Friction and Inertia: Business Change, Corporate Real Estate Portfolios and the U.K. Office Market

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Abstract

It has been asserted that business reorganization and new working practices are transforming the nature of demand for business space. Downsizing, delayering, business process re-engineering and associated initiatives alter the amount, type and location of space required by firms. The literature has neglected the impact of real estate market structures on the ability of organizations to implement these new organizational forms or contemporary working practices successfully. Drawing from research in the United Kingdom, the article demonstrates that, while new working practices are widespread, their impact on the corporate real estate portfolio is less dramatic than often supposed. In part, this is attributed to inflexibility in market structures, which constrains the supply of appropriate space.

Introduction

The spread of new organizational structures and associated working practices—corporate downsizing, delayering, outsourcing, concentration on core business, hot desking and the rise of the virtual office—throughout the 1980s and 1990s has attracted much attention. These changes within the workplace inevitably affect the demand for corporate business space. While opinions vary, it has been suggested that the net impact of business change on real estate is for a reduction in the aggregate space required, a need for a more flexible product and rapid shifts in the nature and location of demand. Less attention has been paid to the role that corporate real estate plays in facilitating—or hindering—the introduction of these new modes of working.

This article draws on the findings of research funded by the Royal Institution of Chartered Surveyors, which sought to examine the extent to which the United Kingdom property market had been affected by changing business practices. The study examined change in leasing arrangements, appraisal methodologies, business practices and their impact on corporate real estate usage. The findings were based on a historical analysis of lease terms, modeling work on the valuation of leases,
a survey of major corporate property users and a series of interviews and focus groups. This article examines business change and the organizational response to these changes in terms of demand for corporate real estate. It also considers the supply side, in particular examining the property market structures that influence the type of real estate product provided. This demand-supply relationship is outlined in Exhibit 1.

The article addresses the following four questions that are related to this demand-supply relationship:

- What are the implications for corporate real estate of economic restructuring and the resulting management response?
- To date, how widespread are the new management practices between and within organizations?
- How significant are the corporate real estate impacts for individual firms?
- How do real estate market structures and the response by key players enable or constrain provision of appropriate business space?

Where real estate issues have been addressed in relation to business organization, most attention has been paid to the physical configuration of space and the need for functional flexibility. Team working and flattened organizational hierarchies imply a need for more group space and the flexibility to reconfigure space as requirements change. Business change, however, also alters the optimum method of procuring space and the duration of occupation of that space. It will be argued that the changing business context demands a greater diversity of real estate product, which is currently not being delivered by the real estate market (see Exhibit 1).

The second and third questions are linked. Are new working practices and organizational forms pervasive or are they confined to a small number of sectors.

Exhibit 1 | Corporate Real Estate Demand and the Supply-Side Response
that attract undue attention? Where new practices have been introduced, what proportion of the workforce is affected? Do new forms of organization transform demand for business space, or do they, at best, have a marginal impact?

The fourth question is neglected in the literature. Attention has focused on the impact of business change on changing patterns of demand, and, in an aggregate way, on real estate markets. However, the supply of space does not adjust seamlessly to changing occupier demand. The reaction of developers and investors is critical to the supply of business space; that response is conditional on the institutional structure of the real estate market (see Exhibit 1), which varies greatly from country to country. The same business forces may have very different outcomes as a result of property market structures. In the market in the United Kingdom, inflexible market structures (most notably the impact of appraisals of non-standard lease forms on developer and investor behavior and the inertial effect of the U.K. “standard institutional lease”) have constrained the supply of appropriate business space and dampened the impact of business reorganization on the demand for offices. This inertia becomes particularly problematic as business change leads to demand for a more diverse range of real estate products and services.

The next section reviews the literature on business change and the potential impacts of that change on corporate real estate. Two linked themes are examined: reorganization and restructuring of business and the impact of information technologies on the workplace. Next, the findings from a survey of major U.K. corporate property users is reported. The survey sought to investigate both the extent to which new working practices are embedded in organizations and the impact that those practices had on usage of business space. The findings and evidence from interviews and a series of focus groups are then presented to explore the effect of property market structures on the implementation of new forms of business organization. It is argued that the forces of business change are mediated through real estate market institutions that vary from country to country. Inflexible market structures impede the introduction of new techniques and have an adverse effect on business competitiveness and productivity. In the conclusion, some of the factors leading to change in real estate market structures are explored.

**Business Change and Corporate Real Estate Requirements**

This section examines two, inter-related, themes from the business practice literature and considers the implication of the trends identified for business space requirements and the corporate real estate portfolio: (1) new working practices and the restructuring of business; and (2) the role and impact of information and communications technology.

Corporate restructuring, core business, delayering, downsizing and new working practices can be seen as a response to wider changes in the organization of
production and distribution. There are many intermingled strands to this literature: these include the idea of flexible specialization (Piore and Sabel, 1984); arguments concerning a post-Fordist organization of production and society; the French Regulation School (e.g., Lipietz, 1985); and the concept of flexible accumulation found in the writings of Scott (1988) and Harvey (1989). The ideas contained in this literature are sometimes contradictory and have attracted critics. Nonetheless, certain common themes may be found: (1) rapid product innovation and product diversity; (2) tailoring of products to niche markets; (3) a drive to maximize flexibility and overcome rigid structures; and (4) greater concern for risk diversification.

These apply at national and regional level and to individual firms. As Gertler (1992) notes, firms seek to make more flexible use of workers and machines; to create more flexible arrangements between firms; to create more flexible market relations; to reduce the amount of capital tied up in inventory (e.g., just-in-time delivery systems); to foster institutions that promote flexibility and to break down barriers to capital mobility. Many of these changes are evolutionary in nature. However, the re-organization 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, a potential impact on the demand for business space.

**New Working Practices and the Restructuring of Business**

The changes outlined alter the competitive environment for firms. As well as global competition, firms are faced with shorter product life cycles, fragmentation of markets and declining unit profitability. To counter these changes, management solutions have been sought that draw from a variety of sources including Japanese working practices, European business experiments and the examination of regional “islands of success” in recessionary periods. These solutions have been advanced out of management and business schools and popularized by business “gurus”: a key common feature is the very limited empirical evidence on their efficacy. Nonetheless, as businesses utilize the models to reorganize working practices, there are potentially profound implications for the nature of business space demand. Three main themes emerge: (1) the drive to improve quality and productivity; (2) changes in organizational structure; and (3) evolving labor arrangements.

A key theme in the management literature has been the search for ways to improve productivity, reduce costs and gain competitive advantage. To achieve this, emphasis is placed on the need to move away from a hierarchical, vertically integrated structure to an organization that is responsive and flexible. The most visible tool to achieve such ends has been business process re-engineering (BPR) as laid out by Hammer (1990), Champy (1995) and others. BPR aims to rethink the way tasks are carried out within organizations and to refocus on business outcomes. Typically, this involves a radical rethinking of corporate structures and
a flattening, or delayering, of the corporate hierarchy with the devolving of decision-making powers. BPR can be linked to the drive to improve the quality of outputs and processes, and hence to total quality management (TQM) and quality circles.

TQM, in turn, links to the idea of the learning organization (Adler, 1990; and Senge, 1990); in an environment characterized by change, knowledge must be transferred quickly throughout the organization. This places strong emphasis on group working and cross-functional teams. Indeed, much of the literature emphasizes the need for quasi-autonomous team working, the teams altering in composition to meet the changing demand for products and services. Once again, this points to a flattening of the organizational hierarchy. A final common thread is the need for the firm to focus on core competencies and shed other, peripheral, functions.

These changes in structure have implications for the size of firms and employment relationships. These, in turn, affect the nature of demand for business space. Concentration on core business, flattening the corporate hierarchy, delayering, downsizing and outsourcing serve to reduce the job security of workers who are not in the employment core of firms. Firms, by contrast, maximize labor market flexibility by maintaining a smaller core of permanent, full-time staff and drawing on “peripheral” labor when cyclical conditions and the product life cycle determine. Thus, labor markets are increasingly characterized by short-term contracts, part-time work, job sharing, sub-contracting and self-employment. For workers in the periphery, there are both positive and negative implications of such arrangements. Overall, the broad restructuring of the workforce implies a restructuring of the space required by those workers.

Team working, group working and business re-engineering alter the way firms use space. They imply a need for more communal workspace rather than discreet, cellular, offices and the ability to reconfigure space. Business space can, thus, facilitate or constrain the firm’s ability to adapt. Concentration on core business, downsizing, delayering and outsourcing reduce the aggregate space required by large organizations (but may increase the need for smaller space by spun-off service providers). Core and peripheral labor structures imply a need for core and peripheral business space—the latter available in times of expansion but “discarded” during more recessionary times. Overall, the changes outlined demand a more flexible real estate product; physical, functional and financial flexibility are all important.

Information and Communications Technologies

Information and communications technologies play a critical role in enabling new market structures, organizational forms and working practices to emerge. Information technologies have an impact on the spatial organization of activities on both a regional and a global scale. They also have a direct impact on the way
certain tasks are undertaken and change the nature of activities, replacing some
tasks but permitting other, often higher level, activities to evolve. Here we focus
on the direct impacts of IT on working practices.

Technology has provided firms with considerable locational flexibility. Firms, and
to an extent individuals, can choose where certain activities take place. Workers
can operate effectively from a variety of locations described by a melange of terms
such as telecottages, satellite offices, teleworking and the virtual office. Home
working is another manifestation of this trend, predicated on the availability (and
low cost) of digital communications technology, laptop computers, modems and
information interchange software.

This locational flexibility enables organizations to make more intensive use of
their office space. Staff who are not regularly at their “place of employment” may
not need a permanent office, desk or workstation. Hot desking and office hoteling,
particularly in sectors where there are high levels of customer contact or off-site
work, allow firms to reduce their floorspace per worker ratios and improve
productivity levels through cost reduction.

These interlinked forces of change, then, have potentially profound implications
for business organization and hence for demand for business space. These include
reduced aggregate demand from intensification of space usage, new and rapidly
changing functional requirements, the need for less permanent space to
accommodate the peripheral workforce, and a greater emphasis on flexibility both
in physical configuration and in leasing or ownership. This demands a more varied
product from suppliers of business space, with consequent impacts on pricing and
investment potential.

However, while business reorganization and new working practices have attracted
much attention, the extent and significance of change over the whole economy is
unknown. It may well be that changes are largely confined to particular, high
profile, sectors such as information technology, management consultancy and
accountancy. For other sectors, the new modes of working may be inappropriate.
Furthermore, even where firms are altering their working practice, the proportion
of staff affected may be comparatively small. Many “office factory” tasks may
not be suited to team working, hot desking or home working. Finally, even where
new working practices are embedded in firms, the immediate impact on corporate
real estate may be less than anticipated. This may result from the institutional
structure of the property market that determines contractual relationships. In a
market characterized by long leases, as in the U.K., a firm may be unable to
discard surplus space. It is to these issues, and to the U.K. situation, that we now
turn.

Business Change and Corporate Real Estate Realities:
Survey Findings

Office demand and office space management issues have attracted a considerable
amount of research since the mid 1980s. Survey work has attempted to identify
the key criteria used by occupiers to select business space; to examine the determinants of the decision to relocate; and, more recently, to assess current and future space requirements. A further strand of research has investigated the management of corporate real estate, both at a strategic level and in relation to day-to-day decisions, for example occupational density.

While these studies provide pointers to changes occurring over the last fifteen years, they generally fail to provide any real insight into the impetus for change; the findings are inconclusive. In part, this results from a tendency to analyze individual building decisions rather than the whole portfolio and in part from a concentration on outcome (how much space have you shed?) rather than explanations (what were the factors underlying your space requirements?). Additionally, the surveys tend to be a cross-sectional snapshot, with very different sampling frames making it impossible to determine trends over the period.

As a result, it is difficult to disaggregate that part of the change that relates to the macro-economic business environment from that relating to new organizational structures and working practices. For instance, where an organization has contracted in recessionary times, or expanded in a boom, was the contraction more severe or the expansion more muted as a result of the implementation of new working practices? This detailed examination of the reasons for change is missing from the literature.

In order to link explicitly the changing management practices outlined earlier to organizations’ office portfolios, a directed telephone survey using a structured questionnaire was undertaken during the summer of 1997. The target group was large U.K.-based organizations that were considered most likely to be at the leading edge of management practice and therefore act as a lead indicator to the introduction of new working practices. They were also known to be more sophisticated in their corporate real estate management decision making and therefore able to respond to the questions in an informed way. Finally, they were the type of “blue chip” organization that institutional investors prefer to have as tenants and therefore an important customer group from their perspective. The data gathered by the survey was further enhanced by interviews and by three focus group meetings attended by corporate users, developers, landlords and advisors.

In total, forty-five organizations participated in the survey representing a broad cross section of sectors from financial services to public sector enterprises. The average turnover of respondents was £2.9 billion ($4.8 billion) with an average employment count of approximately 25,000. The size of the office portfolio varied considerably with the largest occupying 15 million square feet and the smallest 65,000 square feet. In almost all instances, the individual who responded on behalf of the organization was the most senior person responsible for the corporate real estate portfolio. Exhibits 2, 3 and 4 provide key data on the profile of the sample respondents and their real estate portfolios.

Supporting earlier surveys, which examined the management of corporate real estate portfolios by large U.K. organizations (Avis, Gibson and Watts, 1989;
Debenham Tewson and Chinnock, 1992; and Avis and Gibson, 1995), these organizations confirmed that their office portfolio had changed significantly during the previous five-year period. The office portfolio tended to be reducing in size (47% had decreased their property portfolio); the length of leases was reducing (62% had moved to shorter lease lengths); and the preferred location of the office space was changing (33% had moved out of city center to periphery locations and another 11% to new regions). These changes are consistent with the way in which the demand for office space was forecast to alter as a result of the new management trends.

Differentiating this research from previous work, the survey then went on to explore the extent to which the new management practices had been adopted by these organizations and how this had affected demand for business space. Three aspects of business transformation were reviewed: (1) changing organizational structures; (2) the introduction of new working practices; and (3) the implementation of new office technology. For each of these aspects, the firms were asked to identify what proportion of staff were affected and what impact this had had on the organization’s space requirements.
The findings from the survey confirmed the view that these large organizations were likely to be at the leading edge of the new management ideas. In the majority of cases, the organizations had already introduced or were considering the introduction of these new management approaches (see Exhibit 5). More than half (56%) of the organizations had undertaken some form of business process re-engineering, almost 70% had restructured, an equivalent proportion had downsized and 87% had outsourced some of their functions. In terms of new working practices, three-fourths had introduced team working, almost two-thirds operated home working arrangements and just over half had some form of hot desking. These initiatives were supported by the introduction of new communications technology including email (98%), voice mail (73%) and video conferencing (62%).
The impact of these workplace initiatives on the office portfolio depends on the proportion of staff affected. Here the picture was much more varied (see Exhibit 6). Where changes had occurred across the entire organization, a considerable proportion of staff was affected. The management restructuring or re-engineering of business processes was thus likely to have far reaching affects. In more than 70% of cases, at least 15% of the office-based workforce were affected. In discussion with the respondents, the actually proportion of staff affected was very significant with between two-thirds to all staff being mentioned. Similar proportions were observed with team working.

By contrast, for over 60% of the organizations, less than 5% of the office workforce had been subject to outsourcing or home working. Although often reported, these new initiatives appear to be at the fringes of the organization. Perhaps more surprisingly, the introduction of hot desking or other forms of non-territorial office arrangements affected less than 15% of office workers in three-fourths of organizations. Thus, the impact of new working practices may be less pervasive than often assumed.

The respondents were then asked to consider if these new management practices had had an impact on their office portfolio. A significant number of firms (15% to 66% depending on the initiative being considered) stated that these new practices had had no impact on their office portfolio. If there was an impact
reported, it was most likely to be related to a reduction in required office space or a change in office layout (Exhibit 7). For the vast majority (over 83%), neither the lease length nor the location of office space was affected by changes in management structure or working practice.

Seventy-one percent of respondents stated that teamwork had changed their internal layout of office space and 67% stated that downsizing had lead to a reduction in their office space. These were the most significant impacts. For about half the organizations, delayering and hot desking had lead to some reduction in space and home working and hot desking had lead to changed office configurations. It is interesting to note that BPR and outsourcing had apparently limited impact: only 29% and 26% of organizations respectively stated that these had reduced their office space needs.

The evidence, therefore, appears to be that these management practices have, to date, had a relatively modest impact on the office portfolio. New working practices and changing management structures have not had the apocalyptic influence on the demand for space that is sometimes foretold in the literature. Change appears to be gradual rather than revolutionary.
As well as reflecting on the past, respondents were asked to consider key management issues facing their organizations for the future and the likely changes to their office portfolio as a result. Increasing the use of IT and introducing new working practices were the most frequently cited (60% of respondents). Introducing IT was considered the most important issue by just over 20% of respondents. More detailed investigation, then, begins to shed some light on what has been occurring so far. In order to consider implementing new working practices, organizations must first ensure that the IT and communications infrastructure is in place and is being used effectively. This still appears to be a weakness in many organizations, confirmed not only by the survey, but also by further evidence from the interviews and focus groups. Once this requirement is in place, these organizations intend to continue the introduction of new working practices and restructuring their business.

An additional constraint to change was uncovered by the research. Evidence from the interviews and focus groups showed that some occupiers, as a result of the restructuring, recognized the need to differentiate between their core and peripheral real estate needs. The latter, predominately for expansion and less permanent staff, was estimated to account for 30% to 40% of their office portfolio. Firms required flexible forms and shorter lease contracts for this peripheral space while preferring long leases or owner occupation for their core requirement. This diversity of form was felt to be lacking in the current U.K. property market.

Under-investment and under-utilization in information and communications technology acts as a constraint to an organization’s ability to change the way of working. The real estate market creates further constraints. The next section considers in more detail the way that management changes drive a demand for greater product diversity—and the way that real estate market inflexibility, particularly in the U.K., can frustrate that demand.

Friction and Inertia in Real Estate Markets

As organizations change the way they work and their associated management structures, so too do their requirements for space change. The analysis above indicates that the changes that have occurred recently result in the need for a greater diversity of real estate provision, depending on the activity being accommodated. These shifting patterns in office space requirements and in office space management meet friction and inertia from both internal and external sources.

Internal hindrances arise from three main sources. 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 lack of take up of the new working practices. However, since organizations see investment in IT as a key management issue for the next five years, this constraint may be ameliorated.
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 (Kaplan and Aronoff, 1996). The threat appears in different guises depending on the management initiative, for example, 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.

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 an extent, this results from lack of information on the total cost of accommodating workers and hence an inability to quantify the costs and benefits of change. This will be considered again later, in the context of the availability of information within the property market.

External frictions come from real estate market institutional structures. The key actors within property markets make decisions that can facilitate or mitigate against different types of change. The developers and funders of space, the landlords (both private and institutional), the professional intermediaries (including appraisers, legal and financial advisors) and the policymakers (through the economic, planning and environmental legislation) combine to create unique real estate markets in different countries. The demand for new forms of space is therefore mediated through these institutional structures with differing outcomes, at least in the short term.

While the economic, social and technological forces affect organizations operating in different markets in similar ways, the same is not true of the way the individual property markets respond to these new forces. The U.K., with its unusual property market structure, provides an interesting illustration of the way the key players within a market affect the supply of space in response to these forces.

A key conclusion of the research was that business change drives a need for greater diversity of office provision—that different types of office-based activities require distinct types of business space products. Although some occupiers were able to articulate their offices requirements (for example in terms of core-periphery space) most were only able to call for “greater flexibility” (Lizieri et al., 1997). At the same time, commentators have bemoaned the lack of product development in the office sector (Duffy, 1990), but the attention has tended to focus on physical layout and internal usage. However, from a marketing perspective, there has been considerable debate concerning the nature of products and services concluding that the resulting offering is often a blend of tangible and intangible benefits (Shostack, 1977; and Levitt, 1980, 1981). Applying these ideas to real estate, the office product is enhanced by both tangible features and augmented services. In order to understand this perspective, Exhibit 8 is used to demonstrate how office space might be enhanced through service provision. At the core of all of the different products is the essential benefit being sought by the consumer—space.
Product Service

2nd Hand office freehold from private seller

New office freehold on business park acquired from developer (Service level related to management of private roads, landscaping, etc.)

Leased office space (Terms of lease will determine level of service i.e., FRI versus IRT)

Dedicated serviced offices (PFI and Netspace)

Serviced Offices—available on as need basis

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Exhibit 8 | The Office Product–Service Continuum

Adapted from Shostack (1977).

As one progresses along the continuum towards service orientation, the product has been augmented by intangible features giving the consumer added utility through services. Therefore, product diversity in the office sector might be considered in terms of the amount of service provided with the core space. This includes financing, facilities management services and administrative support.

Evidence suggests that the products with greater service orientation at the right-hand side of the diagram have only recently emerged and currently form a small part of the total office market in the U.K. Traditional U.K. lease structures are long term (fifteen to twenty-five years) with the obligations for repairing and insuring being transferred to the occupier. The growth of the serviced office sector occurred mainly in the property recession with players such as Regus and HQ Business Centres emerging. The gap between the traditional lease and the full-service office has only very recently been filled. Regus launched their new product, Netspace, at the beginning of 1998 and the first occupational property-based Private Finance Initiative (PFI) was established in 1997 between the Department of Social Security and a consortium backed by Goldman Sachs. Both of these seek to provide serviced office space at varying levels on a dedicated and longer-term basis that conventional serviced office space.

Even given these new initiatives, the factors impeding the development of greater product diversity within the U.K. are very intense. In order to understand depth of resistance, the role of each of the key players and the relationship between them needs to be examined. The U.K. real estate market remains largely dominated by major financial institutions, defined as both institutional investors, pension funds and life insurance companies, and property companies, who see property purely as a financial instrument. Therefore, their role as a product and service provider to occupiers is an anathema. In fact, this “management” element, in terms of the cost and time required to administer the property investment, is seen as one of the main drawbacks to real estate as an investment when compared
to other asset classes. Many financial institutions will outsource the management of their investment portfolios to real estate consultants who see it purely as an administrative function. Their measures of performance are related to minimizing voids, keeping management costs down, and ensuring that the tenants are paying promptly and meeting their obligations. The client is the financial institution not the tenant, who has little power or influence.

As well as controlling much of the current stock, investors provide the capital to developers to build new space. Therefore, developers see the investor as their client as much as, if not more than, the end user. Funding a development is as much a measure of success as letting it. Consequently, in terms of the physical configuration of space and the quality of building services provided in new office space, the specification has been driven by what the investor felt was appropriate not what the occupier actually needed. This, it has been asserted, led to considerable over-specification from the occupiers perspective and additional cost which ultimately would have to be borne by the tenants (Guy and Harris, 1997). More importantly, it led to standardization of product, driven by the need to be “institutionally acceptable.”

As investors control the supply of space through funding, their dominance in the market means that, especially in times of limited supply, they dictate the negotiation and therefore lease terms. Although the research found that U.K. lease lengths fell sharply between 1990 and 1995, this appeared to be more a function of the phase in property cycle than a longer-term development as a result of changing forces. Again, this dominance dictates standardization and conformity rather than diversity.

The U.K. planning system can act as a constraint to supply in a number of ways. Local authority development plans provide limits to the aggregate amount of business space permitted (and hence constrain new development) while change of land-use (say from retail or residential to office) is subject to planning permission. However, the introduction of the B1 use class in 1987 facilitated transfer of use between light industrial, R&D and office occupation, thus reducing the constraints on supply of out-of-town office space, particularly on business parks. The planning system imposes private costs on the developer (Keogh and Evans, 1992), which may make marginal schemes unprofitable.12 More recently, concerns about environmental impact and the vitality of town centers have led to severe restrictions on out-of-town development, although this has had a greater impact on the retail sector. Planning was not identified as a significant constraint by either the survey respondents or the focus group participants.

As outlined, some innovation has occurred within the property market but this has often been driven by developers where longer-term involvement is envisaged or where branding has been important. Arlington is an example of a more traditional player recognizing the benefits of providing additional services to their tenants with the advent of facilities management services. The growth of the serviced office space sector is an example of a player focusing on the service end of the
product-service spectrum. One of the problems, which the newer service-enhanced products face, is pricing. The solution to the potential complexity of pricing each of the individual elements of the service, is to establish a price per person or workspace that combines the charge for the space with the additional services. However, this assumes that the corporate real estate decision makers understand their current occupational cost structure and or can establish an appropriate benchmark from the market. This data does not appear to be readily available even within an organization and certainly has not emerged into the market as benchmarking information, despite the efforts of the Operational Property Databank. The leads to an impediment to establishing a sound business case and thus the inability to turn potential demand into actual demand for these newer forms of business space.

The consideration of cost issues leads to the role played by professional advisors, notably the valuation profession in the U.K. Funding, financing and investment performance depends on the appraisal values determined by the property professional. The research found that traditional techniques based on ad hoc adjustments to comparable evidence dominated the market. Such methods are predicated on a relatively standardized product. There was persuasive evidence that valuers, confronted by an innovative or non-standard occupational form, were adopting a highly conservative stance and marking values down. This further increases landlord and investor resistance to new forms.

These appraisal impacts result, in part, from professional conservatism. Traditional methods and heuristics are embedded in the U.K. real estate culture, with considerable unwillingness (or inability) to adopt more rigorous analytical techniques from other capital asset markets. However, resistance is reinforced by institutional structures in the market—from professional practice guidelines imposed by, for example, the Royal Institution of Chartered Surveyors, from the effects of legal, tribunal and arbitration decisions, case law and precedent, which entrench traditional methods and models. Conservatism and institutional structures in the legal profession can have a similar dead hand effect on lease contract innovations.

Therefore the factors come full circle. If valuers cannot establish value (or even worse discount value based on their uncertainty of the new product) then investors will not fund new initiatives. Without the funding, new products will not emerge and the U.K. property market is threatened with stagnation.

To break down these inertial forces and frictions, there must be innovation from within the market and new players from outside the market, questioning the status quo. There is some evidence of both emerging in the U.K.

**Conclusion**

Changes in the organization of business and new working practices have major potential impacts on the demand for business space. These impacts include a
reduction in the aggregate amount of space required as firms make more intensive use of real estate, changes in the location of demand at both micro and regional scales, and new requirements in terms of physical form and configuration to accommodate new working practices. Most of all, however, changes in business practice lead to a need for a greater diversity of real estate product—including the contractual terms of occupation and the level of service provision associated with the physical space.

Survey evidence from the U.K. 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. Change is evolutionary rather than revolutionary. This more gradual process of change reflects both internal and external friction and inertia.

Internal barriers to change include under-investment and under-utilization of information technology, resistance by staff and middle management to change and difficulties in establishing the costs and benefits of organizational change in the absence of corporate occupancy cost benchmarks. However, the structure of the real estate market imposes external barriers to change. Lack of appropriate real estate products and services and the inertial effect of existing lease structures act as frictional forces. These real estate market structures are specific to particular countries and regions: as a result, common global economic and technological forces may have quite distinct business outcomes.

The inflexibility of the U.K. property market illustrates the potential impact of institutional structures. Supply of business space has been dominated by institutional investors and private landlords who have been able to impose a standardized form of lease contract that is extremely onerous for occupiers. The ‘standard institutional lease’ does not provide the flexibility increasingly sought by business. Homogeneity of product has been reinforced through professional structures in the market. In particular, adverse appraisals of innovative leasing forms have entrenched landlord and funder resistance to new forms of provision.

Change is, however, occurring in the U.K. real estate market. From within the market, the recent success of the serviced office sector has spawned imitations and extensions of the ‘space plus service’ concept. This trend has been reinforced by the impact of the Private Finance Initiative (as part of the general move towards privatization of state provision). PFI, in turn, has led private sector occupiers to consider similar programs aimed at outsourcing the provision of both space and services. Experience in specialized real estate sectors that are not generally part of institutional portfolios (for example: leisure, inns) may also lead to changes in provision in the office and business space sectors.

These internal initiatives are complemented by external factors, notably the arrival of new players in the market. Globalization of business has an effect on both
occupier and investment markets. In the occupier market, powerful international firms, used to more flexible forms of leasing, may be unwilling to accept the status quo in the U.K.

In investment markets, international investors, more used to a variety of occupational forms and prepared to use evaluative tools from other asset classes, may be more willing to fund innovative forms. Finally, there is increasing competition for real estate management and advisory business, with management consultancy and specialist facilities management firms taking an increasing share. This points to a cultural change in the way that corporate real estate is perceived and analyzed, with greater emphasis on total occupational costs, added value and benchmarking.

This process of change in real estate markets should not be overstated. The more diverse business space requirements of occupiers are yet to be fully matched by supply of appropriate buildings and services. Real estate market structures thus constrain the process of business change. These frictional forces will, eventually, be overcome. In the interim, there are business opportunities for innovative and entrepreneurial suppliers and investors.

Endnotes

1 See Lizieri, Crosby, Gibson, Murdoch and Ward (1997) for a summary of the research.
2 See, for example, Amin and Robins (1990) and Gertler (1992).
3 As Nourse and Roulac (1993) note, any organisation with freehold property is vertically integrated into the real estate market. The logic then of this focus on core business would be that organisations that own their occupation portfolios would rather purchase real estate services like any other input, demanding space and augmented services as appropriate than continue to be in the non-core real estate business.
4 Location criteria have been examined from both macro perspectives, Dunning and Norman’s (1983) work on transnational corporations determining the key factors in selecting regional office locations and Moore, Tyler and Elliott’s (1991) work within the European Community, and micro perspectives, Markheath’s (1992) work on London’s largest companies.
6 A survey of current and future office space requirements can be found in Richard Ellis (1994a, b).
7 Strategic corporate real estate management reviews can be found in Debenham Tewson Chinnock (1992), Avis and Gibson (1995) and operational decision-making data in Gerald Eve (1997).
8 As one of the reviewers noted, such large firms (in contrast to smaller companies) may have both the expertise to identify future occupational requirements and the resources to meet those requirements. Any supply constraints reported by these firms are thus likely to be pertinent to smaller occupiers.
9 See Gibson (1998) for full survey analysis.
10 For a general discussion from a marketing perspective, see Adcock, Bradfield, Halborg and Ross, 1993.

11 The Private Finance Initiative (PFI) was the result of U.K. government policy to encourage the private sector to provide and operate new capital intensive items of infrastructure. Project risk is, theoretically, shared between the private contractor and the government agency commissioning the work. Many of the early projects were for roads or bridges that were based on a design, build and operate basis. More recently, the PFI has been applied to existing infrastructure, such as the real estate occupied by a government department. Unlike a standard sale and lease back agreement, the PFI project is based on providing both space and services to the occupier with very detailed standards of service performance built into the contract.

12 However, planning constraints that curtail supply would increase the price of real estate, making both existing stock and those schemes with planning permission more profitable.

13 The Operational Property Databank was set up by the largest and most reputable organisation producing U.K. real estate investment indices, Investment Property Databank. It has encountered considerable difficulties in collecting accurate and comparable data from the forty plus organisations that are now contributing to the databank.

References


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