

Demand for Serviced Office Space

by

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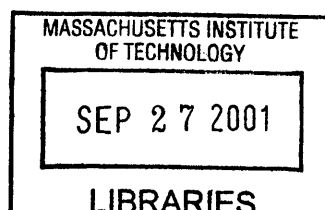
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## ABSTRACT

The work environment has experienced tremendous change in the past few decades. The need for global communication, enabled by technology, has been the prime catalyst to transform the traditional demand for office space from a historically inflexible asset into one that includes more flexible solutions.

Serviced offices combines office space, technology and support into a global network of fully furnished, staffed and equipped offices and meeting rooms, that can be occupied or vacated on flexible terms, and tailored to the specific business needs of the users.

This thesis explores the objectives of these users and the physical characteristics of their requirements for serviced office space. Two case studies further illustrate and verify the analysis. In the pursuit for greater flexibility, serviced office space plays a growing role in the corporate real estate portfolio. This is however an evolution rather than a revolution.

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# 1. Introduction

The demand for office space in general is correlated to fluctuations in the wider business environment. In this chapter, the origin of the serviced office space is explored in relation to the development of alternative work environments, resulting from structural changes in the way business is being conducted worldwide.

## 1.1. Changing business environment

The business environment is evolving rapidly, resulting in strong pressure to increase productivity and spend resources more efficiently. Early-mover advantages such as customer relationships, scale economies in existing technologies, or the loyalty of distribution channels are enough to permit a stagnant company to retain its entrenched position for years. But sooner or later, more dynamic rivals find a way to innovate around these advantages or create a better or cheaper way of producing goods or delivering services. Ultimately, the only way to sustain a competitive advantage is to *upgrade* it – to move to more sophisticated strategies<sup>1</sup>.

As markets become more complex, the participants seek to maintain or improve their competitive advantage through more sophistication and rationalization. Corporate restructuring, downsizing and new working practices can be seen as a reaction to these wider changes in the organization of production and distribution. Other common themes in business literature comprise rapid product innovation and product diversity, a drive to maximize flexibility and greater concern for risk diversification<sup>2</sup>.

These themes apply at national and regional levels, as well as the individual firm level. Firms have sought to make more flexible use of resources, create more flexible arrangements between companies and markets; reduce the amount of capital tied up in inventory and real estate, and break down barriers to capital mobility. The reorganization of production, coinciding with greater globalization of business and governmental deregulation, represents a substantial reordering of economic activity. This inevitably has an impact on the organization and structure of business and, in turn, an impact upon the demand for business space<sup>3</sup>.

## 1.2. Changing type of work in a changing office environment

The Industrial Revolution marked a shift from an agrarian to an industrial economy. The 20<sup>th</sup> century is characterized by the transition into an information-based economy, where the crux of economic life shifted from the factory to the office, from the secondary to the tertiary sector.

The origin of the traditional office building and CBD lies in the scientific management theories of the late 19<sup>th</sup> and early 20<sup>th</sup> centuries. One of the greatest protagonists of such theories was Frederick Taylor. He argued that work is most efficiently executed by breaking it down into its simplest parts, to the extent that people are treated as units of production<sup>4</sup>. This basic concept of

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<sup>1</sup> Porter, Michael, "The Competitive Advantage of Nations", *Harvard Business Review*, March 1990, p.75

<sup>2</sup> Gibson and Lizieri, "Friction and Inertia", University of Reading, 1998

<sup>3</sup> Gertler, M., "Flexibility Revisited", *Transactions*, Institute of British Geographers, 1992, pp. 259-278

<sup>4</sup> Markland, Martyn, "The Future of the Office Building", *Facilities*, University Press, 1998, pp. 192-193

office work has been applied for almost 100 years. Advances in production techniques and telecommunication however, significantly altered the role of the office environment. The scientific management theories have gradually been replaced by the concept of management by objectives, based on the idea that organizations are more than the sum of their individual components and that team environments are more productive. This is leading organizations to become flatter and less hierarchical. In the workplace, this translates into such ideas as management by walking around and open-plan layouts. In practical terms, organizations need far greater flexibility in both contractual and physical arrangements for workspace. Becker and Joroff argue that the way corporations adapt to the changing concept and content of work is through providing a new *integrated* work environment that both reflects and creates the economic, social and technological changes<sup>5</sup>. They believe the success of this integrated work environment depends on the following factors:

1. The workplace is an enabler of work processes; as the patterns and processes of the work changes, the workplaces must be reengineered or reinvented.
2. Work doesn't need to take place in only a central or branch office; the work travels anywhere the worker goes.
3. The prime reason for office space is face-to-face communication and teamwork.
4. Technology must be diffused and accessible to permit employees to work anywhere, anytime.
5. Management and staff have to be retrained to learn how to use technology, organize space and time, and adapt to new processes.

The evolution of the office building itself has been characterized by gradual change as organizations have adapted to new management techniques, e.g. from individual offices to multi-level open plan layouts. In the future, however, the "shape" of the office building and corporate organization is likely to owe more to the information revolution than to organizational theory<sup>6</sup>. The information revolution produced a new type of worker, who embraces this evolving office concept. The knowledge worker is to the information age what the factory worker was to the industrial revolution. The content of work now requires predominantly higher level cognitive skills focused on collaborative problem solving. Today's corporate wealth is being created with specialized knowledge and the ability to acquire, manipulate, interpret, and use information effectively. The knowledge worker is the "intellectual asset" of the organization and, as information becomes the new currency of exchange, the source of wealth creation.

Corporations are trying to address the needs of these knowledge workers. Working arrangements, workspace concepts and designs are being modified to fit the flexible persona of today's changing worker<sup>7</sup>. Becker and Sims at Cornell University distinguish fundamental

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<sup>5</sup> Becker and Joroff, o.c., pp. 6-7

<sup>6</sup> Markland, Martyn, o.c., pp. 192-193

<sup>7</sup> Price, Steven, "Facilities Planning: a Perspective for the Information Age", *IIE Solutions*, Institute of Industrial Engineers, Norcross, Aug. 1997

corporate realities that have surfaced from research and experience with such alternative work environments<sup>8</sup>:

- 1) Precisely where and when an organization will need space or an individual will need or want to work is difficult to predict.
- 2) The time horizon between when an organization realizes it needs space and when it wants to occupy or vacate is short and unpredictable.

This uncertainty in the workplace has become a major business challenge. Corporations are trying to manage their real estate portfolios in ways that address this uncertainty, providing the right type and amount of space, when and where it is needed, for only as long as it is needed. This approach can be observed in office space as well as in research and development, manufacturing, storage, and distribution space. The objective principally follows the same logic as Just-In-Time and lean manufacturing processes: pay for and use resources only as needed<sup>9</sup>.

Where traditional corporate real estate management strategies often have been reduced to cost minimizing strategies, these recent changes in the business environment require a different approach. Research shows that new working practices are more “business-driven”, rather than “cost-driven”<sup>10</sup>. Cost reduction remains an important driver for new working environments, just as it is with traditional space. But the primary companion driver is flexibility, the ability to manage the workplace portfolio with speed in the face of organizational uncertainty. Becker and Sims observe that a variety of policies are available to corporations to integrate their real estate portfolio better with the volatility in the business environment<sup>11</sup>:

1. *Non-territorial space*. In conventional office space allocation, each person has his or her own assigned office or workstation. Therefore any growth in employee population requires physically adding new workstations or offices. Non-territorial space accommodates such growth by changing the ratio of workers to office space. Similarly, this system can accommodate reductions in population without creating vacant workstations that may be permanently reassigned, thus losing the ability to accommodate future growth. The fact that spaces are unassigned maintains this flexibility.
2. *Shelling or dark space* is the policy of deliberately building out space, a shell, which will not initially be occupied. When the need for the space arises, the time between making the decision to occupy the space to moving in the occupants is dramatically shorter than building or leasing new space.
3. *Time vs. event spaced construction* is a variant of shelling. Most organizations wait until a certain event has occurred, the design of a new chip, the start-up of a new program, the launching of a team, and then start to consider how to house them. More innovative

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<sup>8</sup> Becker and Sims, “Managing Uncertainty”, *International Workplace Studies Program*, Cornell University, 2000, p. 11

<sup>9</sup> Becker, Joroff and Stotz, “Manufacturing and the Lean Portfolio”, Norcross, IDRC, 1997

<sup>10</sup> Becker and Joroff, “Reinventing the Workplace”, *Corporate Real Estate 2000*, IDRC, 1995, p. 13

<sup>11</sup> Becker and Sims, o.c., pp. 21-32

companies start with the facility, which will be ready for use, just in time when the need arises.

4. *Swing space* or *flex space* is generally located fairly near the original work environment, and used during renovation or construction to accommodate the employees who will occupy the new space.
5. *Excess capacity space* is used when two organizations find mutual benefit by exploiting excess capacity.
6. *Fully serviced space* is a comprehensive turnkey solution, by definition on a short-term basis, managed by an outside partner. Particularly in the office markets, serviced space has attracted much attention.

While the first five solutions have been in place for a few years, fully serviced office space in its current form is fairly new. Both providers (supply) and users (demand) are still testing this area, exploring the opportunities and challenges associated with the strategies.

### 1.3. Serviced Office Space

#### 1.3.1. Definition

Fully serviced office space can be defined as offices that are fully furnished with a single charge covering a wide range of bundled services, including accommodation, energy, cleaning, insurance, basic office support, and high bandwidth data connectivity, in various types of physical layouts. The accommodation is available for very short periods - sometimes as little as an hour, depending on the provider. At larger centers, clients can choose between closed or open plan, between single rooms or a suite of offices. If required, the provider offers a virtual officing solutions, supplying the non-resident customer with message, mailbox and meeting room services. License agreements for serviced office space can be signed instantly and do not require upfront fees. On completion of the agreed term, there are no contingent liabilities. As such, the process of moving in and out of such accommodation is far easier than with a traditional lease. In general, accommodation can be arranged very quickly, with same-day occupation often possible. It is an adapted application of the same concept as a hotel or car rental.



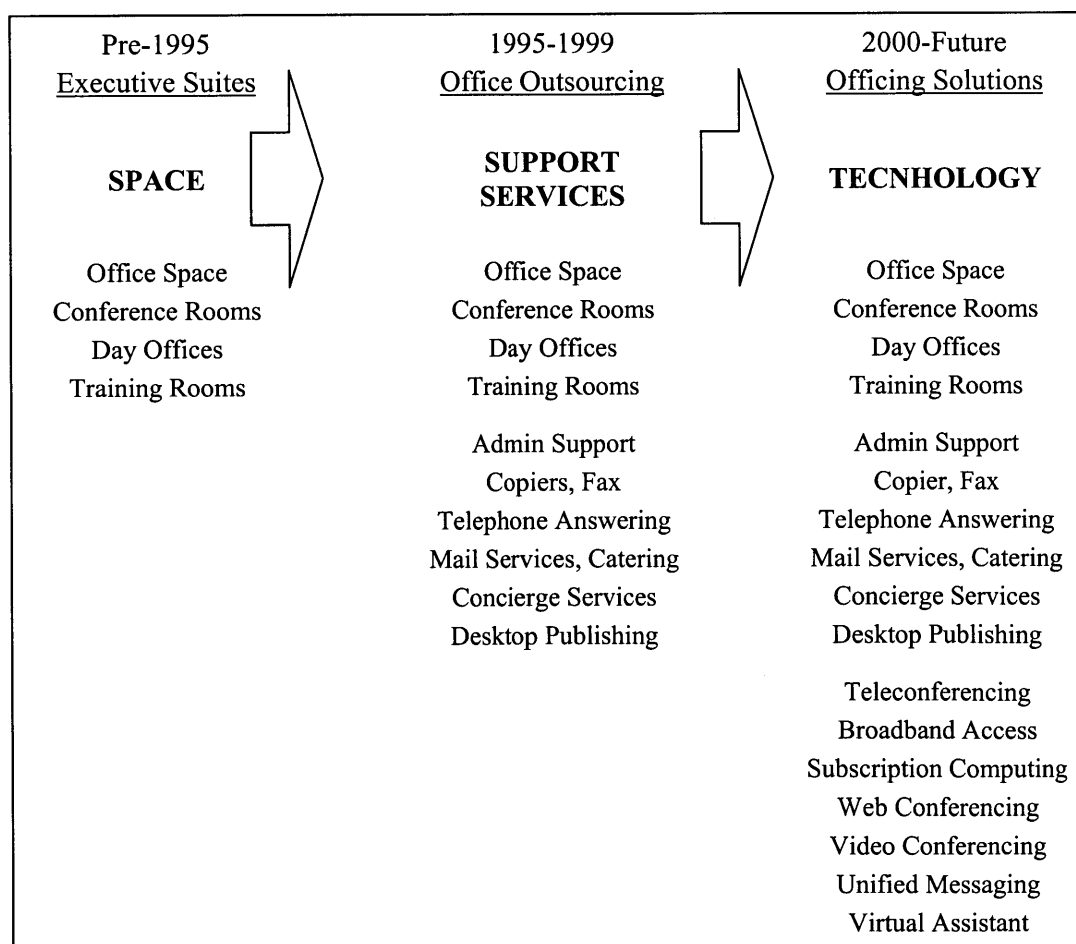
### 1.3.2. History and Industry Overview

Parallel to the global business evolution towards higher flexibility, the demand for office space shifted toward more adaptable space. There are 3 distinct development sequences: before the mid-90s, the mid-90s, and 2001/tomorrow.

The first phase started in the 1970s with business centers or executive suites. The flexibility of the office lease terms was the major selling point. The demand was focused on the pure aspect of space, with little or no amenities or services. The 90s added the support services component. The users requested up-to-date equipment such as fax and copy machines, and additional services such as catering and administrative support. The advent of advanced technological and telecommunication applications expanded the demand for services and initiated the current demand for more complete officing solutions, which were more capital intensive. The office provider managed a fully outsourced bundled entity of space and services.

The table below (Figure 1.1) illustrates the shift in the demand for serviced office space, from the early executive suites to comprehensive officing solutions.

Figure 1.1



Source: *Frontline Capital Group SEC filings*<sup>12</sup>

<sup>12</sup> Frontline Capital Group, SEC Filing 8K, November 7, 2000

By 1999, it was estimated that there were between 3,500 and 4,000 serviced offices centers in the country, accounting for around 10% of all office stock with revenues for the sector estimated at between \$2 billion and \$3 billion<sup>13</sup>. The sector underwent considerable rationalization in the late 1980s and early 1990s. It became increasingly concentrated with a few major suppliers at the top end of the market providing high quality services to large international organizations and smaller operators at the opposite end of the market catering to the needs of small businesses and new startups.

The larger providers were also able to take advantage of rapid but capital intensive technological advances, allowing them to offer a wider range of services to clients and setting them apart from the smaller operators.

Further experience in the use of serviced office space particularly created confidence among landlords and developers, and allowed the sector to continue to expand. In the 1990s, serviced office occupancy rates rose markedly, from 65-70% to around 80%. More recently however, occupancy rates in many of the larger centers had dropped below 50% in the US, and 60% globally.

Throughout the 1990s, the market became increasingly polarized between small, independent providers and large-scale operators with numerous properties across the US. Major business center providers tended to be focused towards larger nationals and multi-nationals for customers. In 1999, Omni Offices (now acquired by HQ-Global) estimated that around 95% of their occupants were national, high tech companies while, across the industry as a whole, around 60% of demand originated from nationals and multi-nationals. Regus estimated that 85% of their customer base comprised major corporations.

The remaining demand was accounted for by entrepreneurs and smaller businesses, which tended to be the territory of the smaller independent operators. The dot-com startups during the Internet boom generated immediate success for many smaller providers. The subsequent implosion exposed the vulnerability of the landlords, especially those who were granted stock options instead of cash lease payments<sup>14</sup>.


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<sup>13</sup> Ryan, Paul, "Business Centre Market", DTZ Research, 1999

<sup>14</sup> Anonymous, "Over-Served or Under-Supplied", *Reed Estates Gazette*, September 1999

Today, the nature of the serviced office demand changes with the type of client of the serviced office space providers. This table characterizes this evolution (figure 1.2):

Figure 1.2

	<b>Individual Clients</b>	<b>Emerging Corporations</b>	<b>Mature Corporations</b> 
<b>Description</b>	Small businesses Local focus Professional Services Industry	Emerging corporation Multiple business geographies Dynamic, high growth industries	Large corporation National/Global business geographies
<b>Usage Characteristics</b>	Utilize 1-2 offices as primary office in a single location	Remote satellite office before going into traditional space	Permanent flexible officing solutions
<b>Demand Timing and Volatility</b>	Constant demand Low volatility	In period of transition Moderate to high volatility	Constant demand Low to moderate volatility

Source: *Frontline Capital Group Annual Report 2000*<sup>15</sup>

The most prominent trend is the fact that large, mature corporations compose a larger and larger portion of the demand of serviced office space. To serve the anticipated demand from large customers, further concentration of the supply is expected throughout the next five years. At the top end of the market, there are expected to be 6-10 main players, along with a range of smaller regional independents catering to niche markets in specific industries and locations<sup>16</sup>. Recent events show intense mergers and acquisition activity in the sector.

The serviced office market is still very diversified in terms of delivery, character of product and service, and in type of customer target. Much of the recent growth in the serviced office industry has been in class-A office buildings with major international providers, focused mainly on large, mature multinationals. These providers are increasing the credibility of the market.

Important differences between countries may also impact the way the sector further develops. For example, one particular issue of relevance in the UK is its traditional focus on long-term lease arrangements, increasing the need for flexible options such as serviced offices. Critics argue the success of serviced office space in the UK is almost solely attributable to this effect, making vigorous growth of demand for serviced office space in other environments questionable. However, the serviced office providers claim the global market for serviced office space is only in its initial stages of growth. They expect 20 to 25% of all office space in the US by 2010 will be leased as serviced office space.

<sup>15</sup> Frontline Capital Group, Annual Report 2000, June 28, 2001

<sup>16</sup> Ryan, Paul, "Business Centre Market", DTZ Research, 1999

According to Gibson and Lizieri, other external hindrances, such as external market frictions, are an impediment to implementing alternative working environments. External friction comes mainly from real estate market institutional structures. The key actors within property supply markets are each making decisions that can facilitate or mitigate against different types of change. The developers and financiers of space, the landlords (both private and institutional), the professional intermediaries including appraisers, legal and financial advisors, and the policy makers through the economic, planning and environmental legislation combine to create unique real estate markets in each location, even though the large users of serviced office space often are multinationals who desire a standardized, yet flexible, product and service. The demand for new forms of space is therefore mediated through these institutional structures with differing outcomes, at least in the short term. Particularly for global operators such as Regus, ServCorp and HQ-Global, the challenge of providing standardized solutions and services is a complicated task.

According to Gibson and Lizieri, these external frictions reveal that the providers and operators of serviced office space are highly exposed to a wide variety of issues, risks and challenges. The most apparent is the disparity in lease terms, where the users of serviced office space generate income on a short-term basis and the providers remain liable for long-term leases. Many building owners remain reluctant to lease space to serviced office operators because of the perceived risks associated with their volatile incomes and lack of asset base.

It is generally assumed that increasing access to ever more powerful information and communications technology is likely to dissolve the bonds that have linked office workers to office work places and each other for many decades<sup>17</sup>. As alternative, more flexible office arrangements are gaining acceptance within the office market, the question arises as to when serviced office space is the best value proposition for space users in terms of flexibility.

### 1.3.3. Players

Offices are financed, built, leased, occupied and managed because the various participants find profitable opportunities engaging in these activities. They can be summarized in terms of their relationships to demand and supply.

As stated before, the serviced office market shows a variety of players, similar to the standard office market. The difference between these markets is that increased flexibility in serviced offices means a more finely tuned relationship with a higher level of interdependency between these actors. This change is attributable to the fact the transactions or relationships between these parties have evolved from a one-time delivery of a static and durable product for a specific duration, to a continuous relationship and service delivery process that frequently needs updating. This is specifically relevant for large, mature corporations who form a more sustainable demand than the small startups.

The most important roles are:

1. *Corporate real estate managers and facility managers.* The job description of these executives has thoroughly changed, as the purpose of the corporate real estate division

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<sup>17</sup> Duffy, Frank, "The Future Workplace", MIT class notes, 2001

changed from a support function concerned with cost-minimization to one concerned with the profitability of the corporation. They had to gain a comprehensive understanding of the core value proposition of the corporation, and became accountable for operational improvements.

2. *Business units.* As corporations are decentralizing, responsibility is being shifted between decision makers in both individual business units and corporate real estate divisions. Specifically in regards to improving flexibility and operational speed of larger corporations, business units are sometimes granted more latitude to make decisions, including business space. If they do, as the eventual users of the space, they also have to gain an understanding of the contractual and managerial issues the corporate real estate managers have, which often is more a burden than the benefit of the decision-making power.
3. *Serviced office providers.* The discussion remains open whether the serviced office space market is customer or supplier driven. Serviced office space providers are redefining the role of landlords, as they evolve from independent suppliers to service-conscious business partners of their customers. Providers embraced the challenge of integrating of product and service with particular attention to technological innovation. The service delivery strategies evolved from passive to more active, as relationships became more symbiotic.
4. *Brokers.* As churn in the serviced office sector is extremely high, providers depend on a constant supply of new customers to keep occupancy levels up. Brokers form an essential intermediary to match this supply with demand. Their role accentuates the interdependency of the different parties within the whole industry. The opportunity for brokers to move into more of an advisory role has not yet been fully exploited, nor is it precisely defined for serviced office space.
5. *Investors.* Real estate requires substantial capital investments. Both the owners and managers of the assets supporting serviced office space are very dependent on capital market fluctuations.

Particularly in the serviced office markets, roles are being redefined, as relationships become more intricate and interdependent.

#### 1.3.4. Service Provider Relationship

The complexity in serviced office space is created by a combination of space, associated infrastructure and services. The infrastructure includes not only the tenant improvements of the office space but also any other generic equipment required to make the office usable such as the provision of IT infrastructure, telecommunication and office furniture. Additionally, basic office support, such as reception, copying and mail handling are included. This generates a more active role for the service provider than the pure provision of space.

#### 1.3.4.1. Standardized vs. Customized Service

The rationale for new corporate real estate and service provider relationships that have emerged in the 1990s is rooted in both serviced demand and supply. Traditional arrangements with real estate providers served corporate needs well when solutions were project-oriented and competitive pressures were primarily local. Today, however, integrative service approaches are necessary for internal corporate real estate managers who are addressing benchmarked performance concerns on a portfolio-wide basis. Even though some companies are using more traditional service arrangements, most expect new service provider roles to fill that need<sup>18</sup>. In general, the corporate real estate department is being redesigned to embrace the work of external service providers. Cutting across reorganization policies is the need to replace traditional, lump sum or negotiated contracts with broader service arrangements. Over time, the relations with external providers in many traditional areas of real estate have evolved from standardized to more customized, as the outside providers become more familiar with the business needs and plans of the company.

A similar evolution can be identified with serviced office space, where companies first use serviced office space in the form of occasional short-term workstations. They discover the advantages of flexibility and investigate opportunities to incorporate new policies in the workplace, for which the provider and the user elaborate a more strategic, tailored solution. The value proposition of serviced office space brings the concept of customization and standardization closer together. The basic components of serviced office space are standardized (furniture, telecommunication package, etc), but the product or service can be easily customized to a great extent for each user.

#### 1.3.4.2. Duration of Relationships

More intricate, longer-term corporate/service arrangements are required for the delivery of customized services. This poses new challenges about the type and schedule of delivery systems and performance requirements. Serviced office space is a short-term contract for a standard product, and as such can be considered a traditional contract. The duration of the commitment and the duration of the use is short-term. Customized service, however, requires a more sophisticated understanding of the customers business environments.

#### 1.3.4.3. Potential Relationships

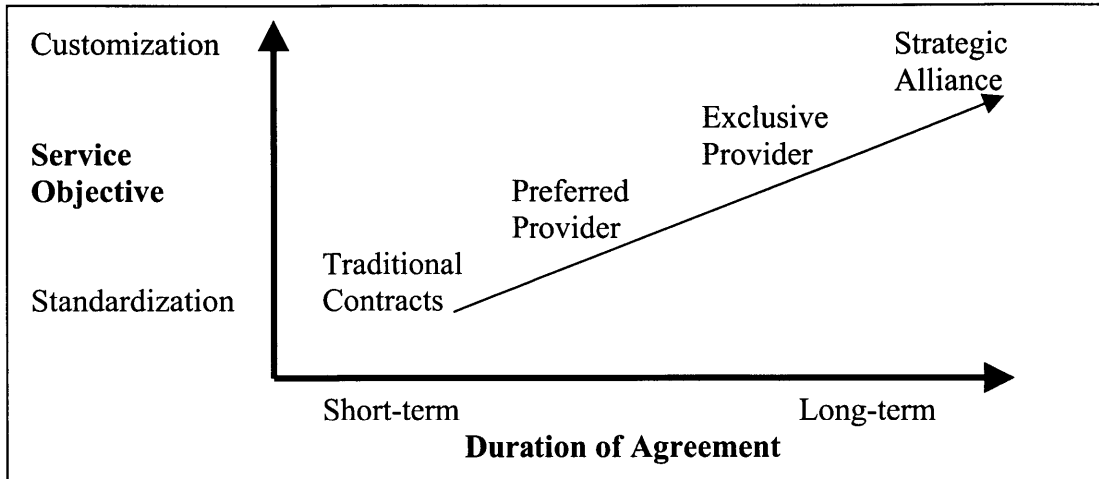
When this demand promotes long-term relationships, corporate real estate executives consider their office solutions provider more of a business partner instead of a pure outside provider. They want and expect their officing solutions partner to understand their business, be creative and resourceful in anticipating the needs and providing high-quality services and support. The following chart (Figure 1.3) illustrates a continuum of relationships identified in the corporate real estate field. This continuum takes into account both the service objectives and duration of

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<sup>18</sup> Lambert, Poteete and Waltch, "Generating High-Performance Corporate Real Estate Service", *Corporate Real Estate 2000*, IDRC, 1995, pp.64-66

the business engagement. Clearly, there is a growing potential for preferred provider relationships with serviced office providers, where high quality and cost-effective service delivery is crucial.

Figure 1.3. The relationships in terms of service objective and duration of agreement



Source: Lambert, Poteete, Waltch, “Generating High-Performance Corporate Real Estate”, *Corporate Real Estate 2000 – IDRC*, 1995, p. 68

Serviced office space providers bundle many aspects of real estate management into a turnkey, all-inclusive solution. It is a form of tailored outsourcing that essentially is changing the relationship between provider and user towards a higher degree of interdependency. Some serviced office providers observe that this is also leading to more strategic relationships.

#### 1.4. Hypothesis

The higher need for flexibility on the part of corporate users has stimulated earnest interest in alternative work environments on behalf of the corporate real estate community. Particularly serviced office space seems to be a suitable comprehensive solution to meet many of the needs. The concept of serviced office space as a fully integrated set of services is fairly new. As a result, it is still being tested in the marketplace. Users lack the ability, knowledge and understanding how to value this flexibility. This thesis explores what precisely characterizes and drives the demand for serviced office space and identifies its issues and opportunities.

## 1.5. Methodology

In order to examine the demand for serviced office space, two specific questions need to be addressed:

- 1) What are the objectives of the users? This question revolves around the *why* of serviced office space. Is flexibility alone the key driver?
- 2) What characterizes the products or services required by the users of serviced offices? Particular attributes distinguish the a-traditional nature of the demand of corporations.

A thorough analysis of existing literature and recent research in this field permits exploring the likely effects and directions of contemporary corporate real estate management strategies. Two case studies are used to test the findings, illustrate and gain a practical understanding of the approaches corporations use to mitigate the traditional inflexibility of real estate resources, and reveal issues and opportunities in the application of theoretical ideal models of agility and flexibility in the real business world. Each of the corporations of the case studies, Accenture and Siemens, is intensely involved with serviced office space in a different context.



## 2. Criteria of Analysis

As the business world is into continuous transition, seeking to develop and enhance competitive advantages, companies make every effort to find the most suitable corporate real estate solutions for their needs. This chapter analyses the *why* and *what* of serviced office space as a strategy for contemporary agile business development: first, the objectives of the users clarify the *rationale* of strategies corporate real estate managers adopt in regards to alternative officing solutions (“why”). Second, the character of the space is analyzed to portray a *physical* perspective of the demand (“what”).

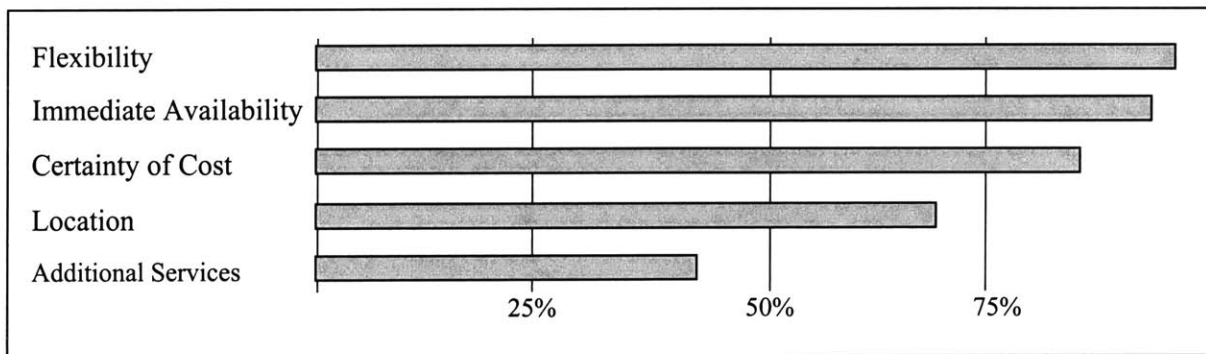
### 2.1. Objectives of Users

The objectives of the users in the serviced office space are as varied as the companies themselves, but they share one major objective: the flexibility to occupy or vacate fully equipped office space, tailored to their needs, with as few constraints as possible. The price that companies are prepared to pay for this flexibility is the fundamental component of the business model of serviced office space providers.

Two major studies have been conducted on the user objectives for serviced offices in the U.K.: DTZ in 1999 and the University of Reading in 2000. The U.K. has been an active field of study because of traditional long-term leases, upwards of 15 years, yielding a promising market for short-termed serviced office space. DTZ surveyed the greater London area, where most providers are located, where as Gibson and Lizieri at the University of Reading explored the whole UK.

DTZ observed 5 key motivators for the demand of serviced office space, in order of importance:

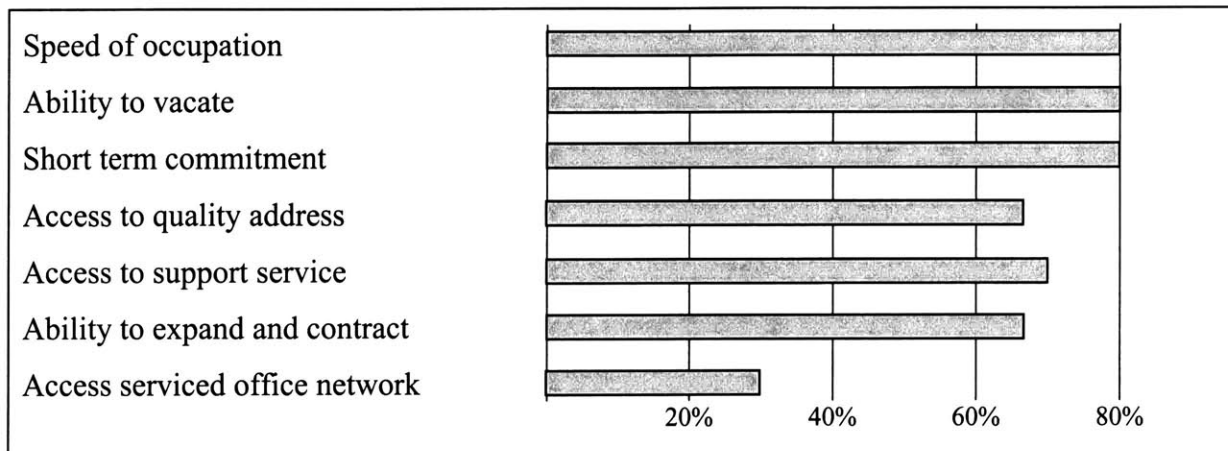
Figure 2.1



Source: Ryan, Paul, “The Business Centres Market in Central London”, DTZ Debenham Thorpe Research, 1999, p. 8

On the other hand, Gibson & Lizieri discern 7 key motivators for selecting serviced office space, in order of importance:

Figure 2.2.



Source: Gibson, V., "Change and Flexibility", University of Reading, p.13

In both studies, flexibility related issues are the prime objective of companies whether or not using serviced office space. Obviously, this flexibility comes at a certain cost. As the business environment and the serviced office space industry are being transformed, demand and supply forces strategically explore, test, and evaluate costs and benefits of serviced officing.

It is often contended that companies find it difficult to project revenue and needs for resources more than one year ahead, certainly not more than three. This is supported by the results of research in the U.K. with less than 20% of the corporations claiming to be able to forecast any aspect more than three years; between 40% and 50% of organizations are unable to forecast the number of office staff, the number of office staff in a building or the number of workstations required in a building for more than one year<sup>19</sup>. This demonstrates their acknowledgement of rapid change and their need to react to business demand as varied as shorter product and business cycles, mergers and acquisitions, e-commerce and globalization as well as comprehensive corporate restructuring. In contrast to all other factor inputs, the heterogeneous and fixed nature of real estate and the thin markets mean that it is virtually impossible to seamlessly match demand to supply.

There is general agreement that time horizons for producing goods and delivering services are shortening, but this varies both between and within companies. In North America and the UK, companies are driven by the associated capital markets where equities were tracked on a quarterly basis. The individual company therefore had to conform to the importance of short-term measures of performance. On the other hand, German and other Northern European companies have traditionally relied on a greater proportion of debt financing and their capital market appeared to be structured around longer-term returns. This may have allowed these corporations to adopt longer-term real estate planning horizons according to Brown<sup>20</sup>.

<sup>19</sup> Gibson and Lizieri, "The Cost of Choice", University of Reading, 2000, p.5

<sup>20</sup> Brown, G., "Duration and Risk", National University of Singapore, 2000

Even within companies there are some parts of the business for which space requirements are easier to predict than others. In reality companies rarely grow organically at a rapid and sustainable pace and therefore are probably not taking on significant amounts of new space. However, growth through mergers and acquisitions is increasingly becoming the norm. These activities present an opportunity to impose greater flexibility into an integrated portfolio.

### 2.1.1. Flexibility

The drive for higher adaptability has direct impacts on corporate property portfolios: where the downsizing and outsourcing creates the potential to *decrease* the overall demand for space, business process reengineering and the focus on core business generated a *change* of the demand, a need for different types of space and in different locations. Corporate real estate managers are challenged to realign their existing portfolios to meet the new organizational requirements.

However, during this realignment phase, in many companies it has become increasingly clear that there is a need to develop workplace solutions that can *continue* to adapt to the changing requirements of the organizations. Typically, real estate is far more durable than modern product development cycles of often only a few months. Flexibility is therefore one of the key issues debated by many corporate real estate and facilities managers: how can they gain greater flexibility in all aspects from a resource that by its very nature is inflexible?

Organizations are examining their activities more closely in order to decide which are core and which non-core functions, and apply this model to all their resources. In the area of human resources, corporations differentiate between core and periphery staff in terms of contract of employment and future investment. On the one hand, core staff will be employed on long-term contracts with substantial fringe benefits. This group will also receive continued investment in terms of training and development. The peripheral staff on the other hand, is composed of those who have to adapt to both business and economic demands of the company and therefore will be engaged in a variety of less permanent arrangements from part-time work to full outsourcing.

Taking this model, Gibson and Lizieri developed the idea of the core-periphery business space model<sup>21</sup>. The argument states that occupiers, and corporate real estate managers, should similarly differentiate between their core and periphery real estate portfolio. The core portfolio is the space likely to be required on a long-term basis, even though it may be used differently over time. Full ownership of space is typically the contractual translation for long-term commitment, but it also needs to include functional flexibility. This means the building can support a variety of uses and activities, changing over time.

Two layers of peripheral space support this core. The first periphery comprises space with shorter-term contractual arrangements, for instance leases of 1 and up to 5 years duration, without the inherent goal to acquire or even occupy the space thereafter. This space could support short term contracts, specific project or any other activity where the long-term future is uncertain. The most important characteristic of this layer is the exit strategy although some facilities management services may also be included. Corporations need to be able to release this space when it is no longer required, making the ability to exit a key feature of this space.

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<sup>21</sup> Gibson and Lizieri, "Change and Flexibility", University of Reading, 2000, p.3

The final layer is space on demand. This layer is where speed of occupation and supporting services become the key driving force. This layer is understood as the piece of the corporate real estate portfolio where serviced office space is most suitable.

Figure 2.3.

Type	Contractual Character	Functional Character
Core Space	Owned	<ul style="list-style-type: none"> <li>- Ability to change use</li> <li>- All aspects are controlled</li> </ul>
First Periphery	Leased	<ul style="list-style-type: none"> <li>- Includes minimal services</li> <li>- Ability to exit</li> </ul>
Second Periphery	Serviced	<ul style="list-style-type: none"> <li>- Immediate occupancy possible</li> <li>- Ability to contract and expand</li> </ul>

Small companies and startups, who comprise a minority of serviced office space users, may consider this space as core corporate real estate. For those businesses, serviced office space is usually an intermediate step before entering long-term leases with more traditional types of office space.

Flexibility within the corporate property portfolio has multiple facets. Corporate real estate executives must distinguish between core and peripheral portfolio requirements and evaluate decisions from physical, functional and financial perspectives<sup>22</sup>.

In terms of physical flexibility, building design, including usable areas, modular floor plates, and the ability to change the internal configuration of space are the issue. Corporate real estate and facility managers continuously try to adapt real estate assets physically to changing business requirements. They pressure real estate developers and suppliers to build products that are physically more adaptable. The emphasis within this debate is on design, construction and services rather than finishes and amenities.

The debate on functional flexibility is directly derived from the evolution towards alternative work environments. Frank Duffy argues that buildings are not designed to support the contemporary office functions because users continue to use office work standards developed at the turn of the century. Team space, meeting areas, cybercafés, and enclosed offices are all potentially needed within a modern office environment.

A second aspect of functional flexibility is the need to minimize the cost of churn. This cost encompasses all costs and downtime associated with relocating teams and individuals within a

<sup>22</sup> Gibson, Virginia, "Property Portfolio Dynamics: the Flexible Management of Inflexible Assets", *Facilities*, Vol. 18 nr. ¾, 2000, pp. 150-154

company. The cost of churn is often considered to be an unnecessary expense in better-designed and better-managed buildings. Some corporations have reduced the cost of churn by either introducing new working practices like hot-desking or more simply by standardizing the office layout and equipment so that people, not furniture, move.

There exists little documentation on financial flexibility. Particularly in the U.K., where very long-term leases have been the standard, corporate real estate managers argue that complete financial flexibility is only possible through all-inclusive ownership. They maintain that a corporate occupier has total control only through ownership over what could happen to the property, such as sell, sublease, or let it go dark. A lease always had both contractual and financial constraints, until the serviced office sector came up with more adaptable solutions. Although the financial cost of occupation may be perceived as high, the financial flexibility, that is the ability to use the space on a very short-term basis and exit quickly, is seen as a priority for certain types of activities and worth the expense.

In the same study<sup>23</sup>, companies were asked to specify how the option of serviced office space fits into their overall real estate portfolio strategy, based on a series of statements.

The majority of the companies agree with one of these three statements:

- “We exclusively occupy serviced office space and intend to do so in the future” (24%)
- “We are using this space for start-up / high risk operations only and will probably move into conventional office space in the future if the business is successful” (23%)
- “We need to get into market quickly but intend to create more permanent non-serviced space” (19%)

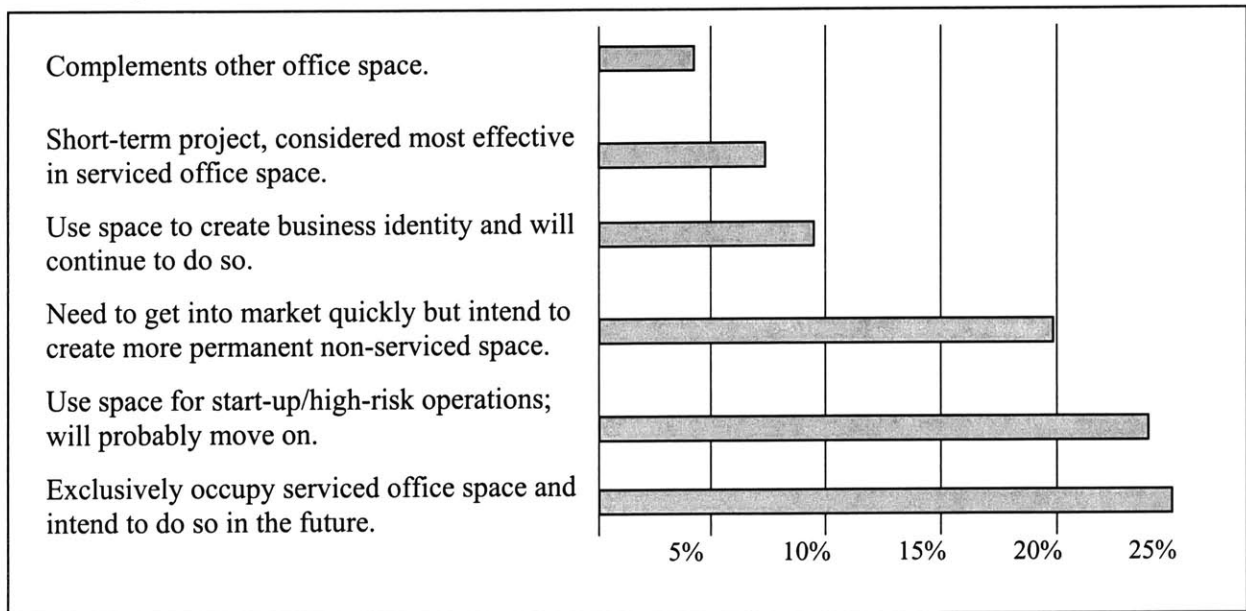
These first two statements reflect the divergence in attitudes towards serviced office space. The first uses serviced offices as core space, but has effectively outsourced the real estate aspect allowing the firm to focus on its core competencies. The second sees serviced offices as peripheral space, suitable for volatile or temporary operations that are not appropriate to be accommodated in part of the central core corporate real estate portfolio.

In the third statement, serviced office space is used for initial market entry flexibility not provided by the conventional sector: a substitute for core space that contributes to risk control by providing easy entry and exit strategies. The following chart captures the results of this study.

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<sup>23</sup> Gibson, Virginia, “Change and Flexibility”, University of Reading, 2000

Figure 2.4.



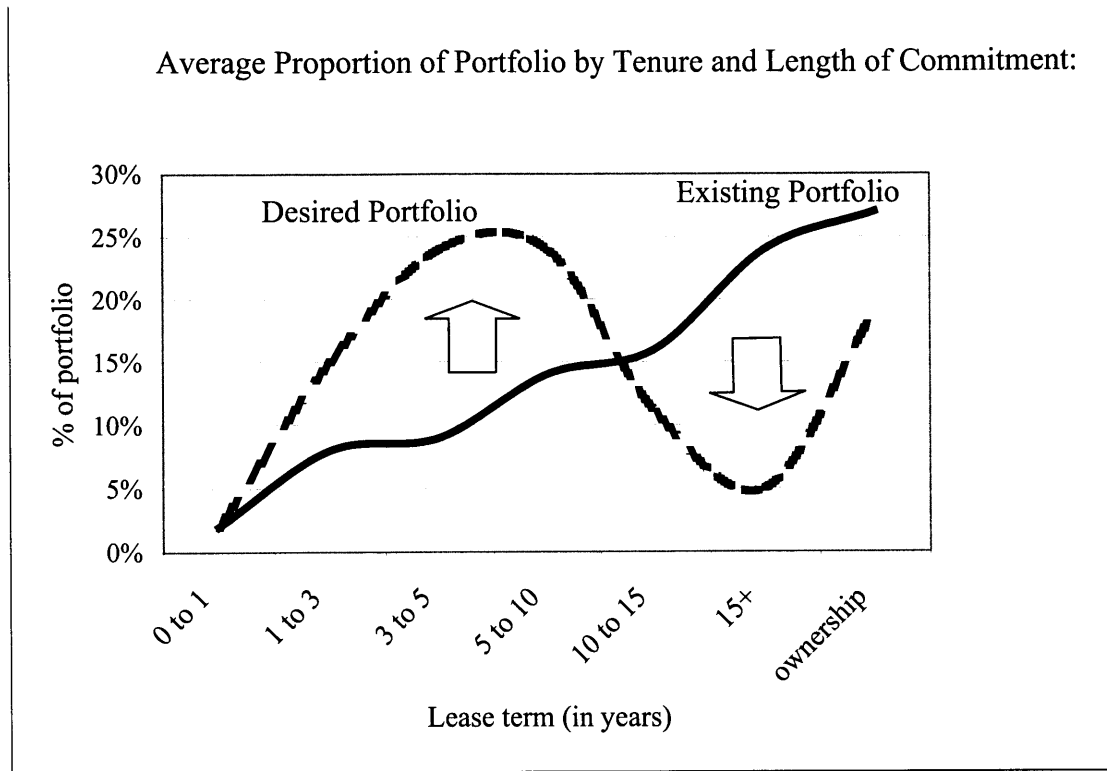
In essence, companies require a balanced system of core resources that is supported by a range of peripheral resources. The difference between the two types of resources relate to the length of contract and the terms of occupation. In the office space market, the availability of products to fulfill the requirements of peripheral space has been dampened by the domination of institutional investors in the real estate market with long-term perspectives of stability<sup>24</sup>. However, the growth of the serviced office market and the development of innovative workspace solutions in general, provide evidence that these service-oriented products are becoming more widely accepted.

The problem of mismatch between a corporation's existing office portfolio and its current needs particularly relates to the tenure and length of commitment. The following diagram shows the contrast between the current and the desired situation, based on a study performed in the U.K.<sup>25</sup>. Generally, the respondents desired a greater proportion of their portfolio in shorter-term contracts. The most significant increase in the proportion held would be in short term leases of between one and five years. The current proportion held in this category was estimated to be 17% on average where as ideally it would be as much as 39% of the total portfolio. This finding reflects clearly the influence of shortening business cycles in the business environment in general.

<sup>24</sup> Gibson, Virginia, "Change and Flexibility", University of Reading, 2000, p.16

<sup>25</sup> Gibson and Lizieri, "The Cost of Choice", University of Reading, 2000, pp.5-8

Figure 2.5.



Source: adapted from Gibson and Lizieri, "The Cost of Choice", University of Reading, 2000, p.7

There appears to be a desire to shorten lease terms within the duration of 3 and 10 years. In regards to long-term commitments, ownership seems to be preferred over long-term leases.

Thus, the results of research so far appear to support the hypothesis that major corporate organizations require different real estate service solutions to support the wide range of business activities in which they are involved, supporting the core and periphery model. It demonstrates that occupiers are concerned not only with physical and functional flexibility, but often see financial flexibility being equally if not more important.

The occupiers of serviced offices at the top-end of the market appear to fall into two groups. The first group uses serviced offices as its sole real estate solution and intends to continue to do so. The second group sees it as temporary space for market entry, project start-up or other volatile activities. The commonality is the focus on financial flexibility both in terms of speed of entry but, most importantly, facility of exit.

Where flexibility remains the main objective of corporations, they also recognize the importance of immediate global presence without the intrinsic weight of real estate assets in a plentitude of locations and markets.

#### 2.1.1.1. Alternative Solutions to Serviced Office Space

The increasing need for flexibility of office space manifests itself through a wide variety of solutions, of which serviced office space is one segment. Some solutions are initiated by the corporations themselves, while others are brought to the market place by existing providers, some by new entrants to the real estate sector. These are the currently available alternatives.

1. *Airport business centers and boardrooms.* International airports today lease meeting and office space on a short-term basis. These leases are available on hourly basis, and usually have full IT support. There are 3 main operators of workspace in airports: the airport managing authority itself, airlines (e.g. Red Carpet Club by United Airlines), and third parties (e.g. Laptop Lane, Aerzone Business Centers).
2. *Telework centers.* Because of increasing commuting time and cost, some office developers chose to build office space in suburbs or city edges. This is generally a smaller scale operation, used as a satellite of the downtown office space. Studies show telecommuters use this option about 2 to 3 days per week<sup>26</sup>.
3. *Adapted hotel rooms.* Hotels hesitated before recognizing the need for adequate workspace in their rooms. They recently started to offer business-like accommodations: larger desk space, adequate lighting, printer/fax/copier, fast internet access, office supplies, ergonomically designed swivel chair, expanded voice mail services, etc. Marriott developed the “Room that Works”, Sheraton offers a “Smart Room” and Westin the “Guest Office”.
4. *Business services providers.* Office supply and business service providers offer a wide variety of office support solutions. Smaller companies are the most common users of these services on an occasional basis. The largest players in this segment are Kinko’s and Mailboxes Etc.
5. *Home Offices.* The home office has often been set in the spotlight in recent years as *the* solution to a better balance between professional and private life, reducing commuting time and costs. Even though many corporations have thoroughly structured their home office policies, employees and their management have not widely embraced this solution. Reasons are lack of team interaction and feedback, lack of managerial supervision, and unsuitability of the job for remote work. Whereas the home office was in theory a great solution for corporations to shed real assets off their balance sheet and contribute to the quality of life of their employees, in reality, the industry has not experienced a substantial shift towards more home offices.
6. *Other solutions and intermediaries.* Large office development and management companies have recognized the increasing need for flexibility, and are providing medium-term leases for serviced office space to their customers, e.g. Fast Office by Equity Office, who provides leases for a minimum of one month. Subleasing is for many

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<sup>26</sup> Tepper, Sharon, “Telework Centers”, IDRC, 1998



corporations a temporary solution, but this market is far from transparent. A few players have emerged to standardize and clarify the process, such as [Offices2share.com](http://Offices2share.com).

Whereas each of these alternatives addresses certain aspects of the corporate demand for more flexibility, serviced office space is a comprehensive, integrated and strategic turnkey solution that is immediately available on a large and global scale.

### 2.1.2. Location and Mobility

The second objective of the users of serviced office space is to obtain unconditional mobility combined with a visible and instantaneous global presence in the best possible locations. In a traditional sense, only very large multinational corporations have been able to aspire to an established global presence. Today, the Internet allows a one-person company to become an instantaneous multinational operation.

Technology provides the tools and drives communication and management costs down, enabling companies to become virtually ubiquitous.. Communication and knowledge networks have become the new neurological spine of any global enterprise, offering flexibility from a locational standpoint of view.

#### 2.1.2.1. Ability to Perform Work Anywhere

Labor, communications and support service inputs for offices are becoming less locally based with improved technology, increased mobility and changing work practices. The locational dependency of all types of offices seem to be weaker, except for those marketing final services (e.g. retail banks) and those in more traditionally concentrated markets (e.g. law firms). Pressures for change of location in the future also include staff expectations of improved quality in the workplace environment and the increasing proportion of the office-based work undertaken from remote locations.

Many businesses today are experimenting with virtual work arrangements. However, even a virtual company needs a physical location where workers can retrieve and answer e-mail, process regular mail, meet with customers, and so on. Generally for smaller enterprises, this means working from a home office. But for larger entities, face-to-face interaction on a comprehensive basis in an appropriate context is still essential. For those companies and even for brick-and-mortar companies that need a temporary office or only some of the functions of an office, serviced office space can provide an essential solution.

#### 2.1.2.2. Need for Interaction

The major challenge with the displacement and dispersal of work is of a managerial nature. Where communication technology has made physical mobility more feasible and effective, the demand on the knowledge worker to manage this ubiquitous system has become increasingly complex. Control and coordinating functions are being dispersed from headquarters to regional

and divisional levels, allowing more local management autonomy on the level of the business units.

As technology gave employees a much higher flexibility, the workplace travels along with them. Both managers and employees have to learn to use this freedom productively. Depending on the nature of the work, the place of work and the place of interaction can be seen as two separate entities in the corporate real estate portfolio.

The increasing dependence of businesses on information technology and travel is likely to make individual place itself *more*, not *less* important. Three apparently contradictory shifts in the concept of location seem to be reasonably well established<sup>27</sup>:

1. Process work is being automated or exported to economies where labor costs less. Customized knowledge work however is difficult to subcontract out to other locations where knowledge workers are not available.
2. Teleworking, home officing, and serviced office space are increasing in importance and acceptance as alternative work environments. The condition for maintaining the benefit of cost reduction to the corporation depends on the understanding that workers give up their proprietary space at the CBD office.
3. The city centers have never seen the draw they have today, in particular the more sophisticated 24-hour cities, where technology often is marketed through avenues of isolation and independence.

It is the last phenomenon that may be the most important fuel in the knowledge economy. What could be happening is that knowledge work is developing its own ecosystem, places where large scale, coincidental, face-to-face contact between this type of workers is most likely to happen. The main condition for this (in-?)formal contact is that the environments of these places quickly become more attractive, more diverse, more complex and more enjoyable. In other words, as the world of work becomes increasingly virtual, the physical world of work has to become more competitive and attractive to survive. In this knowledge economy, “place” needs to be enhanced to attract and retain, to stimulate, and to bring together the kind of people whose contribution to the knowledge economy is most valuable and creative.

Whereas technology and telecommunication revolutionized the way in which business is being conducted, the question of whether it is revolutionizing the real estate industry remains open. The most obvious impact of technology is to make working more mobile, and hence enable companies to base their locational decisions on other considerations besides proximity to clients, providers or their own internal divisions. In this sense the ability to communicate better should encourage the spatial decentralization of firms, both within and between cities<sup>28</sup>.

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<sup>27</sup> Duffy, Francis, “The Future Workplace”, M.I.T. lecture series, 2001

<sup>28</sup> Wheaton, William, “A Perspective on Telecommunications Technology and Real Estate: Office, Industrial and Retail markets”, MIT Center for Real Estate, 1996

### 2.1.3. Cost Reduction

Corporations recognize the delivery of flexible workspace is highly valuable, and there exists a willingness to pay for it. On the other hand, the cost of alternative, flexible property options, such as serviced offices is often perceived as excessive when compared to more traditional procurement options, particularly for larger organizations that already have established long-term corporate real estate portfolios. However, the viability of flexible alternative work environments depends on how corporations calculate cost and benefits, what benchmarks they use and their thresholds for cost versus value of flexibility. In response to recent surveys corporate occupiers considered both lower cost and flexibility as high priorities. But despite this there was evidence that lower cost is preferred even over flexibility<sup>29</sup>.

Jones Lang LaSalle polled occupiers and found a large majority would generally pay a premium of 10%, rarely 30%, of rental value to gain the flexibility offered by short leases and break clauses. This is a wide range, however, leaving much uncertainty. Some landlords are also reluctant to even consider changing their traditional lease terms, because they are unsure whether they will be getting sufficient compensation<sup>30</sup>.

Traditionally, cost of real estate is calculated on a per square foot basis. Serviced office space providers insist this is not an appropriate means of pricing serviced office space. The argument is that they not only offer a product, but an integrated service. The concept is more comparable to a hotel, where operating costs on a square foot basis are considered extraneous. The service does not consist of only space (square feet), but of a comprehensive bundle of officing solutions. Some go as far to say that the real estate is merely an addition to the services offered. The revenue structure is based on a fee per workstation, whether it is occupied by one or more people, or not at all.

Some researchers support the concept of total office occupancy cost when investigating economic and financial benefits from serviced office space. However, companies find managing total occupancy costs a challenging task because real estate, being a static and inflexible resource, is rarely studied with the same intensity and comprehensiveness as other key functions and resources. Traditional senior operations executives often lack the understanding of the economics of corporate space or know how to use the right tools to perform adequate cost restructuring<sup>31</sup>.

Definitions of total cost occupancy vary across the industry. The most expansive definition is that total occupancy costs includes all costs related to procuring, building, operating, renovating, and ultimately disposing of space. Corporate accounting tracks some of these costs but they are rarely collected in sufficient detail or organized in a way that allows managers to analyze them thoroughly.

DTZ for example defines total occupancy costs as the average cost of leasing office space in contemporary well-specified buildings in a prime central business district with a leaseable area

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<sup>29</sup> Axcell, Procter and Fennell, "Survey of Total Office Costs", *Real Estate Finance and Investment Research*, City University Business School, London, 2001

<sup>30</sup> Lawson, David, "JLL offers solution to short lease valuations", *Property Week*, August 1999

<sup>31</sup> Apgar, Mahlon, "Uncovering Your Hidden Occupancy Cost", *Harvard Business Review*, 1998, p.125

of about 10,000 square feet. This includes rent and expenses such as property tax and maintenance costs if these are payable by the occupier but excludes periods of free rent, tenant improvements and other leasing incentives. It does not take into account the varying space utilization standards between countries nor differences in leasing practice<sup>32</sup>.

Apgar differentiates a real estate overhead in excess of the traditional expenses that is difficult to be transpose or relate to a physical, per square foot ratio, such as consultancy, legal and insurance expenses. He further reconsiders traditional expense ratios to include locational, layout and moving expenses, in order to calculate total occupancy costs. Opportunity costs of file storage and other non-revenue producing activities are also a factored. Apgar concludes that reducing occupancy costs is not only a matter of lower rents, but also improving the whole value adding process.

A study undertaken by the Chartered Institute of Purchasing and Supply<sup>33</sup> compares total occupancy costs for traditional office and serviced office space in high cost CBDs, revealing the relationship between lease terms and the number of people in need of accommodation. This table (Figure 2.6.) shows the percentage of cost savings and deficits realized for a certain group of individuals accommodated in serviced office space, compared to traditionally leased office space.

Figure 2.6.

		Number of months facility is needed						
		1	3	6	12	18	24	36
Number of people to be accommodated	1	69%	52%	46%	39%	36%	34%	32%
	5	56%	33%	21%	11%	6%	1%	-1%
	10	57%	33%	33%	9%	4%	-3%	-6%
	15	51%	23%	9%	-7%	-13%	-21%	-25%
	20	51%	25%	12%	-4%	-9%	-17%	-21%
	40	42%	10%	-6%	-26%	-32%	-43%	-47%
	60	43%	11%	-5%	-24%	-30%	-40%	-45%

This table (Figure 2.6.) indicates that the highest benefit can be gained from smaller teams of workers for shorter periods of time. Over longer periods of time, the benefits transform into considerable deficits.

However, in reality, leases for serviced office space are also being signed for longer and longer periods<sup>34</sup>. This suggests some users consider serviced office space a strategic asset in their corporate real estate portfolio. Much depends on how they treat total occupancy costs. Either these costs exceed the cost of flexible leases, or the company’s business model justifies the expense.

<sup>32</sup> DTZ Debenham Tie Leung, “Global Office Occupancy Cost Survey 2001”, *Research*, DTZ Debenham Tie Leung Ltd, 2001

<sup>33</sup> Shelley, Tony, “Breaking Down Barriers to Entry”, Institute of Purchasing and Supply, 1998

<sup>34</sup> Regus press release, June 2001

Cost relates also to risk. Risk is the state of the uncertainty about future outcomes. Measures of risk should therefore reflect forward expectations rather than focus on what has happened in the past. Historic measures of risk are only helpful in terms of defining scenarios that may be useful in forecasting expected risk. As corporations undertake projects with a very uncertain outcome over the short term, it can be advisable not to commit to long leases for office space of the particular project. Although risk transfer is not always a direct and deliberate objective of the users, it usually is incorporated in cost calculations, or plays a determinable role in the decision to outsource office space and its management<sup>35</sup>.

Technology and New Economy companies have been driving the serviced office space market to record absorption levels, with many companies taking space based not on *current* needs but on aggressive projections. To many, this represents a systemic risk capable of hurting not only the property owners and managers directly involved, but the office market overall.

#### 2.1.4. Technology and Connectivity

The mainframe in the 60s, the minicomputer in the 70s, the PC in the 80s and the networks and Internet in the 90s, have been a powerful influences on every aspect of office design, from location to the design of the workstation. This influence was at least as destabilizing as the introduction of the telephone and the typewriter in the last decades of the 19<sup>th</sup> century. Technology is understood as the prime enabler for alternative work environments.

##### 2.1.4.1. Global Communication Strategy

The number one tenant demand regarding technology is a comprehensive global telecommunications services package. These packages typically are bundled telephone, data and Internet access. The importance of this all-inclusive communications package is to assure total connectivity between the worker and the company, as if the employee was working in a corporate office.

The importance of connectivity to the modus operandi of businesses is demonstrated by the severity of responses to an occupiers survey in the UK , that reported that they work remotely from home at least part-time, while 68% of businesses support remote access to their networks. Almost all respondents have access to the Internet, with 63% having access at home and at work. Of those without access, all believed that they would probably have access within the next year<sup>36</sup>.

Every company, regardless of industry, size, or market wants high speed Internet access. Larger, more sophisticated companies not only want access, but also access to multiple providers. The following is a list of additional technology related preferences and demands, in order of their importance<sup>37</sup>:

- Redundancy/back-up power source
- Fiber optic capability

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<sup>35</sup> Becker and Sims, "Managing Uncertainty", *International Workplace Studies Program*, Cornell University, 2000

<sup>36</sup> Hills and Thompson, "Wired up for extra value", April 1998, p.4

<sup>37</sup> Ptacek, Liz, "Technology and the Office Market", PNC Real Estate Finance, Nov. 2000, p.11

- Above standard electrical (up to 12 watts/SF of power)
- Automated building management systems (HVAC etc)
- Access to satellite dish
- T-1 and T-3 lines
- Video conferencing
- Raised floors; most common in California, especially San Francisco. In all markets certain rooms may require raised floors.

Where global communication has been established for decades, the requirements of corporations regarding cost, reliability, and data volume have increased considerably.

#### 2.1.4.2. Sophistication

Office technology evolved from basic desktop computing to highly sophisticated integration of technological productivity and operational processes. Serviced office space has been a pioneer of applying technological innovations to support this integration. For instance, international video-conferencing was a standard tool at Regus' earliest centers. Today, structured cabling, communications rooms and networking between centers around the world are considered standard infrastructure. Where teleconferencing in particular was an important factor in the development of business centers in the early 90s, it is anticipated that through the transition to streaming images through web-cameras in high-bandwidth networks, the use of traditional teleconferencing may subside.

Payment for a fully serviced facility means there is every incentive for the operator to provide full connectivity. This involves a considerable standardization of connection protocol, such as cabling, high bandwidth, plugs, firewalls, and so on. With the standardization of data and telecommunications protocols, the proliferation of proprietary cabling has subsided, and high-grade cable and fiber optics have become much thinner and standardized<sup>38</sup>.

Some operators are experiencing a gradual reduction in revenues from traditional income generators, such as fax services, as users adopt sophisticated office productivity software that allows them to do much more with their own PCs. In view of their charging structure, serviced office operators may be able to offer Internet access priced on a "per connected PC" basis, data transfer volume or bandwidth<sup>39</sup>.

#### 2.1.4.3. Building Performance

New working strategies are driving changes in the infrastructure of office buildings. This includes wiring for electrical power, telecommunication and building control systems<sup>40</sup>. Technology has enabled new work practices due to the flexibility and portability of networks within the office environment. Occupants want to access their computer network from any desk,

<sup>38</sup> Architectural Record, 1995, pp. 70-85

<sup>39</sup> Hills and Thompson, "Wired up for extra value", April 1998, p.4

<sup>40</sup> Ptacek, Liz, "Technology and the Office Market", PNC Real Estate Finance, Nov. 2000, p.11

and have calls to their phone routed automatically to wherever they are. Although mobility may be enhanced by wireless communications, a concern is the fact that the currently achievable degree of portability is much lower inside the office than outside. This may be the result of expectations. Outside the office, users have gotten used to the limitations of modems, analog phone lines, and cellular phones, and are much more willing to put up with a variety of glitches that they would find unacceptable in the office setting. Unfortunately, even with new high tech under-floor systems in traditional buildings, moving a computer or a telephone line from one location to another is not a simple matter of taking a plug from one socket and plugging it into another. Office administrators generally do not encourage telecommunications-equipment portability because it increases equipment maintenance.

Wireless technology, with its potential to avoid a wide range of costly hardware and wiring, is not the silver bullet. Today's rapidly developing and proliferating wireless technologies are having a much greater impact outside buildings than inside, where their limited data capacity and speed are a significant drawback. In serviced office space, wireless systems are appropriate because the space is reconfigured frequently and the need for mobility is high. However, data-transmission rates are low and available radio frequencies and infrared spectrums are limited. This capacity problem can be worsened by encryption schemes needed to ensure communications security for airborne data. This is of particular concern in serviced office space, where a multitude of employees from different or even competing companies could be working next to one another. The transient nature of occupiers further heightens this security concern.

Wireless communications confer a major advantage for communications technology in serviced office space because churn, change of the layout, occurs relatively frequently. However, since workstations require hard wiring for power and task lighting, freeing them of the communications wire does little to augment flexibility.

Paradoxically, wireless systems can make internal reconfigurations of space and furniture more burdensome, because the location of furniture and walls can affect system performance. Additionally, wireless devices need batteries that must frequently be recharged on the wired devices.

A particular problem in preserving building performance is the obsolescence of relatively recently developed buildings because of outdated technology. While there are some creative conversion solutions for antiquated properties, the buildings that are obsolete and low on architectural charm will face some hefty upgrade costs to stay competitive and enter the market for the latest wave of tenants<sup>41</sup>.

The most sought after and expensive improvements that commercial tenants want are technology related. More tenants are seeking high-tech spaces, where communications are already in place, that have uninterrupted power supply systems, backup systems in generators, improved roof access for communications, high-speed wiring, and raised floors to allow ease of access for data cabling upgrades.

Most property owners, brokers and banks state that even though technology is important, it is not a defining factor in attracting tenants for traditional office space. For property owners, technology is required to remain competitive and rarely results in any kind of rent premium.

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<sup>41</sup> Hansen, Kent, "Less Opulence, More Options", Journal of Property Management, 1996, pp.28-32

Technology factors as an important amenity, but comes behind traditional office space characteristics like location and quality of space. In some markets such as Silicon Valley, technology may be used as a marketing tool, however it is unclear how effective it might be<sup>42</sup>. In the serviced office sector however, connectivity and high quality technological support are essential reasons for the demand of serviced space, as most workers' livelihood in this type of space depends entirely on this connection.

Like every new revolution, the full impact of the telecommunications-information revolution will be understood only after it has passed. There is a precedent to consider, however - that of the telephone. There is no obvious evidence that the use of the telephone in business had a significant impact on the demand for space in some aggregate manner. It did, however, give firms and households far greater locational choice and flexibility in developing business relationships.

#### 2.1.5. Efficiency and Effectiveness

The goal of corporate real estate managers during the 90s was efficiency with a focus on building performance, rather than business performance. The objective is however shifting towards *effectiveness*, making most out of people instead of out of buildings.

According to researchers, there exist resistance, inertia, disappointments, and unforeseen effects on behalf of users, management and providers. For instance, in home offices around the country, a number of problems are surfacing as many home-office workers feel as though they are working in a vacuum. Home-workers are not always able to maintain high professional status and separate the office and residential areas to their satisfaction. Other concerns include workers compensation and benefits, zoning and insurance issues<sup>43</sup>. Corporations who implemented remote officing strategies, find that telecommuters didn't necessarily decrease the overall corporate real estate: most keep their office space in the central location, which remains unused while the employees telecommute at an average of 2 to 3 days per week.

In the UK, survey evidence indicates that new working practices and business structures have been widely implemented in the corporate sector. More detailed analysis, however, shows that, in many cases, the proportion of staff affected by new modes of work is relatively small. As a result, the impact on the corporate real estate portfolio is less dramatic than has sometimes been asserted. The change is evolutionary rather than revolutionary. This more gradual process reflects both internal and external friction and inertia<sup>44</sup>.

Careful planning and assessments have to precede the implementation of alternative work environments, or serviced office space in general. Implementing alternative workplace strategies in the corporate portfolio has not always produced the intended results.

Gibson and Lizieri examine inertia as the main impediments to implementing alternative officing strategies. The changes that have occurred result in the need for a greater diversity and flexibility

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<sup>42</sup> Ptacek, Liz, "Technology and the Office Market", PNC Real Estate Finance, Nov. 2000, p.17

<sup>43</sup> Allen and Moorman, "Leaving Home", *American Demographics*, Oct 1997

<sup>44</sup> Gibson and Lizieri, "Friction and Inertia", University of Reading, 1998, p. 13



in officing solutions, depending upon the activity being accommodated. These shifting patterns in space management meet friction and inertia from internal sources.

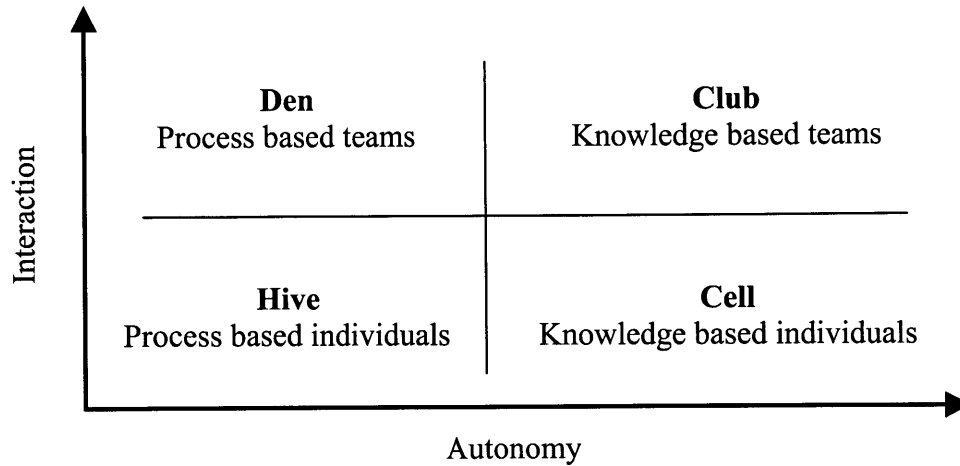
These internal hindrances arise from three main factors:

1. The first concerns the lack of investment in new technology, which is an essential pre-requisite to the implementation of many of the new processes. This is felt to be one of the key reasons for not implementing new working practices. However, since organizations see investment in IT as a key management issue for next five years, this constraint is expected to improve.
2. The second key internal factor concerns resistance to change from both staff and, particularly, middle management who see the new freedom created by these new management practices and structures undermining their power and authority. This affects, for example, resistance to home working (loss of management control), flattening corporate hierarchies (loss of status) and the move to open plan layouts (loss of territory). This resistance from personnel cannot be ignored and is often highlighted in the new working practice literature.
3. Finally, even where the first two constraints are removed, it may be difficult for the corporate real estate decision-makers to make or support a business case for change. To a large extent, this results from a lack of information on the total cost of accommodating a worker and hence the inability to estimate and quantify the costs and benefits of change.

Employees cannot be automatically transplanted in remote locations, whether they are serviced office space or other solutions. Guidance, education and clear-cut strategies should accompany this process.

Frank Duffy proposed the following model to determine in an abstract manner the location for the most effective work place. He observes the evolution of the work environment starting at the *hive*, similar to a beehive or the office model of the 1970s. As concepts such as teamwork and knowledge based work entered the office management environment, a dichotomist development occurred: on the one hand, teamwork increased the level of interaction between workers, turning the workplace from a *hive* to a *den*. On the other hand, as the work process became more knowledge based, the *hive* evolved towards a *cell*, indicating a certain level of symbiosis and interdependence between the different entities. Successful organizations are able to converge these trends and steer interaction and autonomy drives into knowledge-based teams in a *club* environment.

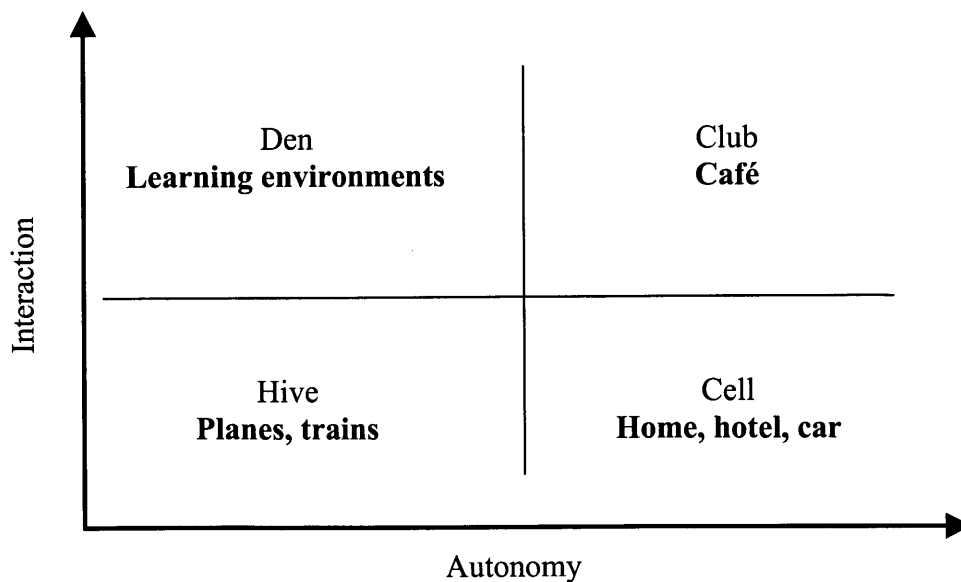
Figure 2.7.



He translates this theory into the actual location of the workplace, describing some characteristics of the life style that accompanies this trend: 24/7 availability, multiple tasks in multiple locations linked by frequent travel, with a more vague distinction between personal and professional space and time.

The intuitive conclusion from recent changes in the workplace leads many to believe the actual place of work has lost its value or importance. Duffy however states that the place of work is has not become less but *more* important. He substantiates this through translating the theoretical work environments above into the contemporary work place:

Figure 2.8.



Serviced office space is acknowledging this trend: the most basic product of serviced office space is the “workstation”, where people work as in the model of a hive. The more complex

model of serviced office space is a “touchdown” environment, where employees connect to the office network, electronically and physically. The embodiment of this model could be the cybercafé setting, which functions smoothly for informal physical and virtual meetings. The café setting turns the office building into a destination.

Duffy concludes: “Powerful and ubiquitous information technology is dissolving the links between office workers and their workplaces. However, serendipitous contacts between networkers are highly valued. Only places that are attractive enough to stimulate such contacts will be able to compete successfully with virtuality”<sup>45</sup>.

## 2.2. Physical Characteristics: Design and Layout

The characteristics of the demand on first sight could be as varied as the number of corporations using serviced office space. However, serviced office space globally shares physical characteristics pursued by the users.

Over the past three decades, researches conducted many studies on organizational and spatial planning and design of work environments. The direct users of serviced office space typically are knowledge workers, who provide high added value to the value proposition of their business units. As their labor is a cost-intensive resource, their companies require that their work environment be of the highest quality. Hence, the global serviced office providers are mainly located in class-A office buildings.

As change becomes the status quo, office tenants are demanding efficient office layouts that reflect the continual moves and changes needed to run a “lean and mean”, market-responsive business. The following trends describe what occupiers in search of higher flexibility ask developers, designers and operators when renovating existing office space or building new<sup>46</sup>:

- Raised floors for fast track moving. Raised floors with wiring running underneath are becoming de rigueur because they enable office users to move around or to add service virtually anywhere without disruption.
- Universal cabling systems. In the past, each type of computer or telephone had a proprietary cabling system; today, a single type of cable can meet all telecommunication and data transmission needs. Technical advances have increased the data transmission capacity of these systems tenfold.
- Demountable partitions and modular furniture. Facilities owners and office managers are asking for office partitions that will accommodate future moves. Despite the added expense, many office tenants are installing demountable partitions, which, along with modular workstations, provide a flexible, open-plan environment that enhances communication and collaboration among employees while making future moves and changes easier.
- Shrinking spaces. The amount of space allocated for individual workers and amenities is shrinking. This remains heavily contested within the corporate real estate industry. All agree however some strategies can make the existing space more efficient.

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<sup>45</sup> Duffy, Frank, ‘The Future Workplace’, MIT course lecture notes, Spring 2001.

<sup>46</sup> Davis, Mat, “Plugging into the Office of the Future”, *Public Management*, Washington, 1996

- More power. Office users are more willing to pay for flexibility than for upscale finishes. This translates into plainer materials and more power behind the walls and beneath the floors.
- Superwalls and superfloors, completely wired for communications hookups are making their way to the specifying tables. These are prefabricated modular units with built-in cabling, still in the development stage.

These requirements are being observed in *all* office developments, but apply particularly well to serviced office environments, as the way this space is used is highly intensive and on the forefront of office development in general.

### 2.2.1. The Open Plan office

When companies introduced the cubicle concept in the late 1970s, they failed to tie design to employee productivity. Cubicles were intended to make communication more efficient but often have the opposite effect because employees become concerned about privacy. Contemporary work involves much more often team-based work, for which traditional layouts are essentially inept<sup>47</sup>.

To solve the problems caused by cubicles, organizations need to transform their physical offices to ones that encourage cooperative work. This provides employees small, quiet places to work, as well as their own team areas for spontaneous collaboration. Offices might include more open space and dedicated project rooms. By setting aside rooms for the duration of a project, rather than scheduling them hourly, employers allow workers to keep brainstorming and development ideas posted as long as they wish, which should help them remain focused on a specific mission.

The key is to integrate the physical environment with technology, management practices and work practices. This allows employees to move where they are needed, find adequate support and work where they are the most productive.

In many cases, companies are abandoning the one-size-fits-all concept of using either cubicles or offices. Instead, they are adopting a hybrid approach in which open spaces are available for team projects and group discussions, and private spaces are used for work that requires deep and individual concentration. Employees who need solitude may have their own offices. Those who do not may use small portable booths for shorter periods.

Another example of new integration is a dominant feature in the layout of new office environments: the central street or boulevard that cuts through a variety of departments and must be used to reach coffee and vending machines or cafeterias. These corridors provide a place for spontaneous interaction among employees. Often these corridors are wider than other halls and lead to a work or team area with tables, wall rails for coffee cups, and whiteboards for writing or drawing.

Physical proximity promotes communication by allowing team members to spontaneously interact, build trust, and share ideas with each other. Studies have shown that likelihood of communication between team members decreases as the physical distance between them increases. Separation by floors or buildings has severe impact on likelihood of cross-functional

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<sup>47</sup> Bencivenga, Dominic, "A Humanistic Approach to Space", *HRMagazine*, March 1998

communication. Likewise, researchers from different departments on the same floor are 6 times more likely to collaborate<sup>48</sup>.

While these new approaches to office space may produce different space configurations, they share a critical element: they work best when human resource management is involved throughout the process. When most organizations are designing office spaces, they need to consider their employees and the way those individuals perform their work, which means HR professionals are, or should be, included in the office redesign teams from the outset as a matter of successful business strategy.

To provide flexibility, virtually all the furniture components can be made mobile: Corner stations with computers and filing cabinets are on rollers; special wiring allows employees to use their computers and telephones anywhere in the facility, rather than being tied to a specific work station; file cabinets are on rollers; whole bookshelves can be removed; and work station walls are not attached to central cubicle spines, so work areas can be reconfigured quickly. Employees who need privacy can use portable, enclosed work areas. Balancing open space with private is crucial, but good design requires something more. It has to be flexible enough to accommodate all sorts of work.

Knowledge workers in particular require periods of private concentration to develop a creative understanding of information and solutions to complex problems. At other times, they need to work in collaborative groups. Knowledge workers who work together to accomplish some common goal tend to function as a community of practice. They build a rapport that enhances their individual capabilities. Critical to their success is for all members of the group to be able to communicate and collaborate as needed. Neither the bustle of an open-plan work setting nor the isolation of small private offices alone is ideally suited to these activities. There are benefits to be gained by providing different work environments so that both these modes of effort can be supported<sup>49</sup>.

Serviced office layouts are tailored to the needs of the users. The infrastructure is designed to swiftly reconfigure the arrangement of the space when new tenants arrive, or when existing tenants need to reconfigure their spatial layout.

As the business environment has become more interdisciplinary, teamwork became a key component in the value adding process of corporations. Human capital takes a prime role in this process, adding to the importance of structured human resource management. The main longer-term trend in businesses is toward individuals and groups becoming more interactive. Research contends that the most appropriate environmental systems to facilitate this shift in organizational demand are likely to be more responsive and controllable at a local level than conventional types. Two basic types of team environments have evolved:

1. The large walled room, reserved and used exclusively by a team for as long as they need it.
2. A comprehensive workspace with flexible and usually an open-plan arrangement of furniture and workstations, clustered around a large team area.

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<sup>48</sup> Sims, Joroff and Becker, "Teamspace Strategies", IDRC Foundation, p.23

<sup>49</sup> Kaplan and Aronoff, "The Productivity Paradox: Worksettings for Knowledge Work", *Facilities*, Vol.14, 1996, pp.6-14

The proliferation of furnishings, equipment, and software designed for collaborative work reflects the determination within companies to break down communication barriers both within groups and across departments and divisions. In many corporations, concerns about costs are secondary to the need for providing productive workplaces for the kinds of high-value professionals who occupy and utilize team environments<sup>50</sup>.

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<sup>50</sup> Sims, Joroff, Becker, "Managing the Reinvented Workplace", IDRC Corporate Real Estate 2000, pp.13-28

### 3. Case Studies

#### 3.1. Accenture

##### 3.1.1. Company Background

Originally, Andersen Consulting spun off of Arthur Andersen as a separate business unit in 1989 under the Andersen Worldwide umbrella, which wanted to offer consulting services in addition to its audit and tax business. At its launch, the firm had 21,000 employees and had first-year revenues totaling \$1.6 billion. Along with McKinsey & Company, Andersen Consulting shared the strongest global brand recognition of any consulting firm. Aggressive marketing efforts have yielded impressive results, considering the firm was weaned from Arthur Andersen only 12 years ago. In 2000, Andersen Consulting changed its name to Accenture and decided to go public. The firm was highly recognized as being on the forefront of developing innovations to improve the way the business world works and lives<sup>51</sup>.

The company structured its services in 18 focused industry groups in five global market units.

<b>Global Market Units and Industry Groups</b>					
<b>Market Units</b>	<b>Communications and High-Tech</b>	<b>Financial Services</b>	<b>Products</b>	<b>Resources</b>	<b>Government</b>
<b>Industry groups</b>	Communications  Electronics & High-Tech  Media & Entertainment	Banking  Health Services  Insurance	Automotive  Consumer Goods & Services  Industrial Equipment  Pharmaceuticals & Medical Products  Retail  Transportation & Travel Services	Chemicals  Energy  Forest Products  Metals & Mining  Utilities	Government

Source: Accenture corporate information fact sheet<sup>52</sup>

<sup>51</sup> Accenture website at [www.accenture.com](http://www.accenture.com)

<sup>52</sup> Accenture website at [www.accenture.com](http://www.accenture.com)

Each of these global market units was supported by eight “service lines” that encompassed different business aspects:

- Strategy and business architecture: strategic operational planning and design
- Customer relationship management
- Supply chain management
- Human performance: human resource management
- Finance and performance management
- Accenture technology labs: inventing and researching business solutions
- Solutions engineering: developing and implementing industry specific solutions
- Solutions operations: evaluating managing and outsourcing solutions.

Each industry group was composed of professionals with broad experience and thorough understanding of the evolution, issues, opportunities and expertise in the industry segment.

Accenture was not only internally structured to provide comprehensive consulting services; it also established strategic alliances with external, complementing or specialized solutions providers. The firm also invested venture capital in starting businesses, providing insight and revenue from emerging technologies. Since its inception in November 1999, Accenture Technology Ventures has invested more than \$300M in more than 70 companies.

The company’s clients spanned the full range of industries around the world and included 84 of the global Fortune 100 and more than half of the global Fortune 500. By 2000, more than 80% of the firm’s top 100 clients had been clients for at least 5 years, more than half had been clients for more than 10 years. In order to serve this expansive customer base, Accenture employed 70,000 people worldwide.

This staff was located in over more than 100 offices in 47 countries, and generated over \$10 billion in revenue. The total office space comprised over 8 million square feet. The firm strongly believed in the integration of technology, service and space, as integral components of the business environment. Since the company aspired to be a leader in innovative corporate thinking, it also strived to set the example in corporate real estate management.

The basic strategy was to possess a portfolio of spaces with cascading lease terms and structures, rather than long-lease space in every location.

### 3.1.2. Objectives

The single most important objective of Accenture’s effort to implement alternative working environment practices was to drive costs down. Real estate costs were considered a part of operational costs. The target was to keep this cost below 3% of net revenue.

Other key motivations include increasing flexibility and improving the life/work balance of employees. The general motivation for the real estate managers was to help Accenture become a more *nimble* and agile company. They estimated for example that due to rapid pace of change in the business world, their business model was to be entirely revised every 18 months. Because of the inherent inflexibility of real estate, corporate real estate managers felt the existing portfolio couldn’t be responsive enough to this rate of change.



Accenture's real estate group pursued a variety of strategies to cut costs and address the need for flexibility in the overall portfolio. The goal of studying new workplace strategies was twofold. On the one hand, Accenture wanted to develop the most efficient work environments for themselves, and on the other hand to apply this knowledge in client projects. Accenture tried to abandon the concept of ownership of desks. In 2001, employees reserved a desk through an online desk hoteling system, in person or over the phone. On average, there was one desk per five employees.

The company-wide space utilization ratio translated into 128 square feet per employee, which seems very low. This can be attributed to the fact that many employees were working at client locations or to successful hot-desking and hoteling policies. The goal was to drive that number down even more.

In addition, about 35% of workers telecommuted to some extent. They visited their corporate office on an average of about 1 to 2 days per week. These commutes were further reduced by Accenture's strategy to locate serviced office space in satellite locations in order to increase the quality of life for its employees. In London alone, they occupied space in 14 separate buildings. Growth periods in the company usually included very strong and sudden growth in employees. However, the growth had flattened, particularly in the US, leading to underutilized space.

The strategies used to cut costs and increase flexibility were:

- Negotiations with hotel operators, where space is underutilized during the day. In 2001, Accenture was exploring this possibility with four hotel operators to study the best physical layout and contractual structure to achieve the highest flexibility at the lowest cost.
- Negotiations with innovative landlords who are open to more flexible approaches, such as shorter lease terms, favorable lease breaks and subleasing clauses.
- Negotiations with other entrepreneurs, joint ventures with clients or other occupants in order to shed or distribute lease risk.
- Serviced office space contracts with different providers (Regus, MWB, HQ-Global and smaller local operators). These contracts have a wide variety of service levels: from individual workstations to large open plan configurations, from short long-term leases, from incidental to continuous availability.

Accenture operated worldwide on assignments that were short-term in nature, while the overseas client base generally has included long-term relationships.

### 3.1.3. Serviced Office Space

Accenture utilized serviced office for specific short-term needs, as its inherent flexibility aligned well with the company's operational needs. While core offices were typically leased on a long-term basis, serviced space was used entirely as additional and peripheral space.

The serviced solution was seen as an integral part of the corporate real estate strategy. The contracts were set up in a staged process with a variable cost structure, parallel to the variable growth rate of the company.

The consulting projects conducted by Accenture were in essence multidisciplinary, and assembled a wide variety of resources, mainly human capital, from very different and specialized backgrounds. Typically, project teams varied between 20 and 40 people.

Serviced office spaces were fitted out with the latest technology. Communication and data access at locations throughout the world were of the highest quality and reliability. Although the management consulting business was peripatetic by nature of the job, technology was seen as a crucial tool to perform the work *and* reduce travel. Sharing of knowledge and resources became essential to the company's business model through Global Market Units and Industry Groups. Project teams depended on the ability to tap into the vast body of knowledge of the company condensed in online database networks. The possibility to securely log on to this network from any location was inherently part of their serviced office space selection. They felt occupying serviced office space did not compromise data access or security. However, in order to preserve confidentiality for their clients, Accenture preferred to lease entire floors or some form of more private office space, limiting interaction with other serviced office space users. Acoustics formed an important factor in the setup. Typical serviced office space arrangements for these types of leases were as follows:

- 1/3 of the space was taken exclusively by Accenture
- 1/3 was leased or subleased to other companies
- In between was 1/3-shared, common space that remained highly flexible to compensate for suddenly increased needs.

The space that was exclusively occupied by Accenture was mainly conceived for collaboration and interaction, as 60% of the serviced office space was set up as open plan office and 40% as enclosed space. So called "war rooms" and informal interaction possibilities were deliberately included in the overall layout. Employees who only visited for a short time did not sign up for dedicated desk space, but stayed in the club lounge instead.

This layout was felt to provide the best combined level of flexibility and security at a minimal cost. Fluctuations in staff level visibly affected occupancy levels across the entire corporate portfolio in the long run, and obviously most immediately occupancy levels in the serviced office entities.

Accenture negotiated short-term leases with a range of serviced office providers. These contracts comprised as well individual workstations as larger office entities. Every deal was considered separately. For more customized solutions, Accenture was entering more strategic negotiations, but didn't achieve concrete, tangible results in 2001.

There was hardly any relationship between the direct users and the providers, as senior management was in charge of negotiating these serviced office leases. However, some policies integrated user needs and preferences to ensure a functional fit for space that was leased on a long-term basis. Ultimately, every deal proposal (including options) was evaluated based on a GAAP analysis.

The serviced solution was considered too expensive to make up a significant portion of the entire corporate real estate portfolio. Hence, this solution was more suitable for resolving peak demand for office space. The serviced office space was also occupied during transitions to long-term leases in other locations, but the goal of using the service for only specific short term needs

remained. Accenture was also interested in considering medium-term occupancy of serviced office space, but they wanted to gain a better understanding of the cost and benefit structure of such deals. In 2001, they had not been able to assess exactly how much they would be willing to pay for flexibility per se.

Accenture entered serviced office agreements with their providers, based on immediate needs. The ability to occupy and vacate the premises was essential in the overall cost-minimizing real estate strategy. Because of the nature of the work, the company gave preference to short-term leases. Where traditional lease terms typically spanned over several years, projects often amounted to only a few months. This suggests Accenture believed serviced office space was the most appropriate way to keep overall costs down during the formative stages of developing their flexible work place strategy. They however were also exploring other innovative solutions with hotel operators, to evaluate which type of remote alternative working environment was the most functional, flexible and affordable over the long term.

Even though serviced office space was essentially a short-term contract, the relationship the company was trying to develop with their main providers was a long-term one. The providers had to learn and understand the intricacies of the business model of management consulting in order to create the most appropriate agreements, to configure the most customized service for Accenture.

## 3.2. Siemens Real Estate

### 3.2.1. Company Background

A young engineer and inventor, Werner Siemens and mechanic Johann Georg Halske, founded the Siemens and Halske Telegraph Building Company in Berlin in 1847. Quickly, that became one of the most dynamic companies in the electrical industry. Within a few decades the company was transformed from a small workshop operating in precise electro-mechanics into one of the largest global electro-technical corporations in the world. The driving force of this growth was the combination of the innovative potential, international scale of the company's main product, telegraphy, and successful entrepreneurial policy.

In 2001, Siemens employed 460,000 employees in over 190 countries; 57,000 employees were engaged solely in research and development. The conglomerate spanned 9 segments:

- Information and Communication: telecommunication
- Automation and Control: logistics and production automation
- Power: power generation
- Transportation: transportation systems and vehicles
- Medical: diagnosis and therapeutic instruments
- Lighting
- Infineon Technologies: chip manufacturing
- Financial Services: finance & investment management
- Siemens Real Estate: corporate real estate division

Siemens Real Estate (SRE), previously called Siemens Immobilien Management (SIM), was founded in 1994. The real estate department of the Siemens Corporation operated the conglomerate's international owned commercial properties: 12,000 acres of land and 200 million square feet of building space, of which 119 million square feet of floor space on 5700 acres of land were under direct functional and commercial responsibility.

The total owned portfolio, valued at \$4.4 billion in 2001, comprised office, manufacturing, and storage space, in a highly integrated network of commercial buildings in 900 locations worldwide. Revenue for SRE in 2000 was \$1.2 billion with income of \$187M.

SRE was structured into four parts:

1. Real Estate Development and Sales
2. Portfolio Management
3. Property Management and Services
4. Construction Management

Maximizing the utilization of surplus real estate was expected to stay the strongest focus.

Additional plans call for expansion, such as building a Siemens campus ("Technopark") in Mülheim, Germany, and other similar large-scale projects in other locations throughout Europe. SRE launched new products, such as Siemens Business Centers in major German cities, which they expected to introduce across Europe as well.

In this business environment, Siemens Real Estate was performing as an innovator for alternative work environments. The Property Management and Services division was conducting a pilot project in office hoteling and serviced office space.

### 3.2.2. Objectives

Although Siemens was considered a mature corporation, it had extensive foundations in the “new economy”. Applications in information and communications technology in the optimization of value adding processes, e-commerce and online strategies had become standard themes in the business model. Products and services for digital and virtual environments were powerful markets, although most of the work within the Siemens Conglomerate was not performed in manufacturing any more. In fact, only 25% of the total corporate real estate remained dedicated to production. At the point where the majority of the industrial space was not used for pure manufacturing, it was being used for distribution, storage, processing of infrastructure for supporting the information and communications technology. Workers were not referred to as industrial laborers but as “information workers”, or “brainware”. The progress in labor organization accelerated this change in the nature of occupiers of the buildings. New IT-supported concepts of management and organization such as Just-In-Time, Total Quality Management, teamwork, profit centers, “lean and mean”, and workflow systems, served to recognize and to eliminate unproductive, superfluous labor and real estate. The new guiding principles in this evolution were de-hierarchization, decentralization, cooperation, communication and customer focus.

The change in the business environment necessitated and generated a higher degree of qualification and education of the workforce, changing the requirements for the work environment. Cost certainly continues to play a primordial role, but the quality and effectiveness of this office space itself is at least as important. A particular effort is put into providing the most desirable office space for the best performing staff as an external motivation.

In 2001, the primary objective of Siemens Real Estate in general was to intensify the use of the existing real estate portfolio, in order to create additional revenue from superfluous real estate. Like other business units, SRE improved the overall company's cost structure through a profit-oriented instead of cost-minimizing real estate management, although this was in part accompanied by reducing under-performing assets through the targeted disposal of real estate.

### 3.2.3. Serviced Office Space

Serviced office space centers were developed for Siemens’ employees, subsidiaries, and clients. The main goal for this serviced office space pilot project was to offer an adaptable officing solution for project teams on a flexible horizon in time and place that supports rapid switching between team-based and individual work. Most of the managerial work was considered to being carried out in offices, meeting rooms, home offices, trade shows, conferences, on airplanes, trains, cars or in the hotel room. Instead, Siemens tried to concentrate these disparate forms of work into a more efficient environment.

SRE developed 5 serviced office centers in Munich, Berlin, Erlangen and Dusseldorf. The goal was to provide productive office space for traveling knowledge workers, clients and other Siemens affiliates. The location close to the airport made the centers a perfect solution for business meetings and conferences during layovers. Each center was equipped with 50

workstations and 2 conference rooms. Teams were generally smaller (2 to 10 persons), diminishing the importance of large open-plan offices.

Connectivity was part of the essence of the Siemens Corporation business model and thus was strongly rooted in the serviced office concept undertaken by SRE. The IT infrastructure was devised entirely by Siemens, as a showcase and a test case for the most up-to-date technology. Because most users of the space were Siemens employees, the system was integrated with Siemens networks. Doing so also gave Siemens' customers exposure to these systems. As a result, customers have implemented Siemens' philosophies and technologies into their own IT divisions as well. The security concern has been addressed through highly maintained firewalls and encryption.

The spaces were fitted out with very flexible furniture and building systems. Walls, lighting fixtures, desks, all electronic equipment were designed to be mobile and flexible. The layout of a particular space could effortlessly be changed in very little time, whether it concerned a new user or an existing user who wants to reconfigure its space. For instance, all furniture and equipment was designed with wheels. This physical flexibility helped keeping the cost of churn to a minimum.

The bundling of services at Siemens centers included support staff, which was fully integrated in the comprehensive serviced concept. This support staff included facilities managers, technology support and administrative staff. This administrative staff assures more than simply a reception service: travel arrangements, mailing and courier services, hosting guests and clients, catering, medical assistance and translation services were standard available packages at these centers. Peculiar however was that the lease contracts were flexible enough to include or exclude furniture and computers, if the user so desired. The philosophy was that clients could choose to use their own existing equipment, without having to incur any extra costs.

In the mindset of "more freedom for your free time", SRE conceived the "SRE-Shop". The user of the serviced office space had access to an Internet portal for grocery shopping. The goods were delivered at the workspace or at another location specified in advance. The same system was applied for dry-cleaning, car cleaning and maintenance, hairdressing, and travel agency services.

Siemens also used this concept as a human resources marketing tool to attract high quality knowledge workers. SRE claimed serviced office space also enhanced productivity. Marketing research at Siemens showed that the occupiers of office space often identified their *work* environment with *living* environment, as *organizing* or *servicing* space. This led Siemens Real Estate to become a systematic provider of an all-inclusive service of officing solutions, blurring the separation between professional and private life.

The Bremen center provided an interesting case in point. This branch consisted of about 200,000 square feet of leasable area for non-territorial desks. These were fully equipped with furniture, computers, IT access, and subsequently leased to Siemens business units. Through this model of more efficient space management and hoteling, the lessee was able to achieve a twice or three times as dense level of occupation of the same space. The remainder of the space was leased by SRE as serviced office space into an external market, which received the same products and services as the internal users.

It occurred to SRE that in Munich, per day more than 1,000 knowledge workers flew in and out of the Munich Airport for business related directly to Siemens. Many were mobile employees and need a touchdown desk space, for a few hours or days, sometimes weeks. The design, business model and level of service that evolved were the same in each business center. Booking occurred online or over the phone.

The office centers were entirely integrated in the existing Siemens office and IT infrastructure. In contrast to external providers, SRE Centers could immediately offer direct access to its IT-network.

The relationship SRE and Accenture each developed with their provider, Regus, was very different. At SRE, each of the five business centers were still *owned* by SRE. The provider was merely contracted to operate, manage it. In fact, SRE through its connection with Siemens, was providing most of the technological infrastructure and support. This meant that SRE was focusing more intensely on integrating service and product instead of merely adding service to a product.

### 3.3. Comparative Analysis

The logic behind the objectives and the actual implementation of serviced office space were very different for both companies. The main objective for Accenture was to align their real estate commitments with their operational commitments: as the consulting projects rarely matched traditional lease terms, Accenture's intent was mainly characterized by the avoidance of long-term leases. SRE on the other hand already owned the space, but wanted to intensify the use of its existing real estate portfolio.

Accenture used serviced office space to accommodate peak demand for space, where SRE accommodated a continuous flow of workers on a short-term basis. At Accenture, staff levels were volatile and it was difficult to predict where this staff would have to be deployed and for how long. SRE chose five centers within Germany for serviced office space. The flow of employees was much more steady and predictable.

The demand for the location of the serviced office centers also originated from a different perspective. Accenture operated globally, and needed to rely on serviced solutions worldwide, depending on the demand and location of their clients. SRE on the other hand accommodated staff in only five locations in Germany, and considered expanding to other Western-European locations, depending on strategic expansions within the company, available buildings and proximity to airports.

The character of the growth of both companies directed their use of serviced office space. Accenture's growth occurred through expanding or adding contracts with existing clients in existing locations, or through entering new markets or contracts with new clients. It is specifically for the latter that serviced office space proved to be very attractive. SRE however grew through innovation in work practices. The ability to contract or expand the corporate real

estate portfolio was important for both companies; but as SRE *owned* the space, they were not able to shed the serviced office component from the overall portfolio.

SRE well illustrates how the use of owned core office space can be flexible over time. Accenture implemented a strategy of innovative work environments, but located serviced office space in the second periphery of their portfolio.

Accenture's perspective to use serviced office was rational and operational in nature. The concept was also studied as an application of alternative work environments. This knowledge was further used in applying new work strategies in and for client projects.

SRE also used serviced office space from a promotional viewpoint. Since the success of serviced office to a great extent depended on technology, SRE used the formula to showcase their newest products and services that enhanced connectivity. Both corporations recognized the positive image serviced officing portrayed to their workforce and the media.

In the market for serviced office space, Accenture was on the demand side. Siemens in fact was performing both the role of demand and supply. Through its subsidiary SRE, Siemens provided serviced officing solutions for its own employees and for those of affiliate companies. Even though SRE attracted Regus to manage and operate the serviced office centers, the ownership of the space and long-term strategies were still in the hands of Siemens.

As large multinational companies comprised the majority of the demand for serviced office space, Accenture and Siemens were adequate examples to illustrate the versatility of the concept and the level of diversity in its demand.

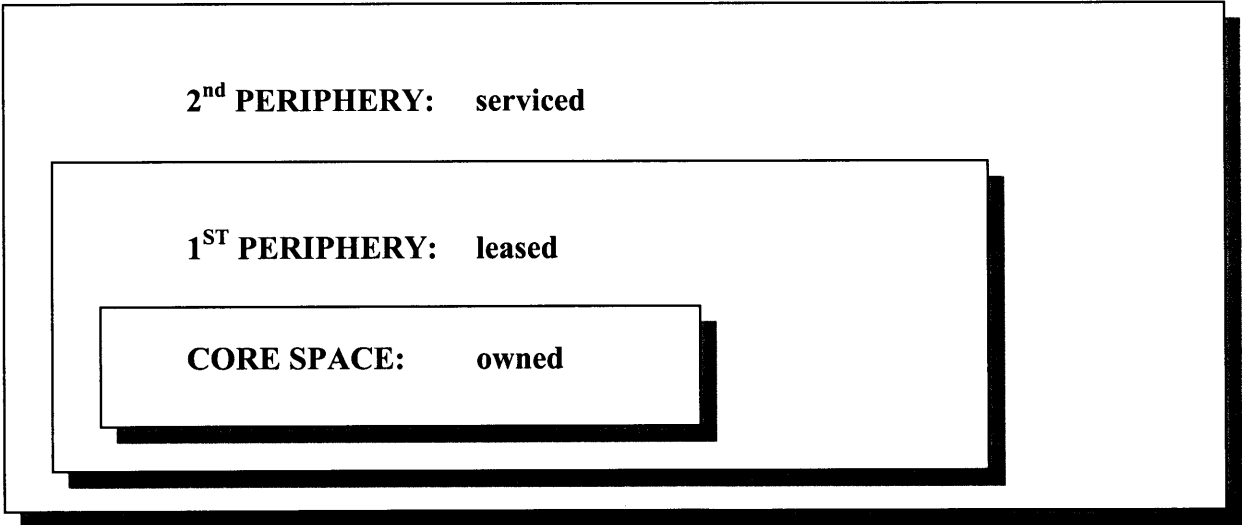


4. Conclusions

4.1. Flexible office space solutions come in several forms; where does serviced office space best fit in the corporate real estate portfolio?

The pursuit for more flexible office space is evolving to a better alignment of interests between demand and supply in the office market. Core office space can be used more flexibly, even though it usually remains owned or leased on a long-term basis. Corporate space in the 1<sup>st</sup> periphery of the portfolio can be occupied or vacated based on long-term economic fluctuations and is typically leased. Highly volatile space needed for peak demand, risky or short-term projects compose the second periphery, for which a number of suitable flexible solutions exist. Both prior studies and this research suggest that serviced office space fulfills a very important role in meeting this 2<sup>nd</sup> periphery demand. Although the serviced office alternative appears costly for longer-term commitments, it is clear that corporations have not yet developed a methodology for evaluating total occupancy costs.

Figure 4.1.



Siemens and Accenture were leaders in developing and implementing alternative work environments and both recognized the value of serviced office space in their corporate portfolio. Even though alternative work environments were able to play a significant role in operational strategy, both corporations found the flexibility of the serviced office formula was most advantageous on the outside periphery of their corporate portfolio.

#### 4.2. Serviced office is an attractive option when pursuing flexibility in the corporate real estate portfolio.

Serviced office space appears to stand out as a highly suitable solution in the pursuit of flexible and alternative work environments since it meets and is aligned so well with the changing demand for office space. It captures well the objectives of corporations. Users benefit from physical, functional and financial flexibility. As today's knowledge workers depend on mobility and the ability to work in the most appropriate location, the larger providers offer serviced office space wherever the workers are, around the globe, in multiple settings. Technology is the enabler to do so; the established serviced office centers are fully equipped and offer superior connectivity solutions. Communication packages are sophisticated, comprehensive, and integrated with the work environment. Depending on how corporation calculate their total occupancy cost, it can be more advantageous to occupy serviced office space instead of traditional office space.. Serviced office space can reduce several obstacles to achieve greater efficiency and effectiveness, providing interaction as well as autonomy for workers. Management of a dispersed workforce remains a continuous challenge and forms the main internal hindrance. Overall, serviced office space accommodates well the demand for more flexible office solutions in an inherently and historically inflexible asset. The objectives of Accenture and Siemens were similar, even though each company's priorities differed.

#### 4.3. Serviced office space is undergoing an evolution, not a revolution

The lack of maturity of the serviced office market segment in its current form, internal managerial inertia, and external market friction are seen as impediments to further development and expansion of the serviced office market. Further, the lack of corporate occupancy cost data is inhibiting users from evaluating serviced office space rationally. Additionally, organizational constraints include the fragmentation of decision-making and the focus on short-term returns within the corporation and the business units.

Even though there continues to be a perception that serviced office space is expensive, corporations do recognize the value of increased flexibility of office space in the process of their change towards alternative work environments. Both the prior research and the case studies suggest however, that the growth of the serviced office market is more an evolution than a revolution. Both Siemens and Accenture were adamant users of serviced office space but both were cautious about expanding the concept in their respective corporate real estate portfolio.

In general, with serviced office space, corporations are able to not only shed real estate assets, but also certain operational aspects that aren't directly related to the business model. In terms of future prospects, the market is considered by all players to have significant growth potential as more organizations recognize the benefits of outsourcing at least part of the corporate property portfolio in combination with the related services.

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