td>
</tr>
<tr>
<td>B] Export or Foreign sales</td>
<td>301</td>
<td>398</td>
<td>507</td>
<td>627</td>
<td>759</td>
</tr>
<tr>
<td>Total revenue</td>
<td>4,385</td>
<td>4,564</td>
<td>4,756</td>
<td>4,961</td>
<td>5,396</td>
</tr>
<tr>
<td>C] Domestic direct service costs</td>
<td>2,825</td>
<td>2,882</td>
<td>2,939</td>
<td>3,019</td>
<td>3,177</td>
</tr>
<tr>
<td>D] Export or Foreign direct service costs</td>
<td>214</td>
<td>303</td>
<td>377</td>
<td>426</td>
<td>489</td>
</tr>
<tr>
<td>Total operation expenditure</td>
<td>3,039</td>
<td>3,185</td>
<td>3,316</td>
<td>3,445</td>
<td>3,666</td>
</tr>
<tr>
<td>Domestic net operating income</td>
<td>1,346</td>
<td>1,379</td>
<td>1,440</td>
<td>1,516</td>
<td>1,730</td>
</tr>
<tr>
<td>Domestic net operating income</td>
<td>1,259</td>
<td>1,284</td>
<td>1,310</td>
<td>1,315</td>
<td>1,460</td>
</tr>
<tr>
<td>Export or Foreign net operating income</td>
<td>87</td>
<td>95</td>
<td>130</td>
<td>200</td>
<td>270</td>
</tr>
<tr>
<td>Domestic overhead expenses</td>
<td>957</td>
<td>973</td>
<td>990</td>
<td>1,007</td>
<td>1,134</td>
</tr>
<tr>
<td>Export or Foreign overhead expenses</td>
<td>157</td>
<td>118</td>
<td>130</td>
<td>143</td>
<td>167</td>
</tr>
<tr>
<td>Total other expenses</td>
<td>1,133</td>
<td>1,091</td>
<td>1,120</td>
<td>1,150</td>
<td>1,300</td>
</tr>
<tr>
<td>Earnings before interest &amp; taxes</td>
<td>233</td>
<td>289</td>
<td>320</td>
<td>366</td>
<td>430</td>
</tr>
<tr>
<td>Total margin</td>
<td>5.3%</td>
<td>6.3%</td>
<td>6.7%</td>
<td>7.4%</td>
<td>8.0%</td>
</tr>
<tr>
<td>Domestic earnings b. interest &amp; taxes</td>
<td>302</td>
<td>311</td>
<td>320</td>
<td>308</td>
<td>327</td>
</tr>
<tr>
<td>Domestic margin contribution</td>
<td>7.4%</td>
<td>7.5%</td>
<td>7.5%</td>
<td>7.1%</td>
<td>7.0%</td>
</tr>
<tr>
<td>Export or Foreign earnings b. int. &amp; taxes</td>
<td>-70</td>
<td>-23</td>
<td>0</td>
<td>57</td>
<td>103</td>
</tr>
<tr>
<td>Export or Foreign margin contribution</td>
<td>-23.2%</td>
<td>-5.7%</td>
<td>0.1%</td>
<td>9.1%</td>
<td>13.6%</td>
</tr>
</tbody>
</table>

1 Formulas (for detailed identification see Table 4-3): [A] (5600000) * (+1.02y1-5 * 1) * (.005* 1+143y1-4;150y5). [C] (2825y1;C1++1.02y1-5,*1y1,2,3,.95y4; .94y5) * (1y1,2,3; 1.06y4; 1.09y5). [E] (A1-5*.18) + (A1-4*.02y1-4;03y5) + (140y1-4;160y5). [B] (155000) * (1y1-5,*1y1;+1.06y2-5) * (.01y1;0125y2;0.15y3;0175y4;02y5,*1y1-5; +194y1-5). [D] (180y1;270y2;355y3;440y4;500y5,*1.08y1;1.04y2;1.02y3;95y4,5) * (1.10y1;1.08y2; 1.04y3;1y4,5, * 1y1,2,3;1.02y4;1.03y5). [F] (B1-5*.1) + (E1-5*.08) + (50y1).
Discussion of Results

The margins of the domestic business deteriorate slightly after an initial increase in years 2 through 3. One reason is the over proportional increase after year 3 of the direct service costs relative to the increase in revenues. Although productivity, because of earlier investments made in R & D (Training and quality), considerably increases after year 3, the simultaneous increase in rivalry among competitors which results in increased expenses more than offsets the gained advantage. Also, overhead expenses remain at a high level due to continuous high spending on marketing. The decrease in margins, although not dramatical, clearly shows that the service products offered do not provide the necessary value to clients. Another interpretation may lead to the conclusion that the increase in efficiency is not enough to face competitors, especially small local firms that have a better cost structure.

The foreign operations break-even in year 3 after an unprofitable start-up phase of 2 years. Considering the “fragmentation” scenario, this is a quite optimistic projection. However, foreign operations do not reach the target margins of 15% by year 5. The profitability is primarily determined by the capacity utilization of the staff employed. This can best be seen in the starting year, when staff capacity cannot be ideally allocated because of the unfavorable volume of the first assignment. An ideal level of business would be annual assignments of about CHF350,000 per senior staff member. The steady build-up of market share reflects SPIM’s gain in reputation as well as an unbroken demand for high quality real estate advisory services. However, the relatively modest share of foreign business reflects the difficult market environment abroad where localization flourishes and local governments impose restrictions on foreign companies. The CHF50,000 spent on marketing during the first year is eventually not enough to introduce the firm to the new market. Doing business on a larger scale would institute the right “word of mouth” effect earlier.

The overall picture looks fair and clearly shows the contribution of the foreign operations to increasing margins of the entire firm. About 14% of total revenues in year 5 are generated through foreign business. Considering the small investment of CHF50,000, this can be seen as a valid success. The foreign business level of approximately CHF0.8 million in revenues p.a. allows SPIM to employ two senior staff.
members and one assistant for this task. Regarding the high profitability, the share of foreign business should be increased to a level that would take immediate advantage of the experience and reputation gained. The domestic business needs to maintain at least the actual profitability or better, to reach the target level of 10%. This is, of course, also important for the longer-term success of the foreign business, considering that continuing with foreign ventures can only be sustained if headquarters can provide a “healthy” financial base.

Assessment and Comparison of Case -C- and Case -E-

This assessment contrasts an identical strategy of entry into a foreign market by exporting a firm's services under two different macroeconomic and industry scenarios. The company's overall performance with the foreign venture will also be considered in the assessment. Figure 5-4 summarizes the assumptions made for the “testing the water” strategy and the prevailing conditions of each of the two scenarios before continuing with the actual assessment.

Figure 5-4 Assumptions for case C and case E

<table>
<thead>
<tr>
<th>Strategy “testing the water”</th>
<th>Scenario “fragmentation”</th>
<th>Scenario “global powerhouse”</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Start-up allocation of resources CHF50,000</td>
<td>- High valued domestic currency continues with higher volatility</td>
<td>- Domestic currency adapts toward ECU value</td>
</tr>
<tr>
<td>- First assignment CHF600,000 for 3 years</td>
<td>- Domestic GDP grows + 2% p.a. yr. 1-5</td>
<td>- Switzerland joins EU in yr. 5</td>
</tr>
<tr>
<td>- Marketing spending CHF50,000 in yr. 2</td>
<td>- Real estate service demand in CEU markets grows at +6% p.a. yr. 1-5</td>
<td>- Domestic GDP grows + 2% p.a. yr. 1-4, + 3% yr. 5</td>
</tr>
<tr>
<td>- Mid-term strategic vision: 5-10% market-share for advisory services in the target market, i.e., in the range of major competitors.</td>
<td>- Leading firms share 25% of real estate services in target market by yr. 5</td>
<td>- Real estate service demand in CEU markets grows at + 7% p.a. yr. 1-2, +10% yr. 3-5</td>
</tr>
<tr>
<td></td>
<td>- Increased competition after yr. 3</td>
<td>- Leading firms share 40% of real estate services in target market by yr. 5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Very strong rivalry after yr. 3</td>
</tr>
</tbody>
</table>
As mentioned before, three kinds of comparative analyses should be made to decide the right entry mode: Profit contribution, risk, and nonprofit objectives. For the purpose of this assessment, the profit contribution comparison is emphasized. Table 5-8 illustrates the estimated profit contributions of the “testing the water” strategy under each scenario.

Table 5-8 Investments and estimated Profit Contributions

<table>
<thead>
<tr>
<th></th>
<th>Year 0</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Cumulative</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(INVESTMENTS) AND ESTIMATED PROFIT CONTRIBUTIONS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(C) ST: Testing Water; SC: Global Powerhouse</td>
<td>(50)</td>
<td>(54)</td>
<td>(16)</td>
<td>1</td>
<td>47</td>
<td>93</td>
<td>20</td>
</tr>
<tr>
<td>(E) ST: Testing Water; SC: Fragmentation</td>
<td>(50)</td>
<td>(65)</td>
<td>(19)</td>
<td>0</td>
<td>42</td>
<td>70</td>
<td>21</td>
</tr>
</tbody>
</table>

The above table clearly shows how problematic it is to start by exporting real estate services into a foreign market, where localization flourishes. Under the “bad case” scenario, a high negative net present value results for the same strategy that started with the same investment. The risks, such as market and political risks as well as nonprofit objectives, such as growth, control, reversibility of the venture, and establishment of reputation are identical in both cases. It has to be mentioned, that “testing the water” in the “fragmentation” scenario still contributes to an increase in the firm’s overall margins under, however, quite optimistic projections. It can therefore be inferred that exporting one’s services without prior in-depth market research into a fragmented market environment is not recommended. Rather, a firm should look for alternative strategies for how to master this difficult business environment abroad. The following options may generate strategic alternatives.
Strategic Options

Case -C- : International Business ("Testing water")
For "testing the water" strategy options in scenario "global powerhouse" please see assessment and options #2.

Case -E- : Domestic Business
- Under this scenario, where fierce local competition to begins in year 4, SPIM should early position itself with subsidiaries of reasonable size in promising national regions. The centralized firm structure where support functions such as marketing, client databases, accounting, information, and management systems can efficiently be provided to the subsidiaries would give the firm a competitive edge over small local real estate service firms with less sophisticated services and business know-how. In addition, not only local overhead costs could be reduced, but also the high service quality standard of the firm would be conveyed to regions where clients are not used to receiving such valuable services.

Case -E- : International Business ("Testing water")
- One option would be to postpone the entry into a foreign market until research can show, in which region SPIM’s services will have the best chance for continuous demand. Assessing a region’s future political stability together with a careful monitoring of the economic dynamics would be crucial in a fragmented environment. In this kind of environment, there is a permanent danger of dispersing one’s internationalization efforts into regions that in the short-term might offer the best profit opportunities. In medium-terms, however, these regions may not continue to generate business because of political and economic problems.

- Another option, that is compatible with the recommendation given for the domestic business, is to position the firm in metropolitan regions along the border such as Geneva, Basle, or Lugano in order to penetrate multinational economic regions from within the national location, or a location abroad but within this economic region.
6. CONCLUSIONS

This thesis was undertaken to provide a framework for strategic decision-making in the area of internationalizing a real estate service firm. The multiple step approach taken was very useful for gaining insight into not only the possible dynamics that can shape the real estate service industry, but also the entrepreneurial issues that arise when a real estate service firm is considering going international. The scope of this thesis was defined by a set of questions to be answered. The insights gained are summarized below.

6.1 Insights of Strategies for Internationalization

It may be difficult to convince the shareholders of a real estate service firm that operates on its home-base still on an acceptable level of profitability, to initiate an internationalization process. In my judgement and based on the work done for this paper, an established real estate service firm that can provide advisory services which are in demand in a nearby emerging market, should start earlier rather than later to pursue international business opportunities. Success in developing an international business depends on the answers given to the questions stated at the beginning of this thesis. These questions together with the answers below summarize the insights gained.

Should one gamble the future on one scenario or should one stay flexible to exploit multiple scenarios?

The results of the assessed combinations did not show major differences in outcome under each scenario. In my opinion, the most likely scenario is “muddling through” with an unstable business environment for the next five years and then probably shift to a “global powerhouse” scenario. Therefore, SPIM should not bet exclusively on the most likely scenario, but also seriously consider the changes and opportunities that the “European powerhouse” scenario might bring in the near future.
What is the right mode to enter into the international real estate service business arena?

The assessments and options discussed clearly showed that there is no single correct mode of entry. Rather, a sequence of different strategies would be most appropriate. Considering the most likely scenario “muddling through,” starting by opening a foreign office would be premature. “Testing the water” with exporting services would instead be a more promising strategy in the first stage. Later, when more information about the foreign market is gained, the company can go a step further and establish a permanent presence. The contributions of each internationalization strategy for the whole firm depend on the respective scenario. The results showed that a ranking of the strategies by net present values is not the same as when considering the overall contribution of the foreign venture. “Diving in” under the “powerhouse” scenario clearly made the largest contributions to increasing margins of the whole firm. In this case, the pragmatic rule of choosing the entry mode that maximizes profit contributions should be changed to a rule that considers the benefits to the entire firm.

What is the international venture’s risk management contribution (i.e., hedging economic exposure and the distribution of core activities)?

The results showed, that the contribution of risk management depends more on the strategy chosen than on the scenario. The “diving in” strategy resulted in a greater percentage of revenue generated abroad than the “testing the water” strategy because a faster revenue build-up was reasonably assumed. Also, the distribution of core activities would be increased with the “diving in” strategy, because more service products, e.g., services that require local presence such as asset management can be offered. However, opening a foreign office and employing expatriate staff would include a greater risk in case the venture has to be reversed. It would eventually not be easy to repatriate this staff and employ them at home again. On the other hand, the “testing the water” strategy shows greater flexibility for playing in different marketplaces with different economic cycles. However, exporting services from a notoriously high cost, high currency country such as Switzerland permanently exposes the “testing the water”
strategy to losses in competitiveness. Both internationalization strategies evidence risk management contributions by diversifying business activities in foreign markets.

*How does timing affect the success of going international (i.e., is there a “window of opportunity” for internationalization)?*

The timing of going international is crucial and very sensitive to related scenarios. It can be concluded from assessment #2 that under the “powerhouse” scenario, a “diving in” strategy would be best. In this scenario, the window of opportunity is small because early entrants build relationships and learning experiences, i.e., cost advantages very rapidly. In the most likely scenario, as previously mentioned, exploring foreign business possibilities from the home base in the first stage is the most appropriate and eventual “costs of lost opportunities” can be minimized by constantly monitoring the environment. In the “fragmentation” scenario, it is most difficult to assess the “window of opportunity.” The results in assessment #3 showed the low overall contribution to the firm by “testing the water” in an environment where localization flourishes. “Diving in” under this scenario is also risky because of the high degree of uncertainty under which the choice for the “right” region has to be made.

*How is the success of internationalization affected by the business’ financial structure (i.e., do “deep pockets” help, and how and where should investments be made)?*

It is key to point out that foreign ventures should be initiated when the firm still has a healthy financial base. All cases, although with quite optimistic revenue projections, showed losses in the start-up phase. If the time of entry is even longer or the build-up of revenue slower than projected, more investment is needed to break-through. In addition, a fast growing foreign business, as assumed in all cases, needs working capital financing from the parent company because increases in necessary working capital most probably will not be covered by foreign earnings. Therefore, a firm that has “deep pockets” provides an important advantage for successful penetration into a
foreign market. Larger investments, as pointed out before, should consider the long-term benefit to the firm rather than only medium-term net present values.

Finally: Is internationalization the key to long term success of established real estate service firms?

Of course, this question is too complex to be answered with a clear yes or no. This thesis did not address important issues within the context of internationalization such as aspects of change in management processes and their implementation, or different nonprofit objectives such as establishing controls or reputation. Also, a detailed investigation of forms other than independent entry such as joint-ventures, acquisitions, alliances, or network membership were not analyzed by this paper although they would present interesting topics for further research.

However, the different conclusions that could be made within this paper suggest that internationalization is the key to long-term success for established real estate service firms. Real estate service firms that have a nation-based competitive advantage in this industry and that operate in mature domestic markets can increase their overall profitability by exporting services that abroad are at a different stage of life-cycle and where economic growth is higher than at home. As shown in assessment #2, case -D-, investing in a new domestic target market can temporarily boost the home firm’s margins. Due to the fact that in efficient, mature markets new service products usually are imitated quite fast and new client segments quickly become very crowded with competition, investments of this kind do not have a long life. Having operations abroad also clearly increases a firm’s attractiveness to high value international clients such as investment funds and multinational corporations.

Finally, following the idea of de Geus (1988), who mentioned that “the ability to learn faster than your competitors may be the only sustainable competitive advantage” doing international business clearly brings dynamic knowledge to the firm and therefore facilitates fast learning.
REFERENCES


Batchelor, Ch. (1990, October 30). *Why Americans are setting up over there*. *Financial Times*, p.2.


116