

Strategic Management of the Fourth Asset Class: Real Estate and the Financial Services Sector



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The State of Financial Services

Revenue Growth. More Revenue Growth. And More Revenue Growth This is the mantra you can hear chanted through the halls of financial services firms all around the world today. It is particularly important to this segment of the economy since share prices have climbed 91% in the last 4 years. So the burning question is where in the future is this incredible revenue growth going to come from? Most organizations would probably answer “product innovation”. However, if you examine this closely, the reality is that even product innovation does not ensure competitive advantage. Over \$11b is spent by financial institutions on this a year, but even a new kind of offering gives a company less than a 3 month lead over its competitors. New products also often bring with them increased complexity, an increase in operating costs and unsatisfied customers. And the failure rate is high, 60-80%.¹

There are other obstacles to organic growth in today’s financial services environment. Where once banking, insurance and financial asset management were three distinct industries, there is a blurring of boundaries between them. There is also a saturation of products in markets which have become mature, increased sophistication of the customer base, new competitive threats emerging from retailers (i.e. Walmart and Target) and insurers, increased costs due to requirements for complying with regulations (not only SOX, but Basel II and the International Financial Reporting Standard) and the costs associated with the high churn rate of customers moving from one financial institution to another. Added to this is increased economic and political risks like the declining value of the dollar, rising interest rates and unstable conditions in countries outside the US.

What some consultancy firms have proposed is that profitability for financial service organizations will come from looking within their own companies. *“The game will be to steal market share and share of the wallet by relearning the growth habit through innovative practices.”*² Two of these ‘practices’ are process innovation and automation of these new processes. By innovating internal operations, greater efficiencies are achieved, the work that is done is more effective and capital can be redeployed to focus on core competencies.

¹ Deloitte Consulting, “Glittering Prize: How Financial Institutions can drive Growth thru Process and Service Innovation.” 2005, p. 5.

² Ibid, p. 2.

This article addresses one often overlooked area for process innovation and technology deployment, corporate real estate (CRE). We believe that executives in the financial services industry should apply their same level of fiduciary analysis to this fourth asset class that they apply to their cash, stocks and bonds. They need to adopt an intelligent workplace management strategy. They can then gain dramatic cost savings. One west coast high tech company has reported they cut workplace costs by 37% and calculated productivity benefits of \$2.4 billion in just one year alone³. One of the major cost reduction strategies this company used was getting a handle on 'shadow vacancy.' This is space that is not being utilized by an organization, but is also not being put back into the market place. In some cases, only 30-40 % of space is actually being utilized at any one time.⁴

The Intelligent Workplace Management Strategy

An Integrated Workplace Management System (IWMS) has been described by Mike Bell, Gartner Group, as an *“enterprise-level software solution that integrates four key components of functionality: project management; real estate portfolio and lease management; space management (moves, adds and changes [MAC]); and maintenance management. The software operates from a single database, and it offers workflow tools, executive dashboards, and predefined and customized reporting capabilities. Most suite applications will interoperate with other enterprise applications, such as enterprise resource planning (ERP), supply chain management (SCM) and human capital management (HCM), via Web services technology.”*⁵

An Intelligent Workplace Management System also has the same definition as Gartner's, but has a stronger financial decision making component to it. CRE professionals are now being asked to have more financial acumen than they currently have and this tool has been designed for them to be able to make smarter decisions on the management of their portfolios. In fact, Manhattan Software has observed in their dealings with Fortune 100 companies, the CRE function is reporting directly to the CFO or COO. Manhattan is one of the global leaders in IWMS space.

For the large financial services organizations involved with all the mergers and acquisitions that have been going on lately, it is difficult for the acquiring company to adjust the business processes and systems of the acquired company quickly enough to affect the performance of the entire company. By implementing an IWMS with a strong financial core, previously manual and cumbersome processes can be integrated easily and both current and historical data on real assets can be made available for immediate decision making.

The goals of an IWMS implementation for a financial institution are to:

- Increase the performance of the portfolio while minimizing the operational risk;
- Ensure faster benefits are recognized from consolidation of businesses;
- Make compliance easier and more accurate;
- Reduce operating and capital costs.

We will examine some of the most important goals of an IWMS in depth in the remaining part of this article.

³ Conlin, Michelle. “Square Feet. Oh, How Square,” [Business Week](#) (July 3, 2006).

⁴ Venable, Tim. “Cisco's Mark Golan: Driving New Thinking about the Workplace,” [CoreNet Leader](#) (May 2006), p.61.

⁵ Bell, Michael A. “Magic Quadrant for Integrated Workplace Management Systems, 2005.” Gartner Research Report #G00135917, 20 December 2005, p.3.

Increased Performance

In terms of office real estate, most of corporate real estate assets are currently underperforming by as much as 60%, as shadow space remains underutilized on a daily basis in our mobile world of work. There have been reports that typical middle managers in organizations are not in their offices 30-40% of the time (on average). This can cost an organization millions of dollars in operating expenses it does not need to spend. An IWMS allows a CRE executive to get a complete profile of the entire real estate portfolio, including information on which assets are owned or leased, which spaces are occupied and which are vacant, where space is utilized to full capacity and where it is underutilized. For retail branches, metrics can be reported on, like revenues per square foot, and then benchmarked amongst different locations or peer institutions. It also provides a chart of accounts to calculate the operating cost (Total Cost of Ownership-TCO) of each of the buildings so that each organizational unit can be charged appropriately. All costs associated with providing and maintaining the workplace and their associated assets are tracked, not only for accountability, but also to benchmark TCO with other properties and the real estate portfolios of other companies.

Increased Consolidation Opportunities

Acquisition of retail branches and consolidation of operations are critical to the strategies of many of even the largest banks. This can be proven by Bank of America's \$47 b. purchase of FleetBoston and JPMorgan Chase's \$58b. acquisition of Bank One. In these instances, real estate was the reason for the investment in the acquired company. Retail banking is back, in fact it never went away as predicted during the "e" explosion. But even if acquiring more real estate was not the reason for the consolidation, information is required for every location to be able to make the best financial decisions on what should remain in the portfolio and what can be sold back into the marketplace. After a merger/acquisition it is a good time to get rid of disparate legacy systems in CRE and facility management which require complex and expensive network infrastructure and replace them with an enterprise IWMS.

Reduced Operating and Capital Costs

Gartner has estimated that an IWMS can reduce asset operating and capital costs by as much as 20%. Savings can be substantial in using an IWMS to:

- Tightly integrate the administration of leases with accounts payable to minimize time and increase accuracy;
- Reduce the time it takes to execute projects which lowers costs due to improved workflow and coordination;
- Increase process improvements by identifying trouble areas and remediating the problem immediately;
- Increase cash flow through componentized depreciation by being able to segment a building by subsystems which each have their own depreciation schedule⁶.

One organization has recently identified a large financial opportunity by reducing their space costs alone by as much as \$901 million per year by using new business processes and technologies to enhance the value of their large real estate portfolio.⁷

⁶ Bell, Michael A. "Bolster Your Return on Investment with Integrated Workplace Management Systems". A Gartner Research Paper #G00125585, 3 January 2005.

⁷ GSA Office of Governmentwide Policy, "Innovative Workplaces: Benefits and Best Practices." January 2006, p. 21.

CONCLUSION

To remain successful, financial service organizations cannot accept the status quo.

The environment that they find themselves in is one of the most complex of all the industries today. They are changing from product-led enterprises to customer focused, competency-based organizations and need new systems to support their change management strategies.

Many IWMS customers have gained savings of tens of millions of dollars year after year by taking advantage of the improvements and savings listed previously. We believe that many more financial services companies could realize these savings also by implementing an IWMS and a business intelligence system for reporting. Static data about space and equipment is then transformed into “actionable intelligence, enabling decisions that significantly reduce vacancy rates, decrease current costs and support planning that will keep costs down over time.”⁸ There has never been a better time for financial services to pay attention to this very important fourth asset class.

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⁸ Ed Lubieniecki and John D’Angelo, “CRE Business Intelligence: A New Tool for Strategic Effectiveness.” 2004. www.realfoundations.com