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What Drives Dispersal?

Examining the Macro and Micro Aspects of Organizational Decentralization

Highlights

- In immediate aftermath of September 11, issue of whether organizations decentralize or not polarized planners into two separate camps; passage of time suggests merits in both arguments
- Decentralization initiatives of several lower-Manhattan tenants not only validates concept, but suggests the strategic importance of real estate in higher levels of corporate policy
- There are very logical reasons for companies to cluster in urban cores including economies of scale and access to a high quality labor pool, however such clustering models also have distinct limitations, including managing turnover, and disposition of excess space in soft economy
- Dispersal seems to be a logical solution, however, a properly executed dispersal strategy involves elements beyond site location, including management control and IT issues
- Long-term nature of real estate time horizons provide decision makers with time to formulate robust plans
- Joint Federal report in US provides basic planning template for organizations to use when considering decentralization
- Change cannot occur overnight, therefore, short term administration of real estate including auditing of leases, and analysis of neighboring tenants needs to be conducted, before wider-scale panning initiatives can be put into place

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Introduction

To decentralize or not, that is the question, and it has become *the* issue dominating discussions of facilities planners for large organizations globally. This topic has taken on a life of its own after the 2001 terrorist attacks, and has been recently fueled by concerns over epidemics such as SARS. As a result, battle lines have been drawn between two opposing camps.

First, there are those who believe events such as terrorism will have no significant effects on the way real estate decisions are made. For instance, in the months following September 11, Sam Zell and Mort Zuckerman, two of the largest real estate investors in the US, stated they did not foresee any trends suggesting long-term decentralization. Zell believed the widespread availability of sophisticated security services in large, centrally located buildings would neutralize any inclination a large central business district (CBD) tenant might have to relocate to the suburbs. Suburban locations simply lacked the infrastructure and systems high profile tenants require in their facilities. Zuckerman agreed, adding: "Companies who occupy space in downtown areas do so because it's where they can get the most talented people, and the most talented people today are still working in urban core areas".

The alternate position is one stressing the critical importance of employee safety and the outdated nature of modern cities. For example, immediately following the attacks, urban planning commentator James Howard Kunstler declared that the terrorist attacks signaled the end of the skyscraper. Prior to September 11 few would have ever given more than passing consideration to employee safety, but they now argue a company's very ability to attract the brightest and the best employees might be determined by the security its facilities provide. Businesses in centrally located trophy buildings may also suffer if talented employees refuse to return to buildings after minor events. These factors suggest that companies will increasingly look toward spreading out operations over multiple locations in order to minimize their exposure. Moving to multiple facilities also serves the critical purpose of ensuring brand preservation (a company can work for years to build a brand, but destruction to a centralized headquarters can instantaneously destroy the efforts that went into building it)..

Decentralization Initiatives of Tenants from Lower Manhattan

The passage of time has demonstrated merits in both arguments, but also implies that the importance of decentralization to an organization is dependent on the nature of that organization. Two years after the attacks, public emotion has subsided and many large organizations remain concentrated in CBD locations. There are, however, other organizations that have acted upon the lessons learned from September 11 and completely reconfigured their facilities strategy. For example, the following table is a summary of findings made by TenantWise, a Manhattan-based real estate firm that has meticulously tracked the movements lower Manhattan tenants since September 11. The table provides a sampling of firms who have adopted different degrees of decentralization in their facilities over the past two years:

Tenant	Total Square Feet	Number of Pre-Attack Locations	Number of Post-Attack Locations
Deutsche Bank	1,688,991	2	12
<i>Citigroup/Salomon Smith Barney</i>	1,202,900	1	4
<i>Lehman Brothers</i>	1,705,900	2	5
<i>Morgan Stanley</i>	840,000	1	4
<i>CIBC World Markets</i>	500,000	1	3
<i>Dow Jones & Co.</i>	372,133	2	5
<i>Cantor Fitzgerald</i>	245,000	1	3

Source: **TenantWise**

In opting for a decentralized facility strategy, these organizations have implicitly recognized the importance real estate plays in corporate strategy. One of the aims of a reorganization project on this scale is lowering the risks associated with concentrating operations, and not maintaining adequate backup and operational redundancy. This suggests geographical dispersion will become a more important aspect of operational policy, especially by firms in sectors that need to be in continuous operation, such as the financial sector. As management policy changes as a result of September 11, the accompanying real estate strategy needs to be aligned with such policy shifts. Decentralization plays a greater role in the future, but the extent to which it unfolds will be a

function of an organization's area of business, size, location, and how it is structured.

The Drawing Power of Large Cities

In order to provide context to the discussion, we need to ask why companies are drawn to large cities such as New York, London, or Toronto in the first place. Many do because of the quality of pool of talented employees they can draw from is not only confined to the city, but also the wide surrounding areas. Companies also choose these centers for other tangible benefits including, proximity to other companies, access to information, and a wide range of local amenities. There are only a few selected markets in North America that possess these characteristics (thus, we should assume future dispersal initiatives will occur mostly in areas with large concentrations of white-collar workers located in the central cores of *first-tier cities*). These fundamental qualities of first-tier cities have in turn, provided the foundation for mega-operations.

James Schriener and Peter Genet of Deloitte & Touche LLP have described that over the past 5-7 years, organizations have increasingly adopted what is described as a "mega" operational model, one that organizes anywhere from 5,000 to 15,000 employees in a central location. "Corporate campuses" which became increasingly popular during the dot-com bubble provide an example of this type of operational model. Aggregation seems logical as it improves efficiency through economies of scale and creates efficiencies in the management of overhead. For example, proponents believe it is easier to manage a single operation of 2,000 employees than 4 sites of 500. The real reason, according to Schriener and Genet is tied to the lack of management talent and span of control issues.

Movement toward this type of model also creates its own problems. Statistically, in an environment where a 10% annualized staffing turnover is common, it is difficult to continually replace staff, especially in an environment where other firms compete for the talents of human resources within the same labor pool. The resulting limited qualified labor pool can cause salaries to escalate rapidly. Additionally, if operations are slowed due to softening economic conditions and organizations that previously adopted the mega-strategy model now require less space, disposition of large portions of space becomes increasingly difficult, especially in a facility that was not designed for multi-tenant use.

Schriner and Genet believed that the end of the consolidation era occurred with the terrorist attacks, as they brought into sharp focus the risk of concentrating operations in a single location. David Shulman of Lehman Brothers echoed this sentiment when he was quoted in a 2001 issue of Site Selection Magazine saying, "Gains associated with clustering of functions within a firm and of firms in similar industries are being offset by risk of terrorism". Almost two years later, these early predictions need to be put in perspective. The high emotion immediately following the terrorist attacks has now tempered, and decision makers realize that decentralization is not so simple process that it can simply be achieved by waving a magic wand – it is much more involved.

Dispersal Challenges and Strategies

Dispersing a headquarters into multiple locations is clearly more challenging than relocating, as corporate logistics must be taken into consideration. For example, a simple relocation involves nothing more than packing up one office and moving to another, whereas, dispersion requires planners to determine the functional lines along which separation will take place. Will it occur along departmental lines, or do other factors have to be taken into consideration?

Earlier waves of decentralization, including the decentralization of government functions in the Province of Ontario in the late 1980's, as well as the first wave of decentralization of New York-based firms to satellite communities such as Stamford, Connecticut would often take place on a departmental basis. The tragic example of Cantor Fitzgerald, who occupied the upper floors of the north tower of the World Trade Center, vividly demonstrated how losses in human capital were virtually irreplaceable. It also showed the risks associated with concentrating key management in a central location.

Therefore, one approach may be to mandate the separation of management functions to multiple locations. If such a strategy were adopted, managers would have to surrender a key aspect of managerial planning: the ability to have face-to-face daily contact. However, advances in new collaborative and remote technologies are now working to neutralize that concern..

Aligning Strategy to the Nuances of Real Estate

Real estate is an industry with a long-term planning horizon due to lags associated with construction. This, combined with the fact that existing ownership changes in real estate assets take time, and lease commitments are long-term, often soften or delay the property decisions of organizations such as corporations or government entities. The lag time provides real estate decision makers with an automatic mechanism to not act in haste, but to carefully plan projects that may adapt over time. Thus, even in the face of catastrophic events, a developer, owner, or user of real estate can properly assess the viability of a project, by putting it into its most logical context over an extended period.

If a user adopts a standardized framework of analyzing usage patterns of real estate, making a decision about whether or not to decentralize can be logically determined. This initial framework was suggested by a federal report released in August 2002 jointly prepared by the US Federal Reserve, the New York State Banking Department, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission. Its authors have created this four-step business continuity-planning checklist that can assist any organization in examining the viability of decentralized planning:

- 1) Create a nodal diagram that identifies the critical activities that provide the supporting infrastructure to critical organizations or business lines
- 2) Determine recovery time targets, as different business lines may need different recovery targets (anywhere from 2-8 hours of permissible downtime).
- 3) Plan to create sufficient out-of-region resources, including real estate, equipment, data and staff; it is suggested that such sites should not be staffed from the same labour pool that supplies staffing for the primary site
- 4) Ensure that backup sites are routinely tested

Short Term Initiatives

The checklist shown above was initially designed for financial market participants, but it is also applicable to other organizations and can thus be aligned to the nuances of those businesses. Because real estate provides the central focus of our analysis, it would now be useful to provide some type of context from which real estate policy can be formulated on a micro level.

For instance, before an organization can create dispersed, out-of-region real estate solutions, it must first deal with existing lease or ownership commitments. In the short-term, tenants of any institutional ilk, will begin to scrutinize certain aspects of their leases, and seek to address issues including business interruption, the structure of pass-through costs, and most notably security standards. Leased and owned space create different potential cost dynamics, as owners have the ultimate discretion as to how much money can be spent on improvements, and the extent to which they will improve the building. Almost all leases for commercial space contain “pass-through” provisions that mostly make the tenant responsible for any increases in common-area costs.

One of the greatest areas of change that has emerged, especially in locations where terrorism has become all too familiar (e.g. London), is the way buildings are designed. The open-access planned buildings that have been commonplace since the 1970’s, will be likely be replaced by closed-access, single-entry locations. Structural design requirements will change, and CBDs will place more emphasis on safety and security, which will probably compromise some elements of tenant privacy. The primary factor that differentiates one building from another today, will change from access to amenities, or transportation to sophistication of security systems and protocols.

Minimizing Exposure

Whether facilities are leased or owned, most businesses will inevitably face increased expenditures on security. The government sector in the US, in fact, provides a glimpse of what security measures will be implemented in the future and at what cost. Recently, Federal government officials have established a rigorous new set of security standards for the more than 6500 buildings it leases across the country to protect workers from biological, chemical or conventional bomb attacks. In Washington, the General Service Administration is now revamping policy on what government agencies can occupy office buildings that also have private tenants. Assuming government can still cohabitate with private organizations, this may subject those private tenants to new security demands. This suggests that plans need to be made that safeguard employees but also bring the needs of private tenants into greater focus.

Some are speculating that even if organizations from the public and private sector work together in formulating comprehensive security plans; they will still be faced to inevitable degrees of exposure in space that is leased from third parties. Part of exposure lies in the

open-access planned buildings that were designed for their ease of entry. These buildings had aesthetic concerns as the principle driving factor in their design; security and control were virtually ignored. Another factor that potentially increases tenants' exposure is the mere fact that many building owners view their properties as investments and are in the business of leasing and managing space. Thus, they lack knowledge of the high security procedures that will become increasingly commonplace in a post-September 11 world.

Conclusion

In the first few months following the terrorist attacks, the high level of emotion prompted several prominent organizations to declare that the city was a concept that had outlived its relevance. New planning initiatives would in fact do away with skyscrapers and the urban core. Two years later, our society has had time to reflect on the changes that actually will occur. Although some of the early predictions may now sound somewhat extreme, there still is a place for increased decentralization. However, any organization that opts for this strategy must be keenly aware of the effort required to deploy a decentralization model that is efficient. This undertaking not only involves locational issues, but span of management issues, as well as technology. Each component of the plan needs to be carefully analyzed to ensure that the operations of an organization are not compromised in the process.