

Key factors driving growth in the facility management industry

in the past, present and future

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This paper discusses the evolution of the Facility Management (FM) industry from the 1980s to the present and offers some predictions about where the industry is headed.

The changing demands in the market require a new way of thinking about the delivery of FM. The industry is transforming from a predominantly single-service local outsourcing model to an integrated services delivery model that seamlessly meets the core needs of the customer on a national and even global scale.



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Executive summary

Worldwide, the facilities management (FM) outsourcing market is expected to grow from \$959.2 billion in 2012 to \$1.314 trillion in 2018 (ISS estimates based on third party data, (ISS A/S Prospectus, March 2014)). Growth is evident across all markets, from North America and Europe to Latin America and Asia Pacific.

The market is not just expanding - it is evolving, with growing public- and private-sector demand for FM solutions that are both global and integrated. Along with this evolving market, customer expectations are broadening to include more value-added FM services. As an example, customers increasingly expect FM providers to assume responsibility (i.e., accept risk transfer) for regulatory and labour law compliance and to

take an active role in advancing the company's strategic mission (Redlein, Redlein, Soborg, & Poglitsch, 2014). To this end, FM suppliers are having to evolve from service providers to strategic partners.

These changing demands require a new way of thinking about the delivery of FM services, as the industry transitions from having a single-service, local outsourcing model to providing integrated services delivered seamlessly to the customer on a national and even global scale.

This paper will describe the evolution of the FM service industry from the 1980s to the present, offer some predictions for the industry and examine the industry-wide drivers for growth.



■ Introduction

Companies are looking at their facility assets and services with an increasingly strategic point of view. Senior leaders are exploring ways to leverage their facility assets and services to support - and even enhance - their core business, while minimising their costs. Additionally, they are looking for ways to focus their resources on their company's core mission and values.

To be good global citizens, companies are increasingly looking for ways to respond to increased social, economic and regulatory pressures. In many ways, great facility operations can help them excel in all of these areas.

As many companies see facility management (FM) and services as non-core to their business, they will strive to benefit from forming strategic long-term relationships with companies that are facility experts.

In conjunction with larger scopes and longer-term contracts, companies will be interested in working with strategic FM partners that deliver increased value through their facility assets and services.

Another way companies will derive greater value is by reducing their contracts through centralised procurement on a national and even international level. This simplification requires service providers that can perform on a broader scope both geographically and across multiple lines of service.

This paper aims to discuss these developments in the context of the evolution of the FM industry, the underlying drivers for recent growth and the solutions that outsource providers are providing for their clients.

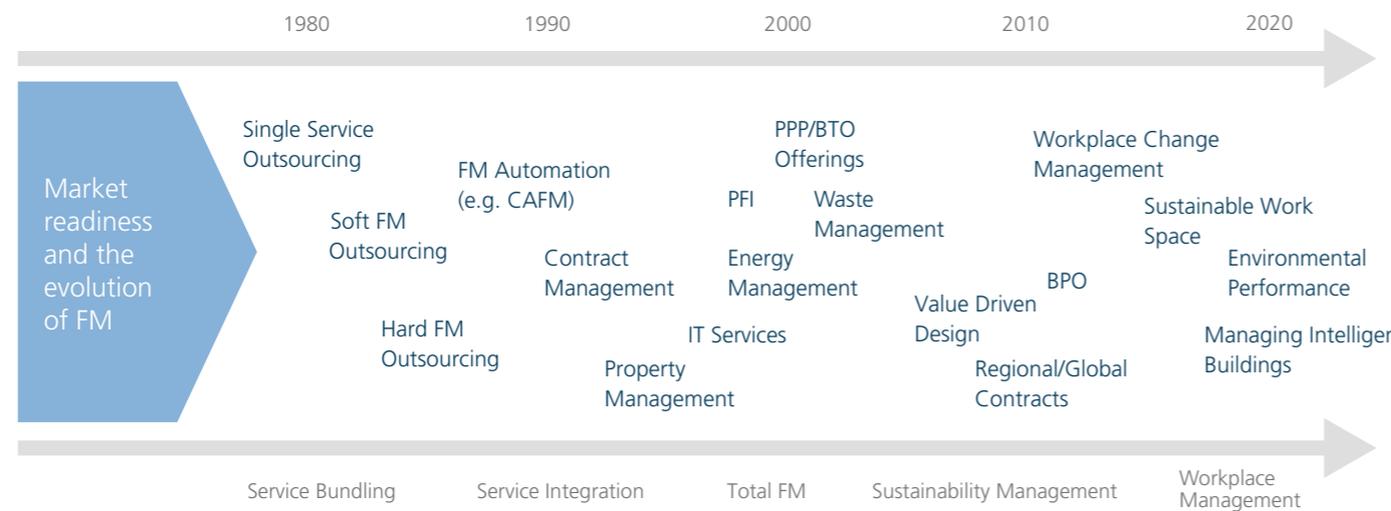
Evolution of FM

The 1980s saw a proliferation of single-source outsourcing, beginning with soft FM services (cleaning, catering, food services, mail room security, etc.), and a move in the late 1980s to hard FM services (mechanical, electrical, heating, ventilation, plumbing, building control, management, fire and life safety systems, etc.). These services were often achieved by bundling individual service contracts.

contract management and property management, including space planning and design, asset management, property acquisition and disposal, and relocation management.

Further integration happened when private investors became involved in public-sector contracts through Public Finance Initiatives (PFIs) and Public-Private Partnerships (PPPs), which

FM service providers also became involved in energy management. In the early 2000s, companies started turning to FM firms for business process outsourcing (BPO) – payroll, human resources, finance and other internal functions outsourcing – as well as waste management. Throughout the 2000s, value-driven design entered the equation, and regional and global contracts started to become more common.



Source: Frost & Sullivan (Pitch to ISS, May 2013)

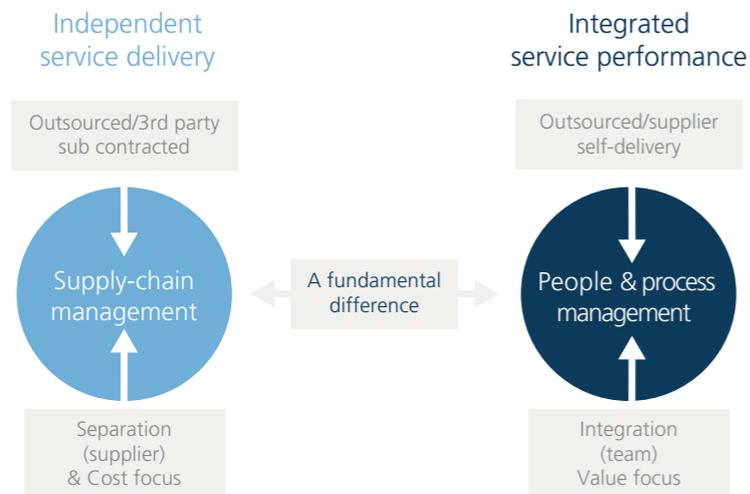
In the 1990s, there was a move toward service integration, facilitated by FM automation (CAFM). FM services grew to encompass

added another dimension to the FM services realm. This trend started initially in the UK but is now catching on elsewhere.

Currently, FM service providers are focusing on strategic initiatives such as workplace change management and risk mitigation as a way to increase the value they deliver to the client (Andersen & Ankerstjerne, 2012). They are looking for new ways to use technology to enhance services delivered.

These include dashboards for monitoring real time work orders and KPIs for all buildings in a portfolio around the globe, monitoring foot traffic in restrooms to schedule restroom cleaning or using GPS and street traffic to schedule mobile maintenance workers routes (Prodgers, 2014).

The ISS model - adding value to FM outsourcing



FM service providers looking to deliver more strategic value to their clients will take on even more aspects of their FM services, including sustainable workspace and environmental performance, as sustainability becomes an even higher corporate priority, as noted in the ISS 2020 Vision White Book series. Hand-in-hand with this is the management of intelligent buildings.

The outsourcing of continually more FM functions over the years has coincided with a shift from service bundling to service integration

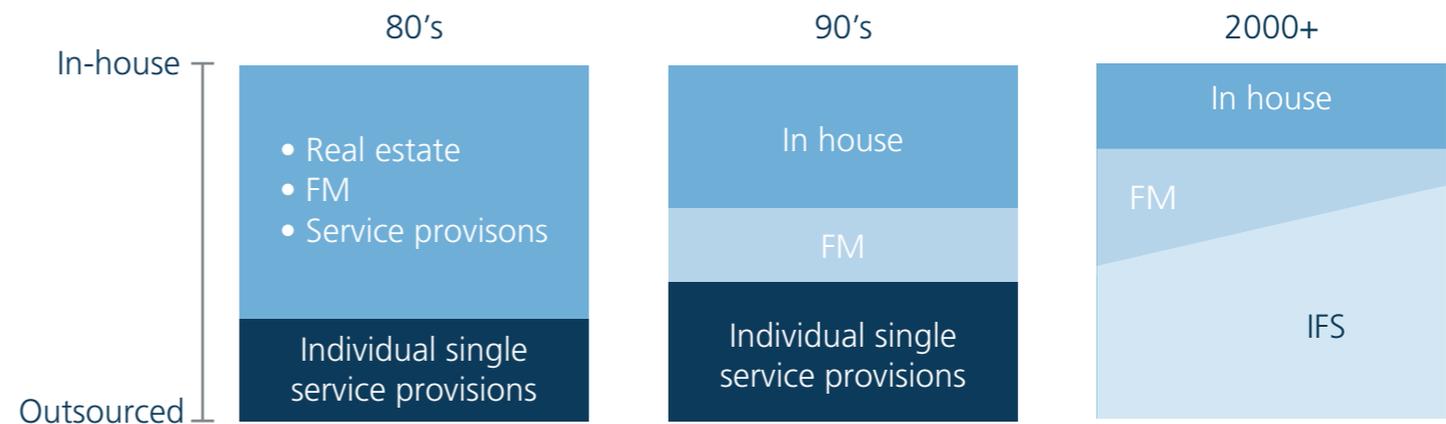
or integrated facility management (IFM, also referred to as total FM), sustainability management, and finally to Workplace Management.

In both the public and private sectors, IFM is seen as a way to simplify by streamlining the number of contracts, lowering costs and driving increased value. No longer are FM functions performed and managed in silos, because FM is looked at holistically. Facilities are no longer simply the places where a company's employees work; they are recognised as assets that can be configured and maintained flexibly to accommodate a company's core mission, culture

and strategic evolution. As the services that FM providers offer have evolved, so have the ways they are delivered.

In the 1980s, about 90% of FM services were performed internally, with the rest by individual service providers. In the 1990s, it was evenly split between in-house and individual service providers, with a small percentage performed by IFM organisations. In the 2000s, Integrated Facility Services (IFS) captured a respectable amount of market share from all three segments, mostly notably from individual service providers.

Development of outsourcing



Drivers for Growth

Ever since the 1980s, the industry has seen an increased desire for outsourcing and vendor consolidation. With globalised contracts, both the service delivery and the contracts themselves are being consolidated.

In one scenario – contract bundling – an FM service provider acts as the supply chain

manager of a customer’s multiple contracts with individual subcontractors.

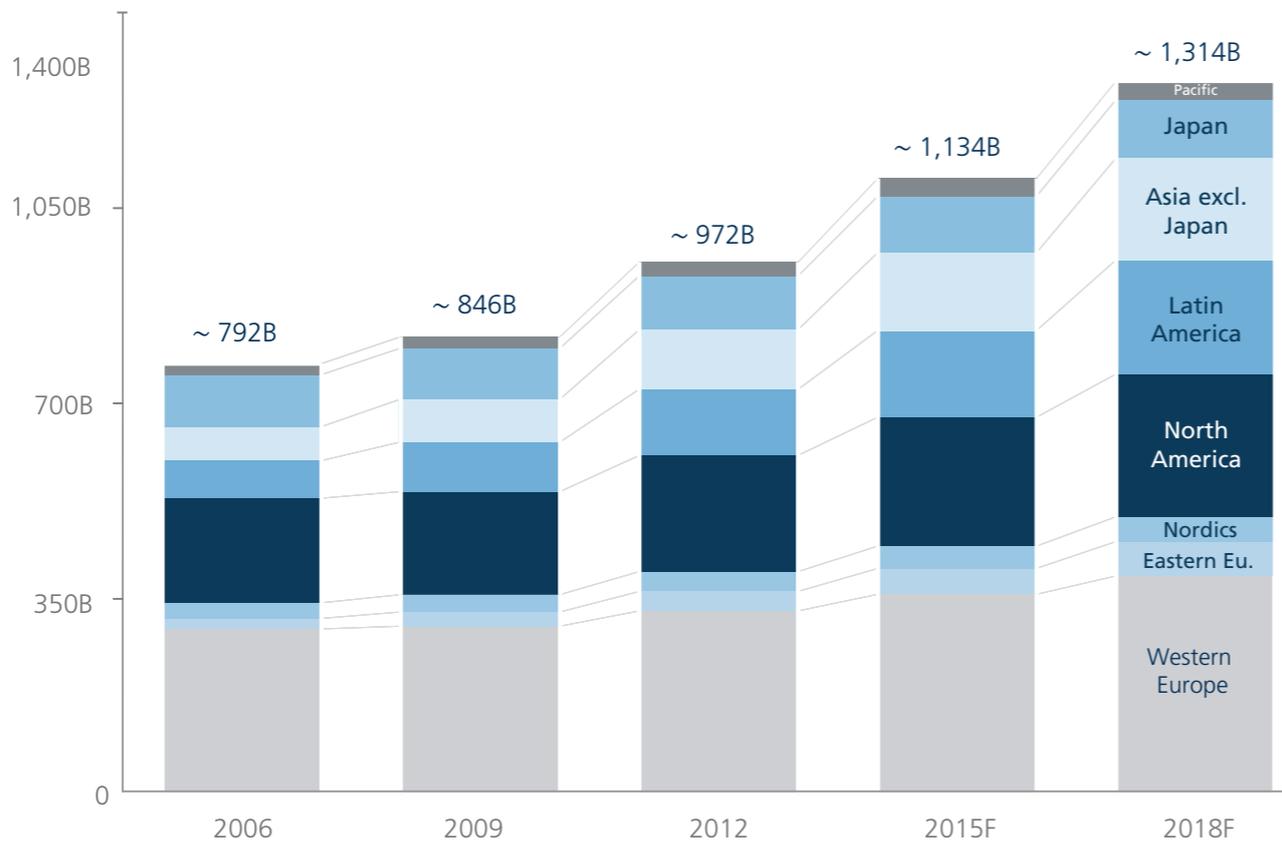
Typically the prime supplier will have a very small internal staff who manage the client relationship and the multiple subcontractors that actually deliver the service. This inserts a layer between the client and the boots

on the ground delivering the services. This arrangement fosters separation of duties among subcontracts. This usually leads to unnecessary silos where services are separated due to contracts, and subcontractor employees resist when asked to do something that is outside of their scope or contract.

Since the 2000s, that environment has become considerably more flexible, with self-delivery and integration of services by the FM providers. In the integrated model, one provider delivers several service lines and cross-utilises its employees to provide services across silos. The higher the percentage of services provided by the prime supplier (versus sub-contracted), the more successful the integration will be.

Other recent innovations in the industry include national and international procurement, and performance-based contracts. In addition, customers are demanding more value-added relationships with FM service providers, such as knowledge of the customer business and focus on risk transfer (Redlein, Redlein, Soborg, & Poglitsch, 2014).

Global outsourced facility services market by region (B USD)



Source: ISS A/S Prospectus, March 2014, pg. 48

Five major factors are driving growth in the industry:

1. Economic and regulatory developments

Economic pressures from regulatory requirements and increased competition are pushing companies to look at how they conduct business. Greater levels of scrutiny and tighter regulations, as a result of financial scandals, have led companies to look to strategic partners that can deliver and manage facility services - while taking on the associated risk.

Organizations are looking for a partner that will help them to protect the investment they have made in facility assets, manage the delivery of facility services to minimise interruptions to their core business and look for ways to deliver added value both from the assets, and services they already deliver and other additional valued-added services. Clients are looking for all this while at the same time expecting improved cost performance and mitigated risk that comes through delivering cost certainty.

Customers are also facing increasing pressure from health, safety, and environmental (HSE) regulatory bodies. In an effort to focus on their core mission, they are outsourcing their regulatory compliance to FM service providers with service level agreements (SLAs) that include penalty clauses for violations. These regulatory responsibilities are driving a new need for greater expertise in FM services.

2. Increased appetite for outsourcing

The FM market is expected to grow by 4-5% through 2018. Penetration of outsourced facility services has increased considerably in the 2000s, most dramatically in the emerging Asia Pacific markets. While the Asian markets overall remain significantly smaller than those in North America and Western Europe, where market penetration there is increasing rapidly.

I would prefer moving to an integrated set-up with a single provider. It seems so much more convenient than our current solution.

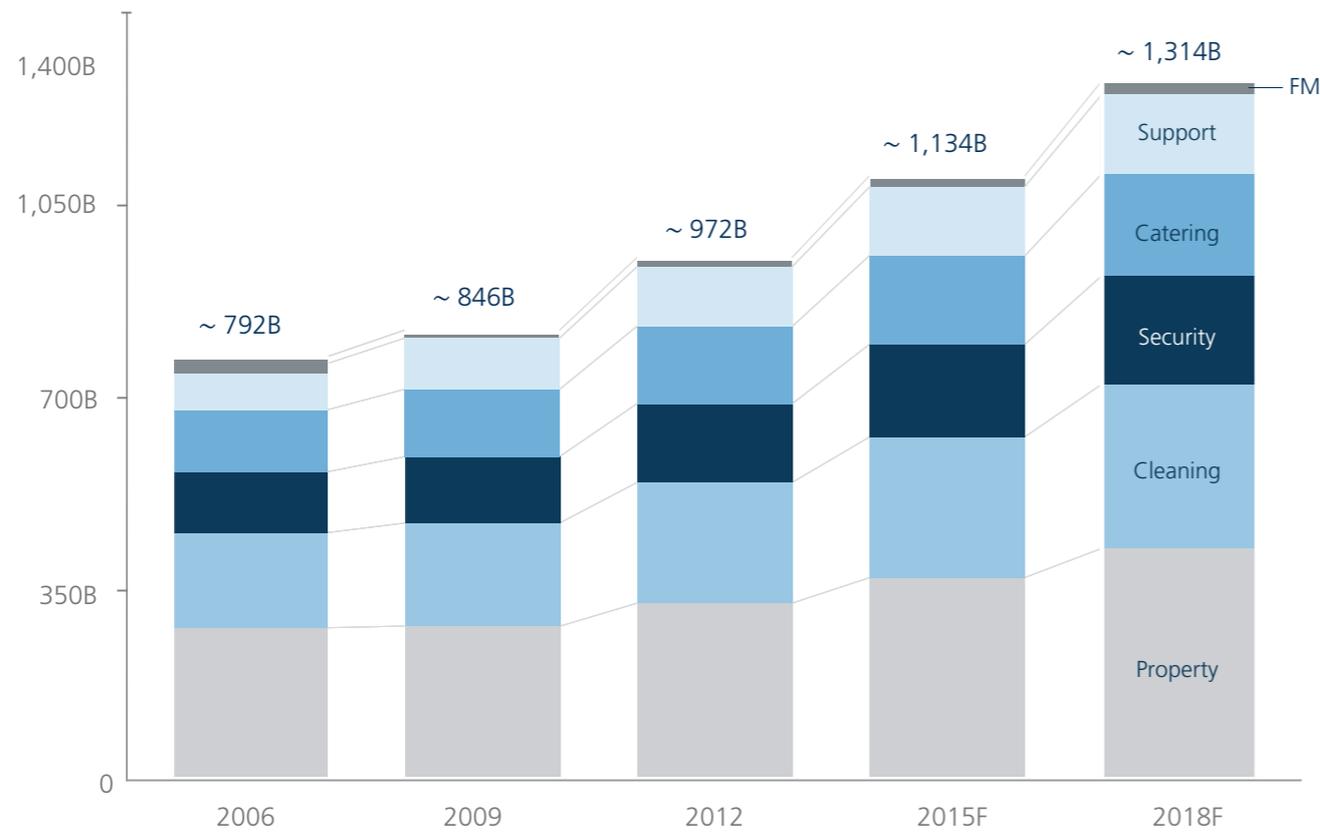
Purchasing manager,
Pharmaceutical Co, India

Even though the rate of penetration is increasing more rapidly in the Asian markets, this development is offset by the size of the markets that are participating. More than 50% of the market growth (revenue) within IFM is linked

to demand in North America and Europe. This increased demand for outsourcing, combined with an increase in service integration, is driving growth in the global IFM market.



Global outsourced facility services market by line (B USD)



Source: ISS A/S Prospectus, March 2014, pg. 49

3. Increased service integration

The revenue generated by the global IFM market is predicted to expand at a compound annual growth rate of 6–8%, reaching \$1.314 trillion in 2018. North America is positioned to remain the largest IFM market, with greater demand from large industrial, retail and public-sector organisations. More than 50% of the predicted growth in global IFM revenue from 2011 to 2018

is attributed to demand from North America and Europe, which accounts for two-thirds of the global market (The Hackett Group, 2013).

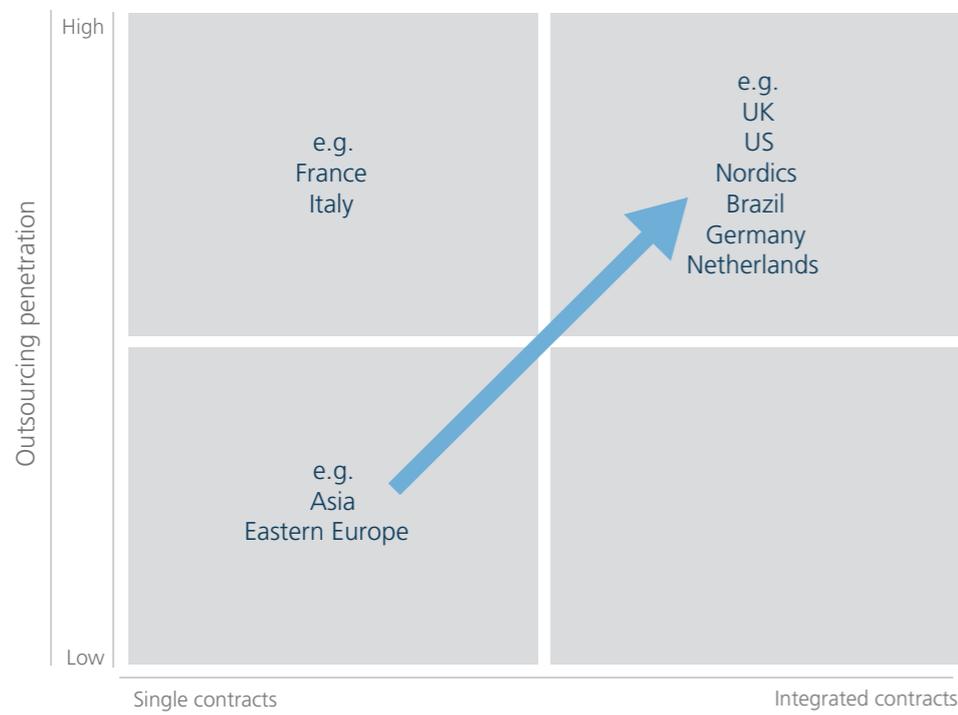
The rate of outsourcing and the demand for integrated solutions follow similar trend lines: in mature markets with higher outsourcing penetration, the demand for Integrated Facility Solutions is typically higher and growing, while the reverse is true in emerging markets.

However, by the late 2020s, it is predicted that China’s outsourcing culture will progress to the point of accepting modern FM solutions, opening the door for massive growth in IFM in that emerging market (The Hackett Group, 2013).

Service integration necessitates specific contract standards and language that differentiate it from a single-service contract. These contracts are more performance based: rather than specifying with a checklist how often a space is to be cleaned, for example, it sets a standard for “clean” and requires that the IFM service provider maintain that standard without prescribing how.

These performance-based contracts require focused forethought for the governance plan.

Examples of sourcing penetration and service integration



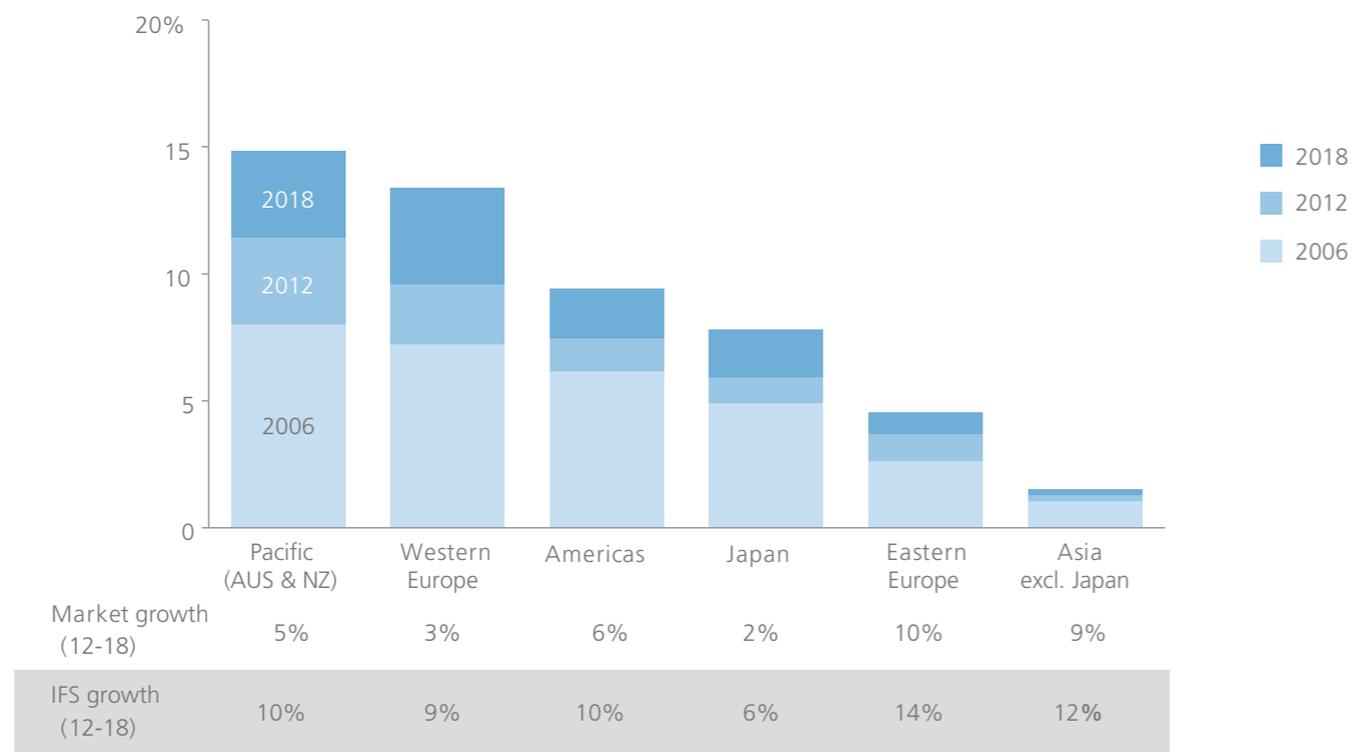
In markets with higher outsourcing penetration the demand for integrated solutions is typically more advanced.

In markets with lower outsourcing penetration the demand for integrated solutions are typically low – though smaller pockets of e.g. MNCs adopting the concept.

This plan specifies the governing structure between the client and vendor, performance metrics that provide measurement of performance, and a defined process to manage the performance and the relationship. From the customer's perspective, service integration provides the convenience of one point of contact, greater efficiency and financial

certainty. This results in a reduction in cost-plus situations, as suppliers are held more and more accountable for their spend. At the same time, the customer benefits from simplification in the form of reduced contracts, more transparency and control, fewer invoices to manage, and a common SLA.

IFS share of total FS market (%)



Source: ISS estimates based on third party data, (ISS A/S analyst presentation (March 2014))

It's not part of our core business to take care of services such as cleaning and security. That is why we choose to outsource them. It's also more flexible to do so than to have these services in-house.

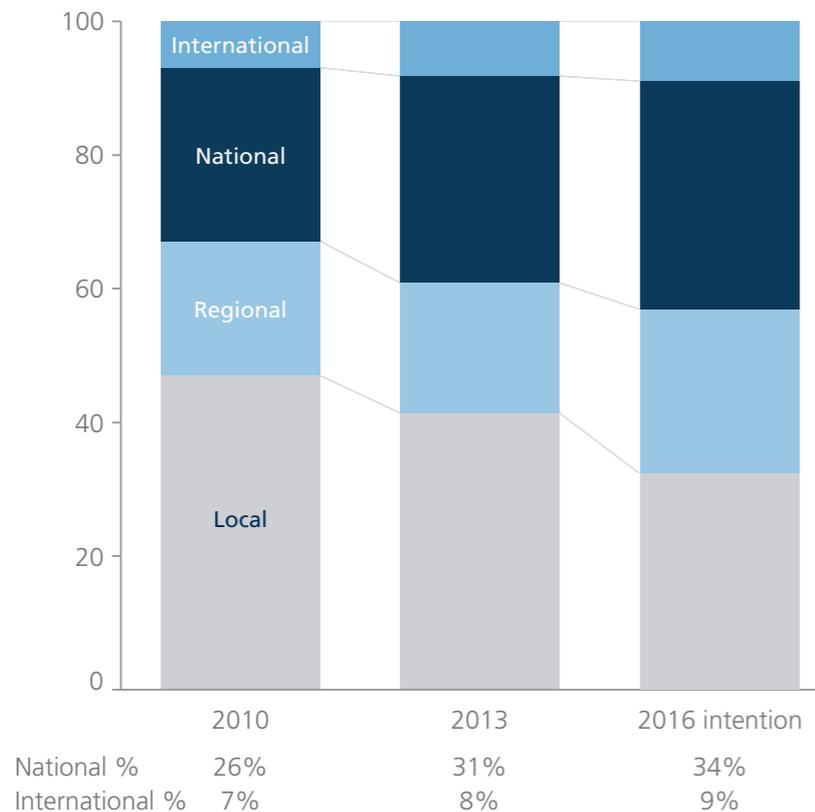
Nordic purchasing manager,
Pharmaceutical Co, Sweden

4. Nationalisation and internationalisation of contract procurement

The international market is fertile ground for FM services. In 2000, there were just a couple of international contracts industry-wide, the

IFS share of total FS market (%)

Share procurement for companies with multiple locations



Source: ISS estimates based on third party data, (ISS A/S analyst presentation (March 2014))

most notable being IBM, with an average revenue of \$300 million a year. By 2010, the industry boasted 30 to 50 contracts – including Motorola, Caterpillar, Shell, Pfizer, CSC, P&G, Kraft, and HP – with an average revenue of \$100–\$500 million. By 2020 the number is most likely to increase again.

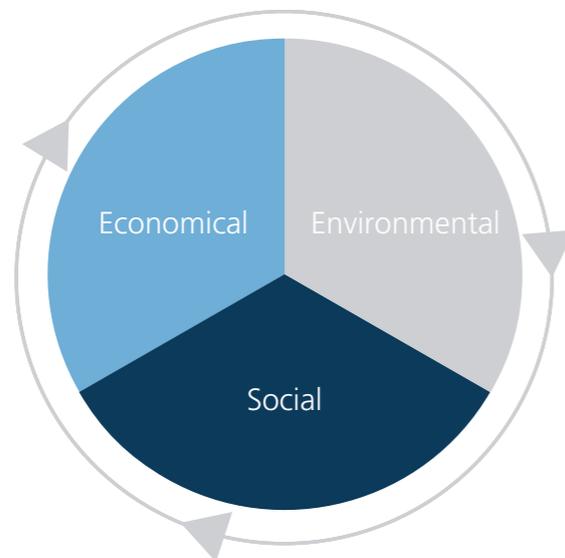
According to studies by The Hackett Group (2013) and Frost & Sullivan (2012), drivers for internationalisation include:

- Pressure to cut costs.
- Demand for simplification and standardisation of services: customers want to be able to make only one call to address an FM issue in any location worldwide.
- Internal pains – performance, productivity and retention of key personnel.

- War for talent – attracting the best employees
- Pressure on corporate real estate to deliver a great place to work, with an increased focus on lifestyle of work, collaboration, cost of operations, flexibility, telecommuting and movement of people.

The move to nationalisation and regionalisation leads to a greater share of the FM market being provisioned through IFS contracts.

Key areas for Value Generation



Centralisation and IFS trends are confirmed through external data showing the growing importance of self-delivery and longer contracts:

- Approximately 15% of customers are considering further centralising their facilities services purchasing over the coming 3 years
- Approximately 5% of customers are considering moving to IFS over the coming 3 years

- Over 75% of customers consider self-delivery important or very important (over 90% of those considering IFS)
- Approximately 80% of IFS contracts exceed 2 years in duration, while the corresponding number for other contracts is about 30%

5. Market demand for value-added services

The decision to outsource is moving beyond the traditional core vs. non-core and cost-reduction parameters. Customers increasingly demand that FM service providers have an intimate knowledge of the corporate mission, and the competency to address the company's specific needs.

The companies expect their FM provider to deliver solutions that help drive the following corporate initiatives:

- Social: Concern for their staff, their customers and their communities
- Environmental: Being a good corporate citizen that focuses on the impact of its environmental footprint
- Economical: Ensure shareholder value currently and in the future

The market leaders are able to provide the client efficiency gains above mere outsourcing... innovation is becoming key, and that requires scale.

Director General, Facilities Management Association

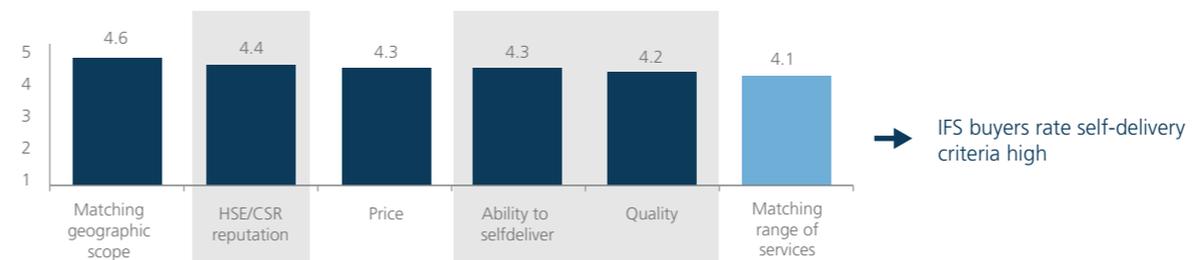
They must have the ability to comply with internal and external regulations – particularly HSE standards – and have the financial stability to assume the responsibility and cover the risk of non-compliance.

The provider must have the ability to deliver a uniform set of facility services internationally, and to integrate these services, as well.

In addition, services must be significantly more efficient. An efficient base organisation must be designed to handle both the daily as well as the peak workload. This is most effectively done through service integration and self-performance of the tasks.

By integrating, the silos of bundled services are reduced or eliminated. The base organisation must also be equipped to provide route-based specialists who service a customer's multiple small regional locations. Self-delivery is another fundamental requirement. The FM service provider must have the ability to integrate services and multi-task employees, as well as take over outsourced staff as new core employees.

How important are the following criteria in purchasing IFS for Multinational companies? (1-5)

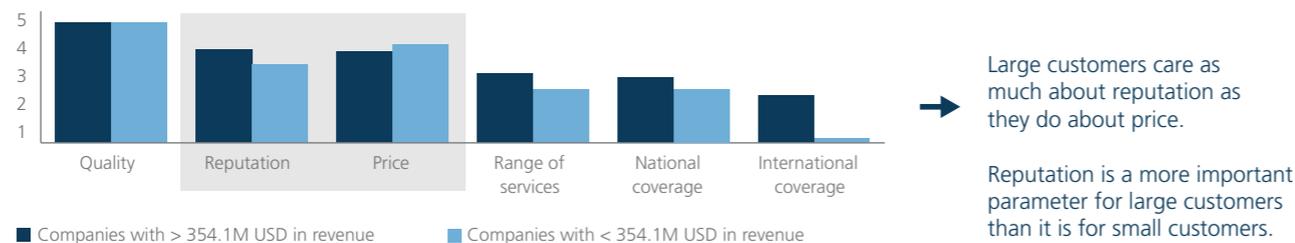


Source: ISS estimates based on third party data, (ISS A/S analyst presentation (March 2014))

Upskilling and cross skilling of employees are fundamental requirements in any successful FM outsourcing project, which require solid transition and mobilisation capabilities and a strong HR approach from the FM partner.

Self-performed services eliminate the extra level of management that exists with a bundled or supply chain model. An excellent FM service provider understands the need to empower front-line employees to maximise delivery effectiveness.

How important is each of the following criteria when purchasing facility service? (1-5)



Source: ISS estimates based on third party data, (ISS A/S analyst presentation (March 2014))

Best practices for FM outsourcing

Customers expect FM service providers to be able to document the quality of their output based on SLAs and key performance indicators (KPIs) and to have the ability to benchmark these with other similar customers. To accomplish this, FM organisations must empower front-line employees and provide them with more responsibility.

- Develop long-term vested partnership relationships to capture the best performance and cost savings:
- Use incentive models to reward the supplier for delivering added value year after year
- Identify suppliers that are the right fit for the organisation:
- Experts who can clearly identify any risks and develop risk mitigation plans (Kashawagi, Sullivan, Kashawagi, 2009)
- An organisation with the right cultural fit and a complementary company vision and practices

- Carefully validate unnecessary service requirements that drive increased costs:
- Over reporting
- Metrics that are not used as KPIs but are given equal weight
- Leverage suppliers that are a good fit for delivering service at all enterprise sites with favoured pricing
- Establish KPIs early in the contracting phase to ensure a clear governance model.

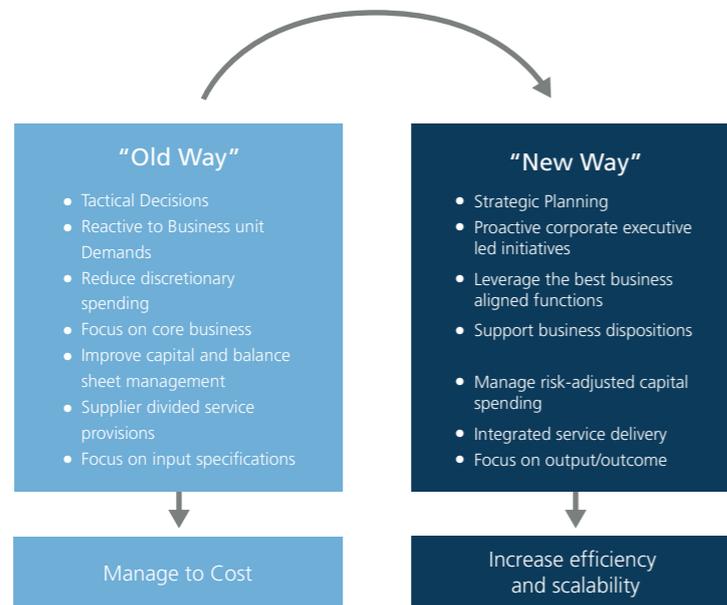
Customers definitely consider demonstrated ability to provide the range of services requested: wide self delivery capabilities in the service offering is therefore essential.



Conclusion

The FM direction and decisions are increasingly being seen as strategic enablers and therefore are being set at a higher and higher level in companies, leading to regional and global IFS/IFM contracts. These contracts are integrated into corporate capital planning horizons that are for 3–5 years or more. These contracts require:

- Transparency of actual spend
- Benchmarking to support and validate service and spend levels
- Improved forecasting
- Enhanced risk mitigation



The FM marketplace is growing, and FM service providers must evolve to keep up with shifting and expanding customer demands. They must offer value-added services, such as credible and effective risk management, including HSE and local labour law management. They must have the capability to provide excellence across a broad menu of services and consistent self-delivery on a global scale, as well as the flexibility to grow and change along with the customer.

On a broader scale, the customer is concerned about the integrity of its brand, and the FM service provider must fulfil its role in protecting that brand. A major food company cannot tolerate being cited for a breach of hygiene levels in the production area, for example, and a software company cannot afford the fallout from a customer’s IT failure because a server room or data centre was not properly maintained.

Companies are increasingly concerned about their image, in part to attract the best and brightest employees. To accomplish this, they are looking for ways to leverage all of their assets, particularly their facilities. They are not looking for a supplier but a strategic partner that is going to deliver best-in-class FM to help them leverage the value of their facility assets.

The customers’ explicit demands are tangible: “clean”, “100% uptime” and “allow me to focus on my core business”. Implicitly, the requirements are reliability, responsiveness, convenience and cost-effectiveness.

Facilities should be seen as an integral part of the strategic and cultural journey of an organisation. The FM provider must be focused on finding new and innovative ways to make facility assets and services not only relevant but critical to enhancing the customer’s employees experience and enabling their core business.

The solutions offered must be adaptive to meet the demands of the changing workforce and world. To accomplish this, companies are looking for FM visionaries.

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* The prospectus contains statistics, data and other information relating to markets, market sizes, market shares, market positions and other industry data pertaining to our business and markets. Unless otherwise indicated, such information is based on our analysis of multiple sources, including a market study we commissioned from Bain & Company (the "Company Market Study") and information otherwise obtained from Frost & Sullivan and the International Association of Outsourcing Professionals. Such information has been accurately reproduced, and, as far as we are aware from such information, no facts have been omitted which would render the information provided inaccurate or misleading.

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