

# Which Corporate Real Estate Management Functions Should be Outsourced?<sup>†</sup>

*Chris Manning\**  
*Mauricio Rodriguez\*\**  
*Stephen E. Roulac\*\*\**

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**Abstract.** Recently there has been much interest in outsourcing corporate real estate management functions. We explain why firms should consider outsourcing and identify both positive benefits and possible negative consequences of outsourcing. Further, we utilize concepts from the neoclassical theory of the firm, supported by the literature on corporate real estate outsourcing, to shed some light on how much and which corporate real estate management functions should be outsourced. Functions associated with “taskmasters,” “controllers,” and “dealmakers” are more likely to be outsourced successfully. “Entrepreneur” and “business strategist” management functions are more likely to be carried out more effectively by internal managers. Outsourcing the appropriate real estate management functions, consistent with each company’s individual needs, should enhance shareholder wealth.

## Introduction

Over the past five years, a number of authors (Andersen, 1993; Bell, 1991; Joroff, Louargand, Lambert, and Becker, 1993; Lambert, Poteete and Waltch, 1995; Manning and Roulac, 1996; Nourse, 1992; Nourse and Roulac, 1993) have extolled the advantages of companies managing their corporate real estate proactively as an integrated part of their company’s overall strategic plan to gain a competitive advantage in their industry. Concurrently, the issue of how much and which corporate real estate functions should be outsourced has also been discussed (Apgar, 1995; Bell, 1991; Bergsman, 1994; Carn, Black and Rabianski, 1996; Collins, 1995; Kimbler and Rutherford, 1993; Lambert et al., 1995; Lucchese, 1996; Manning and Roulac, 1996; Rodriguez and Sirmans, 1996; Silverman, 1995; Walton, 1993) in the literature.

Even though it was brought to light fifteen years ago, that 25% or more of corporate assets were in real property, and occupancy costs of corporate space represented 40% to 50% of their net operating income (Rodriguez and Sirmans, 1996, p. 13; Nourse and Roulac, 1993, p. 475), many companies have continued to claim that “they are not in the real estate business.” As recently as 1995, Lee Dayton, general manager of real estate for IBM, was quoted (Silverman, 1995) as saying “We’re in the information systems business, not the real estate business.” Such statements are only true from a very narrow perspective. From a broader perspective, such thinking is not only naive, but also

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\*Department of Finance and Computer Information Systems, Loyola Marymount University, Los Angeles, California 90045.

\*\*M. J. Neeley School of Business, Texas Christian University, Fort Worth, Texas 76129.

\*\*\*The Roulac Group, 900 Larkspur Landing Circle, Suite 125, Larkspur, California 94939.

dangerous for the senior management of a company. This is because the success of all large businesses today, whether admitted or not, depends upon how well they manage their human resources, capital, information systems, and investment in fixed assets, as these are key factors of any production or service. For a major company today to claim not to be in the "real estate business" is like claiming not to be in the "labor business," "financing business" or "information processing business."

Site location competitive advantages, along with large investments in building technology and process layouts to reduce operating costs while improving quality, coupled with the increased need for occupancy flexibility, are gradually forcing more companies to recognize how integral their real estate commitments (either ownership or leases) are to enhancing shareholder wealth. For example, the high office space vacancy rates from the mid-1980s through the mid-1990s afforded stronger companies, who proactively managed their real property, the opportunity to obtain rent concessions *and flexibility* from real property owners in search of stable tenants.

Yet, in spite of the substantial contributions to shareholder wealth through the astute management of their corporate real estate commitments in recent years (Collins, 1995; Joroff et al., 1993; Silverman, 1995), some large companies, such as Baxter Healthcare in 1990 (Bergsman, 1994) have been "getting out" of the real estate management business altogether by outsourcing all management of their corporate real estate. While few managers disagree that outsourcing of some corporate real estate services is advantageous, many believe that outsourcing in some companies has gone too far (Bergsman, 1994). As the advantages of "intelligent outsourcing" of corporate real estate services are being repeatedly discussed, many managers are asking just what is "intelligent outsourcing" of corporate real estate services. In particular, they are asking, *Which corporate real estate functions should my company outsource?*

Which real estate functions should be outsourced for a particular company will vary, depending upon that company's industry, size, locations, and business strategy. It is generally true that property-specific real estate services such as brokerage, construction and property management, can often be more efficiently performed through outsource vendors. It is also generally true that strategic company-wide real property process management responsibilities can better be performed by in-house executives. (This is not to say that certain specialized strategic decisions cannot be enhanced by the contributions of specialized third-party professionals.) Nevertheless, this still leaves much of what constitutes "intelligent outsourcing" of corporate real property asset management in the "gray zone" of uncertainty.

Questions to address to determine what constitutes "intelligent outsourcing" of the corporate real estate function include:

Is there a different way that senior management can view the question of how much corporate real estate (CRE) management should be outsourced that will provide new insights when planning CRE services into the 21st century?

Is a company's decision to outsource CRE management similar to a "divestiture" decision to not be as "vertically integrated" in the real estate business?

Are there benefits from economies-of-scale, economies-of-scope, or power-of-scale that favor outsourcing over doing the work in-house, or visa versa?

Are there other advantages to "acquiring" CRE management talent within a company?

Has a company's environment or business strategy changed, so that tomorrow it makes sense to contract for CRE management on the outside, where before it made sense to perform CRE management using in-house personnel?

The literature on "the theory of the firm" and "corporate restructuring" (e.g., acquisitions, divestitures, spin-offs, etc.) provides a context for considering questions such as these and also helpful insights on how companies might think about CRE management and outsourcing.

Carn et al.'s (1996) recent NACORE Delphi survey of key corporate real estate managers identified the question of *Which corporate real estate services are the most appropriate ones to relinquish internal control and outsource both the management and provision of the service?* as a research issue that needs to be addressed. Also, the research agenda of the newly formed NACORE/ARES Research Foundation (*ARES Newsletter*, Feb. 1996, p. 7), listed "the effect of outsourcing the corporate real estate function on shareholder wealth" as one of the three major areas where research should be invited. In response to these research invitations, this study discusses the benefits and consequences of outsourcing as well as which corporate real estate management functions should be outsourced.

### **Benefits and Negative Consequences of Outsourcing**

Outsourcing involves using service providers to carry out activities previously performed by internal personnel. Outsourcing may be viewed as a corporate restructuring activity, analogous to spin-offs and divestitures, but on a smaller scale.<sup>1</sup> Outsourcing can benefit stockholders if outside contractors can carry out functions more effectively and efficiently than internal personnel. However, outsourcing gains must be sufficiently large to allow outside service providers to make an adequate profit, an "expense" not incurred by a company when work is done by internal personnel.

Where do potential efficiency gains from outsourcing come from? The primary source of efficiency gains related to outsourcing stem from economies-of-scale and economies-of-scope.<sup>2</sup> Scale economies can be achieved by service providers spreading their personnel across several clients. Scope economies can be achieved if service providers possess distinctive expertise in various related real estate areas such as leasing, selling and analyzing site locations. Firms may be able to reduce costs when they share in these efficiency gains through outsourcing some of their CRE activities.

Outside service providers may be able to assist a company improve its reporting of real estate information.<sup>3</sup> For example, outside service providers can help firms update the value of their real estate holdings. Disclosure of current real estate market values can reduce the potential problem of the stock market undervaluing corporate real estate holdings. In addition, advances in information technology may provide alternative transaction arrangements between CRE executive and service providers that facilitate routine communication and other "connections" that heretofore have been provided on a very expensive basis (e.g., industrial and commercial real estate brokerage commissions).

A partial list of the possible benefits from CRE outsourcing include:

- efficiency gains from economies-of-scale;
- efficiency gains and effectiveness from economies-of-scope;

lower transaction costs for routine tasks;  
timely updates of market values on real estate holdings;  
other real estate reporting improvements.

The "theory of the firm" literature addresses the question of *Why do some business activities take place within the firm while other activities are carried out in the external market?* The literature indicates that, whether individuals produce independently and transact across markets or cooperate through a multiperson firm depends heavily upon the extent of efficiency gains in not only production costs, but also in management of processes and transaction costs (see Coase, 1937; Alchian and Demsetz, 1972; Jensen and Meckling, 1976; Fama, 1980; Weston, Chung and Hoag, 1990).<sup>4</sup>

Outsourcing CRE is not without its disadvantages. One disadvantage of transferring activities from inside the firm to outside service providers is that as transactions become increasingly complex, marketplace transactors may be unable to communicate effectively about the nature of the complex transaction through words that are understandable or contractually meaningful (Stewart, 1997). In addition, as more uncertainty is introduced (as is often the case in long-term contracts), marketplace exchanges rapidly become impractical and contracts are incomplete even when extensive contingent claims are provided for (Stewart, 1997). Furthermore, outsiders cannot know the subtle, implicit, often unspoken, cultural factors that determine how an organization does business. Translation of cultural meaning to outside service providers can be cumbersome and expensive, if it is even feasible.

Another disadvantage to outsourcing occurs when marketplace competition is limited and there are few choices of parties with whom to contract. This problem is particularly pronounced when transactions are complex and uncertain. In such situations, incomplete contracts expose the contracting parties to opportunistic behavior (e.g., shirking, cheating and other suboptimal behavior). In these situations, the environment within a firm allows for a more efficient review and monitoring process that can better evaluate performance and curb opportunism, thereby relaxing the need for complex contracts (Weston et al., 1990, p. 30).

An advantage to carrying out activities in-house is that a "firm environment" enables greater team production opportunities through "organization learning," where firm-based output is sufficiently greater than the sum of output under independent production, thereby justifying the costs of organizing and monitoring team members (Weston et al., 1990).<sup>5</sup> Beyond the possible sacrifice of "organization learning," outsourcing may compromise a firm's ability to build valuable "organization capital" over time that further enhances productivity. "Organization capital," which builds heavily upon "organization learning," consists of three types of information: (1) information used in assigning employees (or managers) to tasks, (2) information used in assigning employees (or managers) for formation of teams, and (3) information each employee (or manager) acquires about other employees, managers and the organization itself (Weston et al., 1990, p. 33). In instances where the corporation's real estate is integral to its service delivery (Roulac, 1995), an outsourcing relationship can compromise not just the enterprise's "organization capital," but also the "human capital" and "customer capital" (Stewart, 1997) inherent in the delivery of services by the enterprise to its customers.

Among the possible negative consequences of outsourcing are:

higher costs, as premium transaction fees are paid in excess of a company's internal costs to accomplish the same CRE tasks or management responsibilities;

loss of power-of-scale when negotiating contracts;

loss of control of key elements that influence business function operation and success (e.g., loss of confidentiality and control of information);

inefficiencies in attempting to control outsource provider performance of complex, uncertain, or long-term tasks and responsibilities;

loss of company learning that builds valuable CRE management organization capital, so knowledge gained from transactions and market involvement is resident with the outsourcing provider rather than the company;

loss of internal relationships that result from networking with other segments of business, such that shareholder-enhancing opportunities that might emerge from informal communications are lost;

loss of CRE participation in overall corporate strategy due to the external as opposed to internal orientation of CRE outsource providers.

This section has identified possible benefits and negative consequences of outsourcing CRE management. The next section reviews the earlier literature and research on CRE outsourcing. Section four addresses the question of which corporate real estate management functions should be outsourced in light of this literature while taking into account the benefits and negative consequences discussed above.

### **CRE Outsourcing Literature and Prior Research**

Of the numerous surveys of corporate real estate executives and other CRE thought leaders to investigate outsourcing issues, Kimbler and Rutherford (1993), Bergsman (1994) and Lambert et al. (1995) appear to have looked most in-depth at the major issues regarding outsourcing corporate real estate management.

Responses from Kimbler and Rutherford's (1993, p. 526) questionnaires indicated (1) "corporations are outsourcing more of their real estate requirements, (2) [service] providers are increasing their staff size to meet the increased demand, and (3) both [CRE managers and service providers] have significant problems working with each other." Kimbler and Rutherford (1993, p. 527) further found that (1) "corporations prefer to work with providers they know," (2) that "the quality of the employee who will be assigned to the project seems to be the most important factor to corporate managers" and (3) that "long-term relationships are important to both providers and corporate managers."<sup>6</sup>

In addition, Kimbler and Rutherford (1993, p. 528) reported that "service providers do not understand the clients they work for [neither the companies nor their cultures]. They [service providers] violate reporting relationships, expect too much corporate input in the process, and present their responses in a format that the client cannot use without rework." In terms of overall management of a company's corporate real estate, Kimbler and Rutherford (1993, p. 531) recommend that CRE managers delegate/ outsource day-to-day tasks and proactively address corporate strategic real estate issues internally.

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Bergsman (1994) provides numerous corporate real estate executive testimonials to supplement his reporting of NACORE's outsource survey. Central findings in the NACORE survey research reported by Bergsman were that "55% of [NACORE survey] respondents reported that outsourcing real estate management was costing them more money than it had when it was done internally." "As part of its survey, NACORE also polled executives about outsourcing ten different real estate management tasks, such as acquisition, construction, utilization analysis, space allocation, property management, design, and leasing. In only one area—utilization analysis—did respondents say that outsourcing vendors did a better job than in-house personnel."

While Bergsman (1994) acknowledges the advantages of intelligent outsourcing, he cautions senior management to guard against two corporate real estate outsourcing mistakes: "One mistake is entering into an arrangement that actually makes real estate management more expensive. And the other is 'eliminating functions that are better handled within the corporate organization rather than outside' [stated by] John Blake, the senior vice president for properties and facilities at Hertz."

Bergsman (1993) goes on to discuss how division managers and executives at companies are not very trusting of the outside service vendors and thus are not as open to sharing information with them. To emphasize how elusive outsourcing cost savings often prove, Bergsman (1993) quotes Harry Stein, Director of Real Estate for General Electric, as saying "Right now, what outside service providers are offering is less than what they really provide [because] it's not profitable enough for them [the outside service providers] to provide what they say they can." Bergsman (1993) also quotes Armen Ervanian, VP of Real Estate for Dial, as saying that often with outsourcing of corporate real estate management, "it doesn't show up as payroll or direct overhead, yet the [total] costs of operations are increasing" as a result of shifting the payment of CRE services to the operating unit managers. "Most [unit managers] who outsource don't even ask what it costs to get the service on the outside."

Lambert et al. (1995) discuss how downsized smaller CRE corporate staffs are looking to forge key long-term trust-based relationships with CRE service providers who can provide them with more comprehensive, more customized, higher quality, and even more strategically insightful, corporate real estate service support. "As CRE units move from standardization to customization, [CRE executives] expect service providers to tailor what they do. Tailoring services requires greater interaction with [business unit] customers and, as a consequence, warrants greater attention to pre-planning the relationship [between business units and service providers]. Both the pre-planning of the relationship and the services that are required call for long-term relationships." Lambert et al. (1995) elaborate on how "standardized services are expected to achieve cost savings and quality enhancements, whereas customized services are expected to achieve important reductions in cycle time and to support innovation."

Lambert et al. (1995), like Bergsman (1993) and Kimbler and Rutherford (1993), believe that companies are finding it significantly more difficult to turn over the management of their corporate real estate service support (i.e., CRE service providers working directly with business unit managers) than senior management expects. Lambert et al. (1995) observe that "by enlisting the services of qualified providers, [CRE] executives hope to avoid heavy involvement in the transaction management process. The results are not always as expected. Efforts to free CRE staff to provide greater strategic value to the company often fail. This is due in part to the fact that strategic value depends

upon strong relationships with internal customers, [the operating business units]. For this reason, CRE staff who are attempting to broaden their services often retain the liaison role with their business units.”

**Which Corporate Real Estate Management Functions Should Be Outsourced?**

So what does this all mean for which corporate real estate management functions should be outsourced? The evolving eras of the corporate real estate function since 1970 (summarized in Exhibit 1) provide additional useful background for answering this question. From Exhibit 1, we observe that the movement to outsourcing the corporate real estate function reflects the corporate climate, business style and perceived needs of business during the “Downsize” era and was consistent with business management priorities at the time. Until recently, the trend of senior management has been to ask CRE executives and other staff support functionaries to do more with less. However, even more recently, during what we term the “Strategic” era, executives (e.g., CRE, human resources, MIS, etc.) are often being asked by senior management to work on matters that have greater impact upon shareholder wealth.

Corporate real estate management priorities since 1970 have been heavily influenced by, and ultimately mirror, corporate business priorities. In the 1970s, corporations pursued expansion through conglomerate mergers and new ventures, essentially pursuing the idea that general management capability in one business could be transferred to another. During this period, the corporate real estate function first emerged as a profit center, entrepreneurially pursuing a variety of profit-seeking activities, which only sometimes were related to serving the corporation’s space needs in the most strategic and cost-effective manner. Then, in the 1980s, there was tremendous emphasis on financial expansion through merger and acquisition activity. It should not be surprising that the financial perspective often emerged as a dominant consideration in dealing with corporate real estate issues during this era.

**Exhibit 1  
Dominant Corporate Strategy**

Corporate Real Estate Era	Years	Management Influence	Corporate Real Estate Role
Custodian	Pre-1970	Benign neglect	Facilities administration
Entrepreneur	1970-85	Growth, expansion, conglomerates, diversification	Active in real estate business: development subsidiary; create space, joint venture
Downsize	1985-95	Cost reduction, performance enhancement, downsizing, reengineering	Outsource, benchmark, financial
Strategic	1995 on	Growth, change, differentiation	Strategic priority re process and service

As the real estate sector was oversupplied and companies were challenged to deliver performance in the late 1980s, during which period many companies were also overstaffed, the emphasis moved to *right-sizing* through staff reduction and improving internal processes (e.g., CRE, etc.). This orientation to downsizing and reengineering of the business setting was reflected through an emphasis on less, cheaper, better. Essentially, organizations and the people within them were pushed to *do more with less*.

As companies paid particular attention to *process*, senior management's focus shifted to whether their company had the requisite scale to achieve economies from higher volume and advantage from greater expertise. The greater expertise resulted from specialization, focus and capital investments to support the appropriate training and systems.

It was at this time that information technology also became a focus for company outsourcing efforts. Consideration of the rationale for information technology outsourcing can provide an instructive perspective for outsourcing the real estate function. Both information technology and real estate have significant cost consequence, influence the inherent functioning of the business, and can make extraordinary strategic contributions. Indeed, leadership in information technology is crucial to what Wal-Mart has accomplished as well as the SABRE reservation system of American Airlines. Like information technology, innovative corporate real estate leadership can also be a source of strategic differentiation and leadership.

Presently, the shift in strategic management is away from a *do more with less* philosophy to *differentiation* and *growth*. Businesses recognize that only so much can be accomplished by a *less* emphasis, since cost savings ultimately reach a point of diminishing, nonexistent and then negative returns. Although there is still much cost reduction that might be achieved by numerous companies in many industries, many corporations recognize that their future improvements in performance are going to come from growth. Thus, we observe the re-emergence of strategic planning along side cost engineering as being a dominant theme of strategic management. This recent change in strategic management thinking is reflected by a *renaissance of big ideas* involving an orientation to consider new ways of looking at the business and new approaches.<sup>7</sup>

In evaluating just what constitutes "intelligent outsourcing," it is helpful to break down corporate real estate management into critical functions or levels. The five critical functions or levels of corporate real estate management are summarized in Exhibit 2.

### Exhibit 2 Corporate Real Estate Functions

Levels of Corporate Real Estate <sup>a</sup>	Function	Strategic Management Application
Taskmaster	Procure cost-efficient facilities	Efficiency
Controller	Standardize space needs to minimize facility occupancy costs	Standardization
Dealmaker	Creative space-needs, problem-solving and negotiation re specific assets	Transactional
Intreprenuer	Provide real estate services as a competitive service provider	Profit Center
Business Strategist	Integrate workforce, workplace and technology trends into overall business strategy	Strategic



Joroff (1992) and Lambert et al. (1995) discuss how each higher level of corporate real estate management capacity, not only builds upon, but also requires the successful performance of the lower level CRE capacities.

Twenty years ago, CRE executives were mostly only "Taskmasters." In the past five to fifteen years, many CRE executives have taken on responsibility that includes "Controller" and "Dealmaker" functions in addition to the "Taskmaster." These first three CRE management levels target saving money through financial, organizational and site selection associated with individual company properties. As the quality of outsource providers improves, there should be increasing opportunity to advantageously outsource some of the management of these first three functions. Improved quality can be expected to follow from the greater access to scale power and economies-of-scale that outsource providers can enjoy as they reorganize their firms to effectively meet their CRE client's needs. Lucchese (1996) interviewed several CRE outsource service providers who make a convincing case that their firm's improved expertise and professionalism are becoming increasingly useful to clients.

The need for some internal CRE management for the overall corporation will most likely never be eliminated through outsourcing. As uncovered by the work of Kimbler and Rutherford (1993), Bergsman (1994) and Lambert et al. (1995), internal corporate real estate management will be needed indefinitely to create and monitor cost-effective, quality long-term relationships between the company's business units and the CRE outsource service providers. This need suggests a priority for (1) overseeing outsource contract relationships, (2) coordinating the work of the outsource contractors with the internal operations of the business, (3) translating internal issues to the outsource firm, and (4) translating real estate inputs provided by the outsource firm to business unit managers.

The control of CRE service cost and quality can usually be more effectively done by managers within a firm, than by an outside service provider, for several reasons. First, an internal CRE staff executive has significantly more valuable organization capital (as discussed above) to match up quality service providers with individual business unit managers. Second, as internal CRE management reduce the number of outsource providers they use, they give up some of the competitive discipline of the marketplace that would naturally curb service provider opportunistic behavior. Third, information and trust can flow more efficiently and generously between CRE internal management and other managers within a firm, than it is likely to between outside service providers and firm management, no matter how long term a key service provider relationship might continue.

Centralized corporate control of outsource vendors and services provided to business units can result in agency cost inefficiencies for shareholders. A general manager running a profit center can encounter circumstances where a centralized CRE department may lack the needed sense of urgency and/or profit incentive to approach transactions and specific decisions on terms that serve the business unit's objectives. At the same time, a general manager running a business unit may (in the hustle to achieve next year's numbers) make decisions that are contrary to the enterprise's overall long-term interest, sometimes by extraordinary orders of magnitude. This situation raises the classic conundrum of the relative advantage of centralized talent, far removed from the point of the decisions, set against decisions being made by business unit managers, often more informed about "local" business imperatives. While business unit managers are often

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more informed on decision details, they usually have less of a long-term outlook, and less knowledge of a decision's impacts upon an organization's overall operations and strategy.

The essence of the conundrum is that the business unit frequently lacks sufficient scale to justify a full-time CRE capability, yet the centralized CRE management function is insufficiently responsive. Corporate real estate managers share this conundrum with other corporate staff functions (e.g., finance, human resources, etc.) who ultimately must develop lines of authority, responsibility and rewards that facilitate an efficient internal cooperative effort and balance between centralized staff expertise and the demands of business unit line managers.

How might companies resolve this "agency cost issue" to efficiently integrate centralized CRE staff expertise with business unit manager needs? Jensen and Meckling (1976) suggest that agency cost inefficiencies are best addressed with appropriate incentives. Thus, manager and staff personnel rewards (e.g., compensation, recognition, etc.) should be tailored at all levels throughout a firm's organization to insure coordinated CRE efforts toward achieving overall corporate objectives. It should be noted here that both corporate staff personnel and unit managers are subject to continuous informal evaluations, as well as the formal "annual review" process. These, along with other appropriate incentives put in place by management, can be a more effective compliance tool than marketplace outsource contracts, particularly when transactions are complex, uncertain, or long term (Weston et al., 1990).

An additional way to reduce the inefficiencies discussed above would be to outsource certain CRE business unit functions, subject to corporate oversight. To anticipate constraints that may be imposed by a centralized CRE function that is less than responsive, a deadline for decisions can be stipulated, with appeal to a higher firm executive (e.g., CFO) and/or outside professional firm that can offer both specialized expertise and objectivity. Yet, it is essential that responsibility and accountability for specific CRE management functions be accompanied by commensurate authority and control.

Further reducing the inefficiencies discussed above, Lambert et al. (1995) and Lucchese (1996) have observed a closer and more trusting relationship structure arising between the CRE executives (who remain after downsizing) and the larger, more professional outsource service providers (e.g., joint ventures, strategic alliances, etc.). Lambert et al. (1995) attribute this to the increasing size and complexity of many CRE assignments awarded in recent years. According to Lambert et al. (1995), in order to reduce CRE outsource contracting costs, CRE executives have also been seeking to reduce the number of outsource service providers they must deal with. This has led to CRE service providers scrambling to expand their services to be one of the "chosen few" and has also led to numerous mergers, as CRE provider firms struggle to accomplish this growth as quickly as possible. This trend toward fewer and longer-term service provider relationships will also increase the need for companies to carefully monitor and control CRE service provider opportunistic behavior.

Concurrent with the trend over the past decade for companies to outsource more CRE management of individual properties, there has also been a growing awareness among senior executives that CRE is a strategic resource (Andersen, 1993; Bell, 1991; Joroff et al., 1993; Lambert et al., 1995; Manning and Roulac, 1996; Nourse, 1992; Nourse and Roulac, 1993). Senior management is learning that creative, as well as prudent, management of CRE impacts (1) many of their operating costs other than rent, (2) their

business units' competitive advantage and (3) shareholder wealth in numerous other ways. From the "theory of the firm" literature (Weston et al., 1990), it appears that overall responsibility for the two higher-level CRE management functions of "Intrepeneur" and "Business Strategist" described by Lambert (1995), in many instances may be better done by internal CRE staff than by outside service providers.

We should expect this to be true for a number of reasons. First, internal CRE management "transaction costs" of complex, long-term, or uncertain outcome management tasks and responsibilities should be less costly than attempting to contract with outside service providers. Second, the greater need for trust and the free flow of information about the firm, combined with the tremendously complex and uncertain nature of shareholder wealth initiatives related to these higher value CRE functions, suggest that using qualified internal CRE staff should produce more value for shareholders. Third, there should be significantly more "organization capital" available to the firm's CRE executives and senior management to perform the "Intrepeneur" and "Business Strategist" roles, than would be available to external service providers. Fourth, while extensive service provider real estate industry knowledge and experience (i.e., consultants) will prove to be more and more invaluable to CRE management in deciding among "Intrepeneur" and "Business Strategist" initiatives, CRE management internal to the firm will almost always have the most "organization learning" and "organization capital" when tailoring CRE service provider support to the unique needs of company business units and overall corporate strategy.

Given the complexity of the forces that influence decisions concerning intelligent outsourcing, firms should recognize that the decisions as to which functions should be outsourced, how they should be outsourced, and how the organization should relate to the outsource contractor, collectively have enormous strategic and operational implications. Decisions about whether, how and which CRE functions should be outsourced, can oftentimes be meaningfully enhanced by using a knowledgeable third-party consultant. Especially where significant strategy decisions concerning enterprise direction are concerned, third-party consultants can often contribute meaningfully to improved strategy formulation and execution. In addition, specialized strategy consultants can bring distinctive expertise and a broader perspective on external issues than is likely to be achieved from executives whose focus is more internal and oftentimes encumbered by organization politics.

General guidelines can be used by firms seeking to address the agency cost issue of centralized control where business units are fully accountable. Ultimately each firm's overall size, scope, diversity, strategy, rate of growth, organizational architecture, and stage of "life cycle" for the product and/or services produced, should be taken into account. For example, firms that are larger, more diverse, growing rapidly, or market products/services in the early stages of their product "life cycle," may be more likely to benefit from greater decentralization of their CRE management expertise (e.g., Hewlett Packard (Ramey, 1990)), while at the same time being able to achieve greater payoff from centralized "Intrepeneur" and "Business Strategist" CRE management efforts. In contrast, firms that are smaller, less diverse, not growing rapidly, or market products/services in later stages of their "life cycle," may be more likely to benefit from centralized CRE management control seeking to support business unit managers with "Taskmaster," "Controller" and "Dealmaker" CRE management, much of which can be advantageously outsourced.

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Insights from the "theory of the firm" literature (Weston et al., 1990) discussed earlier can provide further guidance. For example, this literature suggests that "organization learning" and "organization capital" that accrue to senior CRE executives, backed up by a few talented internal CRE staff possessing broad business backgrounds, will become an increasingly valuable corporate competency, just as MIS, financial management and human resources have evolved into significant competencies of many large and diversified companies. Thus, it is likely to become increasingly unwise for companies to outsource ultimate responsibility for CRE process management, in particular "Intreprenuer" and "Business Strategist" CRE management opportunities. Those companies that do may become vulnerable to acquisition by more far-sighted managers who develop expertise in managing CRE strategically and integrating it with MIS, human resources and other corporate support (internal as well as outsource vendors and consultants) provided to their business unit managers.

The "theory of the firm" literature (Weston et al., 1990) discusses how sophisticated general management support to divisional business units (e.g., financing, human resources, management information systems, etc.) is an important competency contributing to a larger firm's "organizational capital." This literature (Weston et al., 1990) also indicates that it is general management expertise like this that can more easily be contributed by a larger firm to unlock a target company's "hidden value." Senior management who ignore the CRE innovations and contributions to shareholder wealth may soon find themselves obsolete and their company an acquisition target.<sup>9</sup> In such a situation, it does not require much imagination to visualize where one company's expertise in CRE management can create value for its shareholders by offering its greater CRE expertise to a target acquisition, accompanied by cost savings from eliminating obsolete CRE executives who never figured out that their company was inevitably in the real estate business.

### Summary and Conclusions

In summary, as recent trends and the literature suggest, CRE executives have been increasingly successful in outsourcing some of their responsibilities for individual properties, where previously many large internal CRE staffs were needed. However, difficulties have been encountered frequently (Bergsman, 1994; Kimbler and Rutherford, 1993) in establishing advantageous CRE outsource relationships. In the future, the need will be greater than ever for internal CRE managers to create, monitor and control the cost-effectiveness and quality of CRE "transactional" service support to their companies' business units.

Outside CRE service providers are expected to contribute more innovative and comprehensive strategic thinking as well as to become more able to make key contributions to the process management of a firm's corporate real estate portfolio. Yet, CRE management knowledge and expertise specific to the firm will be key to integrating CRE strategies with overall company business strategies. Such tailored strategic CRE contributions to a company's shareholder wealth can be more effectively overseen by internal company managers than by outside service providers.

As the structure of business evolves in response to changing information technologies, organizational concepts, product innovations, competitive initiatives, the relationships between external CRE service providers and internal corporate executives can be

expected to evolve also. New and different types of outsourcing arrangements will likely lead to new and different types of business approaches.

Lastly, a company with a competency in corporate real asset management, which can unlock cost efficiencies and strategic advantages from a target business's real property assets, may be in the position to profitably acquire companies that do not possess this corporate management knowledge and expertise.

## Notes

<sup>1</sup>The finance and real estate literature have found that spin-off and other sell-off activities usually enhance shareholder wealth (Ball, Rutherford and Shaw, 1993; Hite and Owers, 1983; Hite, Owers and Rogers, 1984; Weston et al., 1990).

<sup>2</sup>Economies-of-scale refer to an increase in outputs by a greater amount than an increase in inputs. CRE service providers can benefit from scale economies if proportionately fewer personnel are needed to carry out CRE management functions for many firms. Economies-of-scale may be achieved by lowering "unit" costs at higher volume levels and/or utilizing more sophisticated methodologies, capital-intensive equipment, and superior expertise, not possible at lower-volume levels, which may improve quality as well as lowering costs. Economies-of-scope are present when the joint output from a single firm is greater than the output that could be achieved by two different firms each producing a single different output. Economies-of-scope for CRE management could stem from offering services that require similar specialized real estate knowledge.

<sup>3</sup>Although information is key to management's understanding of real estate, a survey by Arthur Andersen & Company (1993) indicates that most corporate real estate executives do not produce regular reports on real estate performance. Also, this survey suggested that good CRE reports to senior management are key to senior management's appreciation of the shareholder wealth enhancing benefits of CRE management integrated with the strategic plan of a company.

<sup>4</sup>In the neoclassical "theory of the firm," a firm is an entity that economizes on transaction costs. The firm can be defined as a collection of contracts between input owners and firm shareholders where multilateral contracting between input owners and shareholders is replaced by bilateral contracting between input owners and the firm. This contractual structure reduces the number of formal contracts required for business activities because informal contracts arise between managers and those carrying out functions for the firm.

<sup>5</sup>"Organization learning" is defined in the literature as having two dimensions: (1) increased efficiency of individual workers gained over time through experience (represented by products or services with long production runs) and (2) as workers gain experience with each other within a firm's organization, not only production becomes more efficient with practice, but information flows more efficiently among workers and transaction costs are reduced (Weston et al., 1990, p. 51). Trust can grow among workers within a single firm as a firm's organization culture is uniquely able to inspire workers to align their individual self-interest to the interests and goals of the firm community.

<sup>6</sup>Kimble and Rutherford (1993) conducted two surveys of the corporate real estate managers at large companies and larger CRE service providers "to identify issues associated with the outsourcing of corporate real estate from both the corporate real estate manager's and service provider's perspective and to offer general recommendations that should enhance the interaction and communication between [them]." Forty-seven corporate real estate managers returned their questionnaires (51.1% survey response rate) and fifty-three CRE service providers returned theirs (73.6% rate).

<sup>7</sup>These orientations are captured by such leading contemporary strategic management books as *The Death of Competition* by James Moore, *Value Migration* by Adrian Slywotzky, and *Competing for the Future* by Gary Hamel and C. K. Prahalad.

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<sup>8</sup>The five levels of greater corporate real estate management impact described in order of their increasing opportunity to favorably impact shareholder wealth, are the following: 1. "Taskmasters" working for business units to engineer and procure cost-efficient facilities; 2. "Controllers" working with upper levels of management to standardize employee and operating space needs in order to minimize total facility occupancy costs; 3. "Dealmakers" creatively negotiating on behalf of the overall company to seize opportunities to save money through financial, organizational and site selection associated with *individual* company assets. The focus here is on applying standardized project-related negotiation and problem-solving abilities to a business unit's changing space requirements; 4. "Entrepreneurs" working with business-unit executives as a competitive real estate operation in its own right, "benchmarking" their performance in terms of both cost and quality of the real estate services and products they provide. Working with business unit managers, as well as people from human resources, information services, sales and marketing, CRE "entrepreneurs" work to discover product innovations, enhance productivity, and to participate in the business unit's strategic planning process through the provision of needed occupancy cost data; 5. "Business Strategists" work with senior corporate and business unit managers to integrate workplace, workforce and technological trends into a broader strategy that will enhance competitive advantage, productivity and shareholder value. CRE staffs work with "stakeholders" within the company, combined with outside resources and service providers, to anticipate business trends, monitor and measure their impacts, and contribute to the direction of the corporation as a whole through the development of an occupancy strategy.

<sup>9</sup>Evidence suggests that real estate assets have been managed in a suboptimal manner (Andersen, 1993; Rodriguez and Sirmans, 1996). Ambrose (1990) reports that corporate real estate plays a significant role in determining the likelihood of a firm becoming a takeover target. This result is consistent with the notion that managers that mismanage their real estate assets may indeed find themselves obsolete and their company an acquisition target.

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