The promise and perils of location decisions

Corporate location planning in a rapidly changing business climate

Corporate Solutions Research

Location optimisation has never been more important for corporate occupiers

Deciding where to locate all or part of your business in an uncertain world is critical to competitiveness and success. The intensifying war for talent is raising the stakes even higher given the role of real estate in attracting and retaining talent and maximising its productivity. Navigating the multiple push and pull factors of competing locations can be challenging.

This report assists corporate occupiers to see through the complexity. It demystifies the what, where and how of location planning to reveal why certain businesses choose certain locations. It helps corporate occupiers to make best-in-class location decisions.

> There are three things that matter in property: *location, location, location*
>
> Lord Harold Samuel

1

Risk and value

High stakes, high reward

Location decision-making is imperative for businesses. It is a complex process offering great reward, but carrying high risk if it is not done effectively.

The success or failure of a location decision has a significant impact on businesses.

A tale of two companies

Company A

A global corporate had an extensive European property portfolio. Portfolio optimisation allowed the firm to consolidate back office support functions on fewer, bigger locations. This allowed them to better serve the business structurally and secured £150 million of cost savings. It also helped to alleviate long-standing difficulties securing software development talent.

Company B

A rival global corporate undertook portfolio realignment to lower costs by decentralisation. The new portfolio delivered lower real estate costs, but the loss of talent, clients and the adverse impact on market perception was significant. Unwinding this location decision cost millions. Senior talent left and its brand was tarnished.

Why was the experience of these two companies so different?

The answer lies in the decision-making process.

In the current business climate, every international corporate will face major location decisions over the next few years. The UK's approaching exit from the European Union has created further impetus for location contingency planning. Firms in every sector, from legal services to manufacturing, financial companies to tech businesses, will be assessing how best to align their real estate to achieve strategic goals and minimise risk in a changing business climate. A lot rides on the decision. Good decisions can significantly increase long-term company performance. Poor decisions can cost millions in capital, talent, productivity and brand.

The decision-making process can be daunting. However, there are methodologies which make the process easier. There are overarching themes which, if understood, assist to ensure that the right outcome is reached for the right reasons. Changes are afoot which will fundamentally alter the structure of business operations, impacting how and where work is done. These must be understood by decision-makers to future-proof change. This report will help you be like company A, not company B.

Drivers and motivations

The magnificent seven

Motivations for undertaking location decisions commonly fall under one of four categories:

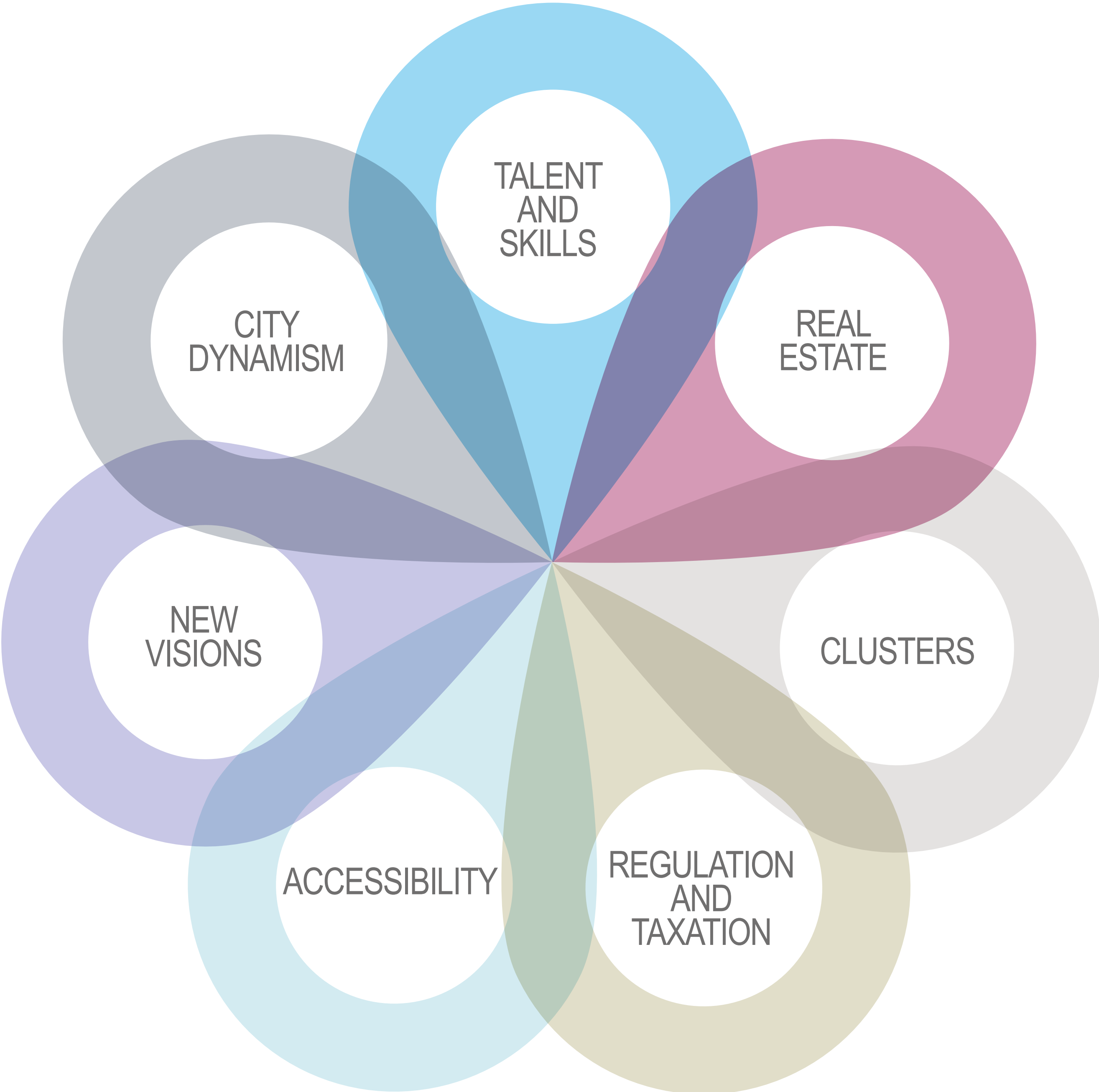
Source: *Dunning model*

From 'location, location, location' to 'talent, talent, talent'

A wide range of drivers prompt location decisions to be made. Every company will have unique reasons for optimising their portfolio. Whatever their drivers, to make a best-in-class decision, firms must understand more than just today's trends. Locations must be planned for the future, ideally for at least a decade.

Thorough planning, risk mitigation and a deep and robust analysis of the current and likely future state of the organisation are the only ways to future-proof decisions. This requires businesses to consider what they will look like and where they want to be in ten years' time. Real estate must align with business strategy and objectives.

The magnificent seven:
7 common drivers of location decisions



Talent and skills

The pre-eminence of talent is increasing in focus, with the quality of talent being a critical part of business success. Positioning real estate to attract and retain the best talent is gaining importance, and frequently, this means accessing centrally located real estate. Driven by re-urbanisation, a new geography of talent with city centres at the fore is emerging.

The rising focus of talent and offices in city centres is being driven by:

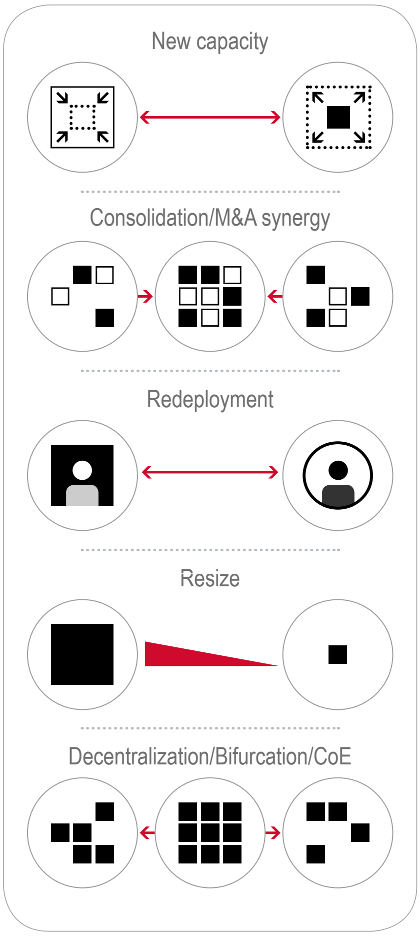
1. **Demography and lifestyle** - cosmopolitan inner city living as an attractive choice for young people.
2. **Immigration and globalisation** - increasingly internationalised talent and workforce co-locating in cities.
3. **Working practices** - flexible working, mobile computing and rising self-employment reinforces the need for central, accessible offices in cities for meetings and collaboration.
4. **Sustainability and accessibility** - central offices promote walking, cycling and public transport.
5. **Accessibility improvements** - European cities are investing in transport, cycleways and pedestrianisation. Inner cities are becoming easier places to get to and get around.

A company may be well known in one market, but unknown in another. Companies must be aware of their local profile and match their location decisions, recruitment decisions and strategies accordingly. Using their brand awareness, only a handful of companies have the luxury to attract the top talent – even though the location is not completely adequate. As industry trends change, it is prudent for all companies to future-proof location decisions by aligning to the new geography of talent in cities and urban areas.

Real estate

Real estate is often the second largest cost for businesses after labour costs. Ensuring real estate is deployed optimally and used efficiently brings significant financial benefits. Firms may use location decision-making to align to new corporate strategic drivers.

Strategic drivers of change



Clusters

Clusters provide an ecosystem which can help drive innovation, knowledge sharing and collaboration. Cluster benefits for companies could include:

- Access to a large talent pool allowing specialisation
- A concentration of customers and suppliers
- Access to financial markets and investors
- Brand prestige from being situated in a well-known cluster
- Access to government and regulatory bodies
- Specialist business support services
- Economies of scale usually reserved for large companies
- Access to shared resources
- Collaboration opportunities with business and universities
- Knowledge sharing through face-to-face interaction
- Attractive social and lifestyle infrastructure

Increasingly firms are seeking to drive performance benefits through locating in existing or emerging clusters. Clustering is a low risk business option but it can be expensive. Competition for talent and real estate is often strong in a cluster. The positive and negative aspects of clusters must be balanced.

> *There are a number of benefits to developing fewer, bigger locations. In particular, it provides better career opportunities for staff and allows for the development of broader skillsets as people are able to move across a number of locations.*
>
> International financial services company

Regulation and taxation

Corporate tax rates vary between jurisdictions. Financial regulations change across markets, as do factors like liability, confidentiality and data storage requirements. Countries with lower tax rates or with less regulation are weighted more heavily in decision-making if such imperatives are important to a firm.

Today, there is global pressure for more consistent financial regulation and taxation. The OECD countries have drawn up common rules preventing companies from leaving money in tax havens. While we may see differences in the balance of decision-making, harmonisation is, however, still some way off. Regulation and taxation are of crucial importance to location decisions.

Changes in labour laws or the free movement which alter access to talent can trigger location decision-making. As location planning must be forward looking to future-proof the decision, consideration of future regulatory changes is essential. Contingency planning to mitigate regulatory risk is prudent.

Accessibility

Accessibility is a prerequisite for new investment. What accessibility means differs considerably between companies and sectors. For some it may relate to accessing new markets and customers. For others it may mean access to physical or natural resources. Transportation is critical to supply chain speed and resilience, meaning access to existing or new infrastructure is key for suppliers, manufacturers and retailers.

New visions

Growth, corporate strategy, technology and leadership change is often a catalyst for location change. New directions and strategies create new requirements for portfolios.

The ability of talent to work from anywhere means that offices must become more user focused, prioritising experience and promoting worker productivity. Central meeting places become more important. Corporates are consolidating and streamlining their portfolios to strategic locations in talent hotspots via the hub and spoke model. This provides a central hub with meeting, co-working and flexible space supported by multiple smaller spokes elsewhere.

Greater flexibility and user experience requirements prompt significant impacts. Increasingly sophisticated and diverse portfolio models are emerging, which are escalating demand for location planning, and increasing its value, too. Planning physical locations when individual choice is so high is challenging. It requires detailed understanding of how workplaces are evolving. If the hub is too small, it may become a victim of its own success with insufficient space to serve demand. Too large means portfolio inefficiency and financial cost.

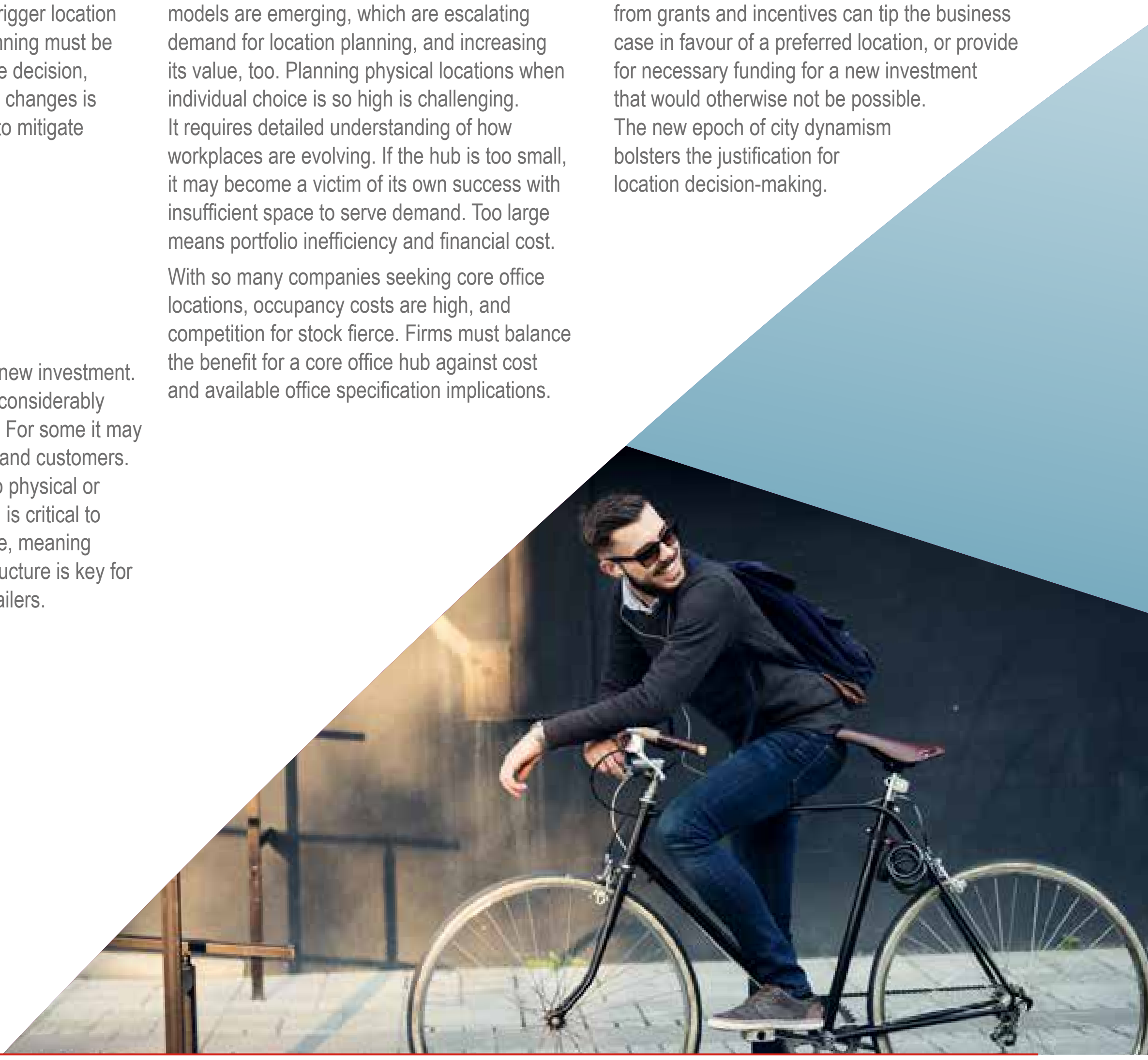
With so many companies seeking core office locations, occupancy costs are high, and competition for stock fierce. Firms must balance the benefit for a core office hub against cost and available office specification implications.

City dynamism

European cities are responding to changing social and corporate dynamics by becoming more entrepreneurial in attracting investment. Devolution and localism is transferring power from central governments to regions and cities. Mayors are becoming more active in promoting their cities.

Greater local power allows some cities to cater specifically, via grants and incentives, for the needs of prospective businesses looking to locate or expand. Enterprise zones or their equivalents can also have this effect.

Whilst rarely a leading driver of corporate portfolio review in isolation, city dynamism can pull businesses to a particular location, or push them away once the fundamentals of a location are proven to be right for the business. Pull factors from grants and incentives can tip the business case in favour of a preferred location, or provide for necessary funding for a new investment that would otherwise not be possible. The new epoch of city dynamism bolsters the justification for location decision-making.



Location planning in action

A financial services example

Situation

An international financial services company was seeking to explore potential locations across Central and Eastern Europe (CEE) for a new Financial Shared Service Centre accommodating approximately 1,000 staff.

Scope

A long list of 16 potential city locations across CEE countries was created. A financial and non-financial analysis on each location was run to produce a shortlist with weighted scores. Site visits to each shortlisted location included meeting representatives from local government, recruiters, competitors and universities. This allowed the recommendation of the most appropriate location for their new centre. Negotiations with local government in the shortlisted locations commenced to maximise available incentives and grants with the recommendations adjusted accordingly.

Results

Warsaw, Poland was recommended and accepted by the company as the optimal location following extensive analysis and multiple site visits. Local tenant representation helped procure suitable leasehold stock. Phase 1 - 3 of this project successfully led to 7,500 sqm of grade A office space being secured.

3 *Mechanics of optimal location decisions*

The six phases

Harnessing the corporate value chain

The corporate value chain is the whole range of activities which add value to a corporate product or service. Maximising corporate value chain efficiency increases competitiveness, flexibility and return.

Harnessing the value chain to optimise locations decisions requires a deep understanding of how each function operates in the wider corporate context. Each function relies upon different location capabilities. Analysing potential locations based on function allows firms to optimise each one through a unique locational decision. This helps to avoid trade-offs that may come with co-location of all functions in one place.

Example of the relative importance of locational capabilities by business function

Function / Assessment	Intellectual property/R&D & headquarters	Financial shared service centres/BPO and centres of excellence	Operations & production	Marketing & sales	After market service/customer contact
Talent	***	***	**	**	***
Financial	**	***	***	**	***
Economic	**	**	**	***	*
Regulatory	***	*	***	*	*
Operational	*	**	***	*	**
Fiscal	***	*	**	***	*
Competition	*	***	*	***	**

The criteria above and their relative weight are flexible, varying between businesses. Each location search comes with its own priorities and must be tailored to the business. The table does however reflect nuances for each type of business function.

Key

*** Critical
** Important
* Less important

Understanding the mechanics

Talent assessment

Optimal locations must offer suitably skilled and educated talent. They must also offer this in sufficient numbers to allow new and expanded business functions to be sustained. A small labour pool will drive up costs and challenge recruitment. Achieving and maintaining a perfect balance between talent supply and demand is difficult. If demand for talent consistently exceeds supply, new capacity will be added through new faculties, colleges and research institutes. However, this takes time and may not provide a short-term solution. Well-informed companies will avoid a location which is suffering from a saturated employment market. Ensuring a thorough understanding of the nature and depth of talent, through access to detailed labour analytics, is critical for almost all segments of the corporate value chain.

Financial assessment

Analysing the corporate value chain allows cost centres and profit centres to be distinguished. Successful companies recognise the importance of business support processes and allocate sufficient resources but technological advancements allow these to be located virtually anywhere. Achieving talent cost savings, lowering total occupancy costs and enabling cost effective supply chain strategies are often the drivers behind the decision-making process. A successful financial assessment applies long term modelling and forecasting. Wage cost inflation and foreign exchange rate risks may jeopardise what is a compelling short-term business case.

Economic assessment

A sound and stable macroeconomic environment is a big advantage when entering a new market and is valued by businesses. However, reaping the benefits of emerging and fast growing economies may require engaging in more volatile markets with lower levels of transparency and less developed institutions bring greater uncertainty. The right balance between opportunity and risk is unique to every company.

Regulatory assessment

Countries set national regulations but operate in a global trading context. From trade blocs to monetary unions, some common regulations supersede national boundaries. Countries that are members of the OECD and WTO could be attractive as membership may confer greater certainty around labour, tax, transfer pricing and trade principles. Conversely operational level differences in industry compliance rules, labour laws and rule of law could favour certain locations. Free trade or economic zones may speed up operational lead times due to favourable planning procedures. It is essential for companies to identify the regulatory environment of potential locations and determine operational implications when undertaking decision-making.

Operational assessment

In a manufacturing site selection process, it is critical to conduct a technical due diligence of several of the finalist sites to limit construction risk and quantify hidden development costs. Being the investor, it is important to have a back-up plan in case unforeseen circumstances such as adverse geo-technical conditions, floodplain issues, and various permitting and planning hurdles emerge with the "winner site". It is crucial to understand and measure environmental risk, timing, obstacles to development, and geographically variable construction costs.

For office related functions such as transaction processes, trading and business services, a stable power supply is imperative. Additional investments in dual feeds or back-up generators might be necessary in locations with regular power cuts. Full commuter assessments must be carried out to comprehend traffic flows at peak times. Understanding severe weather patterns and taking appropriate measures will mitigate business disruptions, commonly experienced in certain parts of the world.

Fiscal assessment

Companies assess differences in corporate income tax, capital gains tax and tax withholding to optimise their corporate tax structure. Big savings can be realised when risks, responsibility and control are appropriately allocated to the various functions in the value chain. An example of this is the 'toll manufacturer' and 'principal structure'. In this, the principal holds title to the goods throughout the manufacturing process, buys raw materials and bears all inventory risk whilst the toll manufacturer is allocated tax reimbursement. This structure requires locating the principal in a low tax jurisdiction.

Competition assessment

Locating operations offshore in popular destinations, such as Central and Eastern Europe (CEE), India and the Philippines requires very careful planning. Due to increasing competition, companies without powerful human resource programmes could be exposed to high talent turnover. A lack of investment in training programmes could mean problems retaining talent. Understanding the competitive landscape, identifying the largest employers, interviewing employees and establishing non-financial staff motivations are essential elements of location due diligence.

From an outsourcing perspective, global service providers search for new and emerging locations to benefit from lower costs in untapped markets. To help understand the scale of these operations, consider that Accenture employed approximately 130,000 employees in India and another 50,000 in the Philippines in 2015 based on published records. Indonesia and Vietnam are becoming attractive offshore destinations on the back of the success of India and the Philippines. CEE centres typically employ between 500 and 1,000 employees. Unlike Asian centres, they increasingly offer complex and client facing activities.

Location planning in action

An automotive manufacturing example

Situation

A medium-sized automotive manufacturer enacted a site selection initiative to determine the optimal location for additional facilities that could fulfil strategic objectives.

Scope

After filtering seven countries and 150 regions across Russia, Ukraine, Romania, Hungary, Croatia, Czech Republic and Poland, a short list of candidates was established for validation of economic, non-economic and risk criteria. This assessment provided a thorough understanding of the ability of each location to support proposed operations, constraints, costs and risk.

Synthesized data inputs were collated on capital costs (one-time and recurring), operating costs, business climate (regulation, availability of government incentives, both financial and non-financial), site availability, cluster analysis and trends, demographics, labour markets (national, regional, local), transportation and logistics, supply chain, economics (macro/micro), real estate market and risk (economic, political, environmental, business continuity).

Results

A preferred locational hierarchy was determined, allowing negotiations with local government in the top-ranked locations. Maximum statutory and discretionary incentives were awarded to the firm in the first choice location. Secured incentives included: land allocation at no cost worth savings of £8.0 million; a reduction of corporate, property and land taxes; all power, water, gas, IT, road and rail infrastructure brought to site boundaries at no cost to specified capacities within specified timeframes; all utility connections provided at no cost; and expedited permitting procedures and bureaucratic support. In total, the incentives package negotiated was worth £50.0 million.

The six decision-making phases

The optimal location decision-making process must be forward-looking and aligned to future business plans and objectives. It is a long-term game. It takes time and money to re-align real estate and to yield additional value. The assessment process must also adopt a long-term view.

The optimal location decision-making process has six phases.

1

Corporate value chain analysis

- Break down the corporate value chain to business segments
- Identify key success requirements for each segment
- Ascertain talent requirements
- Assess current footprint
- Define any knock-out criteria

2

Frame the decision

- Understand the purpose and objectives of the location decision-making exercise
- Develop a decision-making framework to reflect objectives
- Consult with relevant stakeholders
- Obtain necessary buy-in from the business

3

Assess potential locations

- Distil long list locations to a shortlist using project drivers and success attributes to eliminate options
- Use quality, in-depth data in the assessment
- Account for the impact of time on costs, talent and risk
- Evaluate locations in three dimensions: financial, non-financial and risk, using appropriate criteria weighting
- Include a fatal flaw assessment to dismiss unviable locations

4

Validate the outcomes

- Conduct community and site visits, overlaying the findings to the assessment
- Deliver a refined benchmark model
- Research available government incentives and grants at EU, national, regional and local level

5

Negotiate the best deal

- Negotiate with local government stakeholders from a position of strength prior to the decision being made
- Extract the best possible incentives and grants
- Confirm all offers with a Memorandum of Understanding

6

Execute the optimal decision

- Refine real estate objectives and accommodation needs
- Future-proof the outcome by accounting for business growth and reflecting future trends
- Define programme and planning process
- Negotiate with landlords and/or developers on terms
- Sign and commit to a site/office/development

Reaching the optimal outcome

The optimal location decision-making process can appear simple when laid out in this logical approach, however, the reality is often more complex. Each stage provides opportunities to enhance the decision-making outcome or missed opportunities if they are not acted upon.

Stakeholder engagement

Stakeholder management is key to the success of the project. Decision-making success hinges on buy-in from the multiple and potentially divergent agendas of internal business stakeholders. HR may view location as a recruitment tool, finance may view it as a cost item and the real estate team may view location as a matter of operations. The effective alignment of these objectives will determine their perspective on what makes a successful location. An optimal decision will engage with all relevant stakeholders, ascertain their wants, needs and desires and build consensus. Topic-based workshops around major considerations help to ensure the result works for all.

Long-term planning

Enacting location decisions is expensive and time-consuming. For investment to be financially viable, investments may need to be operational for a decade or more. Allowances must be made for the impact of time on cost items, such as wages and real estate, inflation and exchange rate volatility. Political risk should also be accounted for. Locations which seem compelling today could see their business case ruined when accounting for long-term planning and forecasting. Long-term planning also means enshrining portfolio flexibility. Decision-makers must account for changes in key variables over time.

Quality data

Bad data in means bad conclusions out. It is imperative to the robustness of the process and outcome that high-quality data is applied to the decision-making model. Stakeholders must strive to use the most appropriate and the best quality data.

Part science, part art

Inputting quality data up front helps to ensure robust shortlisted outcomes are derived, but these must be validated with "on the ground" experience. Are the outputs implied in the statistical model actually happening? Are there other intangible success factors that a numerical model will not detect? Optimal decision-making combines a data led-scientific approach with a softer data approach gained through site visits and community consultation.

Use visuals

It may be hard to believe but not all stakeholders will be enthused by the prospect of sifting through data analysis to inform a location decision. Representing the data and analysis in a highly graphic, visually appealing way helps both to engage the stakeholder and clearly articulate the findings. Interactive GIS based mapping tools can deliver additional value.

> *It is recognised as a positive attribute if competitors are already based in a location we are considering as it means we are not breaking new ground, which reduces risk.*
>
> Major global services business

Location planning in action

An investment banking example

Situation

A global investment bank sought to reduce structural costs and improve access to talent by reshaping its operating model. It resolved to review deployment of back office, support and technology functions.

Scope

The existing service delivery model comprised in-country support in high cost locations combined with large, inefficient off-shore centres in saturated labour markets. The site selection scope covered identification and analysis of alternative candidate locations globally. This included the analysis of all existing locations to determine which would best serve the bank's requirements.

The decision-making process provided insight into the strengths and weaknesses of each location in three dimensions: financial, non-financial and risk. These were compared on a single analytical framework to understand the trade-offs between locations. Fatal flaws were identified where they could not meet the bank's stated preferences.

Shortlisted locations offered an optimal mix of conditions based on their alignment with the bank's operating objectives. Further analysis, field validation and negotiations were then completed, as well as due diligence of operating conditions.

Results

The project equated strategic, operating and risk objectives to criteria for measuring geographic deployment scenarios. Significant structural cost savings were achievable through redesigning the bank's footprint, extracting high cost functions and consolidating them into lower cost hubs. The location decision also allowed the firm to resolve long-standing difficulties in sourcing software development talent.

4

Decision made

What next?

A company has followed the advice in this paper and achieved an optimised portfolio. It has increased its competitiveness, enhanced its profitability and reduced risk exposure. You may think that is the end of the location story. For some businesses, it may be. For those that are growing rapidly, which depend on securing the best talent or have a large portfolio with multiple lease events, location planning must be an ongoing process.

The beauty of location planning is that it enables firms to future-proof their operations by capitalising on trends, positioning for emerging opportunities and lowering the risk of obsolescence. Demographic, technological and workplace trends are always in a state of flux and geopolitical change is a constant. Today, the hub and spoke model is key in responding to the new geography of talent and flexible working. Tomorrow, a new style of working may be needed to respond to change.

Large corporates must monitor trends and keep their portfolio under review at all times. Ongoing location analysis is a critical component of long-term business planning and a tool to create a structural competitive advantage. Portfolio optimisation is a marathon and not a sprint.

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