Linking Real Estate Decisions to Corporate Strategy

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Abstract. **An organization's real estate decisions will be effective if such decisions support the enterprise's overall business objectives. This result can be achieved only by the explicit consideration of how real estate strategy supports corporate strategy and the substrategies for component elements of the corporation, and then in turn how specific real estate operating decisions support the real estate strategy. This approach provides a context for negotiating competing interests and increases the likelihood that a specific real estate decision will be consistent with the enterprise's overall real estate strategy and thereby support realization of corporate business objectives.**

While some organizations explicitly consider how a specific real estate transaction relates to their real estate strategy, the vast majority not only fail to make this consideration, they do not have a formal real estate strategy. A primary reason most businesses do not have a formal real estate strategy is that the real estate strategies that corporations might pursue have not been explicitly articulated. Consequently, most businesses proceed implicitly concerning their real estate, inevitably miscalculating and failing to consider the appropriateness of a specific real estate transaction in the context of the organization's real estate strategy. More seriously, lacking consensus about what the enterprise's real estate strategy is, such organizations pursue real estate transactions without a strategic context, and consequently risk electing real estate transactions inappropriate to the enterprise's overall business strategy.

Surveys of corporate managers have revealed a curious ignorance and lack of interest in relating their real property assets to the overall strategies guiding their business (Veale, 1989; Zeckhauser, 1983). Both management theorists and practitioners take as a given that any business will perform more successfully if it is focused on what its business is and works out how to achieve that goal through operating decisions and implementation. Strangely missing, however, is the connection between how the business addresses its operating decision generally and the implementation of the strategy through its real estate decisions. The all too prevalent cliché that managers use to cut short discussion of real property strategy by saying, "We are not in the real estate business!," lacks verisimilitude, since 25% or more of corporate assets are in real property, and occupancy costs (annual costs of real property

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services) represent 40% to 50% of net operating incomes (Zeckhauser, 1983; Bell, 1987).

Our purpose in this paper is to demonstrate the linkages between real property strategy and overall business strategy and between real property strategies and real estate implementation decisions. Effective real estate decisions are integral to the realization of overall business objectives. A select collection of firms utilizing real estate strategy to complement their overall business strategy and thereby be more successful includes McDonald's, Teradyne Connection Systems, Mead, and AT&T.

Driving Force Defines Business Strategy

A precondition to formulating a real estate strategy that is derivative of the corporate business strategy is articulation of the corporate business strategy. The need to balance the theoretical with applied, ensuring both pragmatic specificity and conceptual breadth, requires an approach that is beyond "cookbook" while not being so narrow as to limit the range of relevant considerations.

The strategic management literature abounds with numerous models and ways to think about corporate strategy (Mintzberg, 1990). Porter's framework has been broadly recognized for the contribution it makes to thinking about how competitive forces impact strategy (Porter, 1985a, 1985b). Rappaport provides a means of valuing the strategy selected (Rappaport, 1986). Porter's framework focuses on the five competitive forces of threat of new entrance, threat of substitute products, bargaining powers of buyers, bargaining power of suppliers, and rivalry among current competitors. Rappaport has operationalized Porter's competitive framework to ensure the best value-creating strategy through an emphasis on the analysis of how shareholder value impacts the business strategies. Tregoe and Zimmerman (1980) argue that the framework, if it is to be practical and useful, must specify the scope and boundaries of each area of critical choice concerning the corporation as well as how each is related to the other.

Ultimately, strategies must be translated into the specifics of the organization's scope of products and market, which Tregoe and Zimmerman (1980) term the fundamental strategic decision. The specification of the scope of products and markets provides a basis for considering what physical facilities are needed to support the organization's strategy, and therefore the real estate strategy that is needed to support the organization's strategy. According to Tregoe and Zimmerman, *the primary determiner of the scope of future products and markets is the organization's Driving Force, which in turn provides "the basis for defining the other choices in the strategic profile."* Arguing that all of the corporation's important activities—resources and capabilities, plans and structure, decisionmaking and problem solving—ultimately are directed towards its products and markets, Tregoe and Zimmerman argue that the Driving Force is a central hook that can serve as a clear and simple concept to guide top management in developing the strategic framework.

Tregoe and Zimmerman identify nine possible strategic driving forces, as listed in Exhibit 1, that determine the future product and market scope that define a business and provide a framework for guiding operating decisions. While the authors note that all nine are important to a business, they assert that usually only one is the primary

Exhibit 1
Strategic Driving Forces

Products/Markets

1. *Products Offered*
A business with this driving force defines the business by its products and products similar to existing ones. The search will be for new markets for those products and ways to improve those products. Its capabilities support the development, production, promotion, sale, delivery, and servicing of those products. Examples include Ford, MGM, and Bank of America.
2. *Market Needs*
A business with this driving force defines the business by attempting to serve the particular needs of a particular segment of a market. The search will be for new services or products to serve the market. In new markets the same segment will be served. Its capabilities will support needs analysis and new products to serve those needs. Examples include Playboy Enterprises, Inc., Gillette, and Merrill Lynch.

Capabilities

3. *Technology*
A business with this driving force defines the business by attempting to provide products, services, and markets derived from its technological expertise. The search is for applications of its technology. Its capabilities support research in its field of knowledge and in finding applications for this knowledge in new products. Examples include E.I. Du Pont de Nemours, and Texas Instruments.
4. *Production Capability*
A business with this driving force defines the business by attempting to provide products and services that can be produced using its production capabilities. This capability may be in large scale, or in job shop size. In either case, the products provided to markets are determined by the process to make them. Its capabilities support improving the production process and searching for new products that utilize those skills. Examples include U.S. Steel, R. R. Donnelly & Sons, and International Paper.
5. *Method of Sale*
A business with this driving force will define the business by attempting to provide products and services that can be sold by the company's way of convincing customers to buy. Its capabilities will support improving the knowledge about this method of sale and finding other products and markets that can be approached this way. Examples include Avon, Book-of-the-Month Club, Franklin Mint, and Spiegel.
6. *Method of Distribution*
A business with this driving force defines the business by attempting to provide products and services that can be sold by its distribution system. Its capabilities support improvements in the distribution system and finding new products to distribute and markets to serve using the system. Examples include AT&T, McDonald's, and Canteen Service.
7. *Natural Resource*
A business with this driving force defines its business by attempting to provide products and services that are generated from its control and use of particular resources. Its capabilities support ways of controlling and conserving its resources and new products or services that utilize these resources. Examples include Gulf Oil, the U.S. Forest Service, and De Beers.

Results

8. *Size/Growth*
A business with this driving force defines its business by attempting to provide products and services that meet new size or growth objectives. Its capabilities support finding new products and markets with the requisite potential for growth. Because this emphasis contradicts the usual strategic message to build on one's strengths and capabilities, size/growth is not a sustaining driving force. Tregoe and Zimmerman's examples include City University of New York (1960s), Boise Cascade (1960s), and Litton Industries (1960s).
9. *Return/Profit*
A business with this driving force defines its business by attempting to provide products and services that will meet its targeted return or profit measures. Tregoe and Zimmerman say that switching products within a given market or product area is not what this driving force is. Rather, it is the willingness to search for unrelated products and services yielding particular rates of return. Once again, this primarily financial orientation seems to defy admonitions to emphasize one's capabilities. The business' capabilities support the search for new products and services that will generate the targeted rate of return. Examples include International Telephone and Telegraph, Gulf and Western, and R. J. Reynolds.

Source: adapted from Tregoe and Zimmerman (1980) determinant of what the business does. The driving force of a company may change over time with changes in the environment, markets, and other forces that determine business direction and competitive position. Since the organization's future product and market scope define its real estate needs, the driving force concept is a most powerful model for providing the context to consider the linkage of corporate business strategy to real estate strategy.

Linking Business Strategy to Real Estate Strategy

Real property is purchased, along with human resources, equipment, and raw material. Economists discuss firms as purchasing inputs—land, labor, and capital—and transforming them through a production process into goods and services sold for a profit. Economists, however, are very careful about the definition of the service from real property. In their equations real property is an asset generating a service per unit of time. The price of real property in production functions is the price per unit of time for the services provided by real property—not the asset price. What appears to be a trivial nicety in theory is profoundly important for managers. Investing in real property assets is engaging in a real property business that provides monthly and annual real property services to users (Nourse, 1990). Notably, long-term leases are instruments for entering the real estate business.

A reading of Porter and other writers on strategic management (Porter, 1985a, 1985b; Rappaport, 1986; Tregoe, 1980) suggests that both managers and scholars consider the purchase of real property assets to be a purchase of an input and not the vertical integration of a firm into real property business. Although Porter writes a long chapter on vertical integration as a policy, none of the examples or the discussion relate to real property decisions. Discussion of real estate or facilities is limited to purchasing decisions, especially with respect to locating the facility. Rappaport is explicit about facilities as purchases of assets resulting in investment expenditures. He carefully demonstrates how such purchases must be evaluated in a discounted cash flow framework and how strategies using such investments must be evaluated in the same way, but nowhere is there a discussion that real estate is indeed another business requiring a strategy to complement the overall business strategy.

The particular strategy that an enterprise elects to pursue determines what resources will be required to implement that strategy. Answering the classic *What business are we in?* question necessarily prescribes what resources are needed to do that business. And, as real estate resources are integral ingredients to the realization of business purpose, a real estate strategy cannot properly be crafted without careful consideration of the implications of the real estate requirements of the primary business strategy.

The implications for the requisite real estate decisions associated with an enterprise's business strategy follow from consideration of such basic issues as:

- What contribution does real estate make as an input to the production and service delivery function of the business?
- Is real estate central to distribution of the company's products, such as in a retail food business, or is it ancillary, such as in a business that sells its

goods and products through indirect channels and does not directly relate to the customers.

- What role does geography play in the business? If the business is defined by the markets in which it is located, such as a bank chartered to operate in a certain geographic region, then geography is critical. This geographic determination is in contrast to a business whose product is intangible, or one that has a high value relative to its mass, or whose use is not related to close physical proximity, or which delivers an intangible uninfluenced by geographic considerations.
- How important is interpersonal interaction between workers within the organization? For those to whom interaction is critical, proximity is important, whereas it is much less a concern for individuals who interact on a face-to-face basis only infrequently.
- What amount of space per worker is required for the type of work done by that function? The appropriate space per worker requirements can be influenced significantly by standards established by what competitors allow, which standards may have little to do with what space is optimal or necessary, with the result that the standard can be much less space than is really appropriate, or at times more space than is appropriate.
- What message does the company want to send by the image, external appearance, and internal ambiance of its space to employees, suppliers, customers, the financial markets, and the broader community in which the business is based?

Answers to these and related questions are a function both of the strategy pursued, which provides a certain set of parameters from which appropriate answers follow, modified by the corporation's particular emphasis on generic means of implementing such strategies. These generic strategies include cost minimization, quality differentiation, and service leadership (Porter, 1985a). The particular approach employed by the company, as reflected by its culture and values, provides further definition to the uniqueness of the enterprise's strategy.

The collection of corporate considerations including driving force, the generic strategies employed to implement that driving force, and the particular culture and values of the company determine which real estate strategy or strategies may be appropriate.

Real Estate Strategies

Whereas management theorists assert that corporations should concentrate on a single primary value, theme or driving force (Tregoe, 1980), the multiple factors concerning products and markets that need to be supported by real estate often mandate multiple rather than single real estate strategies. Certainly, the consideration that a corporation has multiple facilities serving multiple market segments on different scales, purposes, and levels mandates different priorities. Consequently, multiple real estate strategies and different priorities are needed.

We believe that there are eight types of real property strategies that encompass how

Exhibit 2
Alternative Real Estate Strategies

1. Occupancy Cost Minimization
   — Explicit lowest-cost provider strategy
   — Signal to critical constituencies of cost-consciousness
2. Flexibility
   — Accommodate changing organizational space requirements
   — Manage variability/risk associated with dramatic escalation/compression space needs
   — Favor facilities that can readily be adapted to multiple uses by corporation and others
3. Promote Human Resources Objectives
   — Provide efficient environment to enhance productivity
   — Recognize that environments are important elements of job satisfaction and therefore compensation
   — Seek locations convenient to employees with preferred amenities (transportation, shopping, reference, entertainment)
4. Promote Marketing Message
   — Symbolic statement of substance or some other value
   — Form of physical institutional advertising
   — Control environment of interaction with company's product/service offering
5. Promote Sales and Selling Process
   — High traffic location to attract customers
   — Attractive environment to support/enhance sale
6. Facilitate and Control Production, Operations, Service Delivery
   — Seek/design facilities that facilitate making company products/delivering company services
   — Favor locations and arrangement that are convenient to customers
   — Select locations and layouts that are convenient to suppliers
7. Facilitate Managerial Process and Knowledge Work
   — Emphasize knowledge work setting over traditional industrial paradigm
   — Recognize changing character, tools used in, and location of work
8. Capture the Real Estate Value Creation of Business
   — Real estate impacts resulting from demand created by customers
   — Real estate impacts resulting from demand created by employees
   — Real estate impacts resulting from demand created by suppliers

property decisions can be guided. These eight alternative strategies are summarized in Exhibit 2 and described more fully below.

1. *Occupancy Cost Minimization.* It is important to distinguish between being cost effective and seeking the lowest occupancy cost, which objective may compromise quality of space. All decisions should be cost effective for the quality space sought, but the strategy considered here emphasizes the search for the lowest cost decision. An illustration is the location of back office bank operations in remote low cost places. Since these are often operated around the clock, security and comfort for the workers is required, but prime space downtown in major cities at very high rentals is not needed. Those locations should be saved for aspects of bank service that require contact with clients.

2. *Flexibility.* There is also the concept of minimizing occupancy cost in the short run versus doing so over the long run, the life cycle of a production process or business. Decisions about the construction, design, or maintenance of facilities may be made because of their impact on future transactions (Nourse, 1992). For example, if the life cycle of a particular product is expected to be short, designing a special

purpose building for its production may increase production cost unnecessarily. Special purpose buildings are more difficult to finance and are more difficult to sell because few buyers will be interested. Placement of a facility in the center of a site may make it impossible to sell surplus land if the total acreage is unneeded.

Designing more flexibility into buildings by careful attention to the heating, ventilating, and air conditioning systems, the plumbing system, the electrical system, and trusses for broad open areas with movable wall partitions, may make it less costly to renovate and expand the original building for new uses. Such flexibility may make it possible to adapt the building to a new use within the business or to sell it at a more favorable price when surplus, thus reducing occupancy cost over the long run, although it may be increased in any one year.

3. *Promote Human Resources Objectives.* Retention of skilled workers may require a particular location and quality of space, adjacent amenities, or adjacent complementary facilities. Keeping a low turnover of the work force may require careful location of the facility with respect to the location of the homes of the work force. Several illustrations come to mind. Research and development firms seek to hold skilled engineering and scientific talent by locating in places with amenities for these employees to enjoy off-work hours. Firms seeking clerical or industrial facilities search for sites within a labor market with unemployment 5% or greater in order to reduce wage competition for workers and to be within easy commuting distance for them. Short-sighted firms have allowed facilities to be located adjacent to manager's homes with resultant high turnover of personnel because of the commuting distance to the average employee's residence.

4. *Promote Marketing Message.* The physical image of the facility may provide a way to advertise and attract attention to the firm's services and goods. The physical image of the facility may also be used to entice the targeted buyer group into the facility by meeting the needs and preferences of that group. For example, fast food restaurant chains, and other retail food chains use the same symbol at each location for easy identification of the product— McDonald's arches, Pizza Hut's roof, etc. One problem may be that when sites go sour, it is difficult to remove the symbol in disposing of the property, especially if it is the shape or outline of the physical structure, as in the case of Pizza Hut.

Transamerica's pyramid in San Francisco is the prime example of the use of the headquarters structure as a symbol for the company. Another was the Xerox strategy, undertaken for a short time, to consolidate offices in each city into one building with the company's name emblazoned thereon. The idea was not only for Xerox to reduce office occupancy costs by owning its own building, but also to provide a greater symbol of the presence of the company in each city. Finally, we can contrast the strategy of Wal-Mart to symbolize its low cost operation by maintaining its head- quarters in a small town in Arkansas, whereas Sears' strategy to achieve symbolic status with a very tall office building may have become a monument for the burial of that company.

5. *Promote Sales and Selling Process.* The easy concept here is the location of retail outlets to the center of markets being served, or to appropriate access points. The location of supermarkets, service stations, shopping centers, motels, and hotels, etc., all fall in this category. But a new concept has also been developed by the large chains and that is to establish the network of store locations to enhance sales and take business from the competition.

6. *Facilitate and Control Production, Operations, Service Delivery.* The design, layout, quality of facility, capacity, location, ownership rights, and financing are all combined to achieve greater efficiency or control of operations in alignment with corporate strategy. For example, McDonald's leases each restaurant to a franchisee. Franchisees do not choose sites; McDonald's chooses new sites to conform to regional development plans. The lease itself provides for rent of 8% of sales to the corporation. Without this mechanism, the corporation lacked a means for profiting from the development of its concept. Finally, McDonald's leases also provide that franchisees who do not meet inspection standards for quality, service, cleanliness, and value, can be removed as tenants. This enables McDonald's to control the image of the outlets (Love, 1986).

A manufacturing firm decided to develop factory outlet shopping centers because it found that managers and owners of such centers were not sensitive to the manufacturer's image and would create tenant mixes that the manufacturer thought hurt its image. By developing centers the manufacturer controls the tenant mix to favor its product.

An example of design enhancing control of an operation is Teradyne Connection Systems (TCS) (Seiler, 1984). The major strategic goal of the company was to convince potential clients that they should purchase client-specified configurations of standard subcomponents from TCS. These businesses had been purchasing the subcomponents from elsewhere and configuring the units themselves because of price fluctuations, and problems with quality and delivery of customized parts from suppliers such as TCS.

Although TCS had solved the technical problems of manufacturing the subcomponents, it hit snags in customizing the assemblies. In its old plant, each department was in a different place and had little or no contact with other departments. Assembly was conducted in an area "out back" that was uninviting. When problems arose, sales engineers and design engineers were nowhere around to help, even though they had information that would be useful in the solution. Sales engineers negotiated price and delivery with the clients. Their work was passed on to the design engineers for drawings and specifications. Once these were completed, they were passed on to production. As each department completed its task, it went on to the next client project.

Exhortations to everyone to cooperate did not work. When management built a new facility, the architects suggested resolving the problem by designing the facility to encourage more participation. The architects located the assembly area in the center of the building and made it the focus of the whole operation. Automated production of subcomponents now takes place on one side of the assembly area and products are fed into the center floor for assembly. The sales engineers, design engineers, and other specialists are located around the center area, so all are involved with the assembly processs.

A visitors' area with a glass wall overlooking the process gives a view of the three stages of production: automated production of subcomponents, a semiautomated fabrication unit, and the assembly floor. Visitors can observe the difference in activity and quality of each of the processes. Thus, the design solved an operations and a marketing problem, too.

Another major corporation with many divisions was trying to find a way to shift decisions from corporate headquarters to divisions by managing divisions through profit results. Facilities were constructed at different times, so that the resulting accounting measure of return on net assets was not an appropriate measure of a division's performance. The solution was a real estate strategy to sell off property and lease it back. Not only were managers on an equal footing, but it turned out the corporation had lower occupancy costs leasing than if it owned.

7. *Facilitate Managerial Process and Knowledge Work.* As the knowledge work process characterizes the senior management function for all enterprises, attention to guiding real property operating decisions in a manner that facilitates knowledge work is a distinctive, singular and prospectively high payoff real estate strategy. The selection of the real property in which a business operates too seldom is based on an explicit consideration of facilitating the functions of managing the business effectively, profitably, and progressively. Although great attention is given to plant layout in the manufacturing setting and to store design in the retail context, very little attention has been given to how the design of physical work space for knowledge work complements the doing of knowledge work.

Most business space is of an industrial paradigm in an era where that paradigm no longer applies. Significantly, most corporations unwittingly victimize and constrain their workers by using physical considerations of work space that do not facilitate knowledge work. As Winston Churchill insightfully observed, "We first design our structures and they design our lives." The real estate strategy to facilitate knowledge work explicitly addresses how to design structures that will complement the doing of knowledge work.

Almost without exception, the selection of space in which businesses operate is made without explicit consideration of how that space prospectively might complement the work of the workers who will work in that space. Since few corporations recognize the connection between the physical spaces and the managerial processes and knowledge work conducted within those spaces, that there is not an explicit connection between the real estate and the work done on that real estate is not surprising. A growing priority in the coming years, however, will be the design of physical spaces that complement managerial processes and knowledge work.

One company that has addressed the design of its physical environment to facilitate the managerial process and knowledge work of its business is CNL Systems, a business that is involved in developing and financing major retail facilities. Building upon its recognition of the impact the physical environment can have upon the retail experience, CNL senior management have critically considered how to design a work environment that will promote the type of work that its management group does. Thus, concepts of space can facilitate meeting effectiveness, which is embraced through the recording of the information and strategy generated through that meeting to create and extend a corporate memory and promote a learning organization.

8. *Capture the Real Estate Value Creation of Business.* Often a business will create value in surrounding property by its presence because it attracts new businesses as suppliers or customers. This strategy would be to own the surrounding land and profit from the increase in value, or to obtain special lease discounts for occupying a particular space because of the external effect on an owner's profits.

The everyday example of this strategy is the anchor department store or supermarket in a shopping center. Since it attracts traffic to the center, it could reap the development profits itself by owning the shopping center, or it could reap the benefits by obtaining a very low rent to lease the property. Another common example is the triple A credit tenant in an office or industrial park that will enable the developer to obtain financing. In this case the tenant could develop the center itself or obtain a discounted rent from the developer for the financing and attraction of other tenants that are brought by its presence in the development.

The classic example of capturing the real estate value creation of business is Disney (Weimer, 1966). Disneyland in California has limited acreage and greatly increased land value in the surrounding area because of the traffic it created. Because others controlled the crucial surrounding land and the businesses located there, Disney could not take advantage of the business opportunity its traffic created. In Orlando, when Disney created Disney World and Epcot Center, Disney acquired more land than was needed for the operation so that it could capture the increased values that it created.

The two best examples of complementary real property and business strategy are McDonald's and Teradyne Connection Systems. Tregoe and Zimmerman already indicate that McDonald's driving force is method of distribution. Real estate complements that strategy by finding a way to control franchisee quality, service, cleanliness, and value by inspecting and requiring passage of inspections as a lease condition. Furthermore, the lease terms provide generous financial rewards to the corporation so long as the tenant does well, which encourages the corporation to assist franchisees in doing well. Furthermore, McDonald's attention to location and the ambiance of its restaurants all complement the driving force of the business.

TCS, on the other hand, appears to be driven by a production process. Real property decisions complemented that strategy by the design of a facility that improved that process and enhanced the service and production capability of the firm.

Firms driven by market needs and technology may work with short product or service life cycles since these products may change rapidly. Therefore, these firms may find a need to hold down real property expenses by using more flexible facilities. Their property should be capable of being rapidly changed from one product or service to another. Firms driven by technology may also find the need to attract technical personnel by using real property location and improvements to promote human resource objectives.

Firms driven by products offered or by method of sale are most likely to complement that policy with a real estate strategy of minimizing occupancy costs. Those firms driven by returns or profits, that is, those that are searching for any kind of business that will make greater profits, are more likely to undertake capturing real estate value creation by entering the real estate business to develop surrounding property. Most others might take advantage of the leverage in negotiations to obtain lower lease or purchase costs for own property. This might be termed efficient real estate operations and negotiations as opposed to a strategy of horizontally integrating into the real estate business.

Linking Real Estate Strategy to Corporate Driving Force

These eight real estate strategies can be linked to the nine corporate driving forces depicted in Exhibit 3. As seen in the exhibit, for each corporate driving force there is

Exhibit 3
Linking Real Estate Strategy to Corporate Driving Force

	Driving Force								
Real Estate Strategies	Product Offered	Market Needs	Technology	Production Capacity	Method of Sale	Method of Distribution	Natural Resources	Size/ Growth	Return/ Profit
1. Occupancy Cost Minimization	P	T	S	T	P	S	T	T	P
2. Flexibility	T	P	P	NA	NA	NA	NA	S	S
3. Promote Human Resources Objectives	T	T	P	P	T	S	T	S	T
4. Promote Marketing Message	S	S	S	S	S	P	S	P	S
5. Promote Sales and Selling Process	S	P	S	S	P	P	S	P	S
6. Facilitate Production, Operations, Service Delivery	P	S	S	P	S	P	P	S	S
7. Facilitate Managerial Process and Knowledge Work	S	S	P	S	T	T	S	S	S
8. Capture the Real Estate Value Creation of the Business	NA	NA	NA	NA	NA	P	P	S	P

P = Primary; S = Secondary; T = Tertiary; NA = Not Applicable one or more primary real estate strategy, with the other real estate strategies being assigned secondary or tertiary importance. In the instance of capturing the real estate value creation of the business, that particular real estate strategy does not have a logical linkage to the driving forces other than for those business strategies that are inherently real estate intensive, specifically, method of distribution and natural resources, or financially defined, specifically, size/growth and return/profit. The linkage relationships in Exhibit 3 are suggestive and certainly will vary depending upon the particular strategies of a business.

By reviewing the linkage relationships shown in Exhibit 3, insights can be gained as to the relative priorities of different real estate strategies for various types of business emphases. As a case in point, those companies that are defined by their method of distribution will in their real estate strategies place primary emphasis on promoting their marketing message; promoting their sales and selling process; facilitating and controlling production, operations, service delivery; and prospectively capturing the real estate value creation of the business. Technology companies, by contrast, will place primary emphasis on flexibility, promoting human resource objectives, and facilitating knowledge work.

As the linkage relationships depicted in Exhibit 3 highlight, a real estate strategy that makes sense for one type of business may be totally inapplicable for another type of business. Thus, the tendency of the literature and practice of corporate real estate to emphasize generalized approaches, rather than strategic-specific approaches, is misdirected and can lead to the selection of real estate that frustrates rather than promotes realization of corporate objectives. Particularly significant in this regard is the dominant orientation of minimizing occupancy costs, a strategy that is really of secondary or tertiary priority for six of the nine driving forces identified.

Real Estate Operating Decisions

The transaction decisions businesses make concerning their real property are operating decisions embracing the processes of acquiring, controlling, managing and disposing of real property interests. By definition it would appear that real estate businesses fall in the product offered driving force category. Since we have already defined the purchase of real property as entry into the real estate business, the corporate real estate unit is in the real estate business, and its driving force is the product offered. The driving force is the particular real estate product or service offered: architecture, construction and development of particular types of buildings, property management, marketing, valuation, financing, and management of real property portfolios. But this is far from the whole story. Operating decisions about these products or services can be molded in a variety of ways to serve different user needs. So let us look at what real property operating decisions businesses face.

Real property operating decisions logically comprise fourteen critical distinct decisions, including (1) location, (2) quantity, (3) tenancy duration, (4) identity/signage, (5) building size/character, (6) building amenities, (7) exterior quality, (8) company space, (9) mechanical systems, (10) information/communications systems, (11) ownership rights, (12) financing, (13) control, and (14) risk management. Each is discussed below.

1. *Location.* Embracing broad regional location strategies including country and/or part of country, metropolitan statistical area, downtown or suburbs, the particular submarket, neighborhood and finally the specific building.

2. *Quantity.* Consideration of the amount of space need to provide for immediate and near-term needs as well as to allow for future expansion, possible additional space needs resulting from relocation of other business units, planned or opportunistic acquisitions. Some organizations consciously control additional space beyond their anticipated needs for the purpose of speculating on future rental market conditions and/or controlling adjacent tenancies and uses.

3. *Tenancy Duration.* The minimum and maximum time horizons over which the corporation's access to the space is assured, which is controlled through leases, options to extend and/or buy, plus direct ownership.

4. *Identity/Signage.* The *message* that the space conveys through signage on the building and/or in the lobby as well as the entrance to the facility, influences the perception of the space and therefore the advertising message it sends to the corporation's audience.

5. *Building Size/Character.* Whether the business locates in a facility where it is the dominant tenant, one of many occupants of a multi-tenant building, or a minor tenant in a building dominated by another organization influences the ambiance of the work environment and also has important real estate strategy consequences.

6. *Building Amenities.* Amenities available in and proximate to a facility have a substantial influence on the perceptions and experiences of those working in the space. Among the amenities of concern available within the building are newsstand, drug store and food outlets. Amenities of interest proximate to the building where the work space is located include a health club, gymnasium/swimming pool, child care, a variety of restaurants and cocktail lounges for business meetings and social interaction, stores, and open public spaces, interior pocket parks for lunch time and other breaks, and other spaces that can be enjoyed before, after and during breaks from work.

7. *Exterior Quality.* The quality of landscape, building design and materials, public spaces, and building systems determine the visual appeal and influence the functionality of the space.

8. *Company Space.* The interior space, layout, design, finishes, furnishings, and art define the ambiance and functionality of the work environment.

9. *Mechanical Systems.* The heating, ventilation, and air conditioning systems as well as transportation (elevators, escalators, moving sidewalks) influence the comfort of the work setting.

10. *Information/Communication Systems.* The support the building facility provides for communicating and processing information largely impacts the functionality of the space and the organization's productivity.

11. *Ownership Rights.* Which ownership rights are obtained through the transaction, including short-term rental, long-term leases, plus options to extend and/or convert these positions as well as full ownership, have critical operating and financial implications.

12. *Financing.* How the financial obligations are paid through what types of

financial arrangement have important financial consequences. Alternative approaches including lease arrangements with periodic monthly payments, escalating payments, inflation-indexed payments, front-end loaded payments (paying all or a major portion of the rent up front and/or financing all of the intended improvements), back-end loaded payments and the like. In an ownership setting, a critical decision is what portion of the property investment is paid at the time of acquisition and what portion is financed, and of the amount financed, how it is financed.

13. *Control*. The degree of control an enterprise exerts over other types of uses that may impact its enjoyment of its space is of concern since the presence of specific tenants in adjacent space can have important operating impacts.

14. *Risk Management*. Among the risks associated with space occupancy and rights are liability to third parties for acts and accidents at the property, responsibility for employees working in the space, financial exposure to disaster (fire, earthquake, storm, environmental contamination, etc.). Whether these risks are insured with third-party insurance organizations, assigned to the building and/or other third parties, or self-insured by the company, and to some degree its employees, has critical operating implications.

Given the diversity, breadth and complexity of these critical real property operating decisions, there is a plethora of different alternatives that might be considered. The critical strategic concern for the corporate real estate function in implementing these real property decisions is how to guide these decisions in a way that corresponds to the enterprise's real estate strategy. Again, lacking an explicit real estate strategy, real property operating decisions may be made that are unrelated to or even in conflict with the enterprise's overall business strategy rather than being consistent with the real estate strategy and thereby reinforcing the overall business strategy.

Linking Real Property Operating Decisions to Real Estate Strategies

Just as it is inappropriate to specify a company's strategy for its real estate decisions without consideration of its primary business strategy, so also is it inappropriate to make a particular real estate decision without considering that company's specific real estate strategy. In practice, since few companies are explicit in articulating their real estate strategies, real estate operating decisions tend to get made in a vacuum. That such decisions are often inappropriate, leading to frustration for those working in the space and financial disappointment, is not surprising.

Independent of which real estate strategy(s) the company elects to pursue, there are common considerations that drive the determination of the appropriate approach to real estate operating decisions. Specific considerations that should be addressed in implementing real estate operating decisions include:

- the changing role of real estate in business;
- market conditions concerning relative availability of the quantity, pricing and type of space a company might seek;

- the importance of a special or unique real estate environment to company operations.

Because the real estate decisions must be implemented in the context of market realities, it is important that those responsible for such decisions have a clear understanding of the circumstances in the broader real estate markets and those that apply particularly in the markets in which the company contemplates implementing a real estate transaction.

A crucial test in the implementation of real estate operating decisions in the context of real estate strategy is to confirm not just that the real estate decision is consistent with the company's real estate strategy and therefore its overall business strategy, but also to confirm that the real estate operating decision is consistent with the company's other critical component strategies for such factors as human resources, operations, marketing, finance and information. Although a real estate operating decision may logically follow the real estate strategy and thereby be consistent with the overall business strategy, if that real estate decision is not linked to, consistent with, and supportive of the other basic substrategies for the enterprise, it will necessarily be less effective than it might otherwise be.

While the eight real estate strategies have varying degrees of applicability to the nine strategic driving forces as discussed previously, all fourteen property operating decisions must be addressed in each real estate strategy. These fourteen real estate operating decisions are made either explicitly or implicitly every time a real estate decision is made, either through the explicit implementation of the transaction or as an implicit decision in the form of *not* implementing a transaction. One approach to identifying certain dominant considerations in linking real property operating decisions to real estate strategies appears in Exhibit 4, which highlights certain priority operating decisions for each of the eight real estate strategies. This presentation necessarily is incomplete and purposely suggestive, since it must be customized to serve the objectives of the particular corporation's business objectives, markets and products, and resources.

Implementation Requires Negotiation

Implementation of real property operating decisions involves negotiations between multiple parties characterized by highly diverse objectives, resources, requirements and constraints. Consequently, the decision process is not unilateral but rather involves the search for solutions to resolve conflicts in a manner that both creates the greatest benefit to the corporation and also is acceptable to all involved parties. Real property decisions become a focus for inside managers of marketing, operations, finance, and personnel, as well as the outside developers and real property specialists with whom the firm is negotiating. Thus, real estate executives have an integrative function—integrating across the functional areas of business and across the real estate market (Lawrence, 1967).

The negotiating tactics and methods to assist these managers in the middle are described by Lax and Sebenius (1986). The important point in such negotiations, however, is that the managers in the middle, as well as all the other parties, must

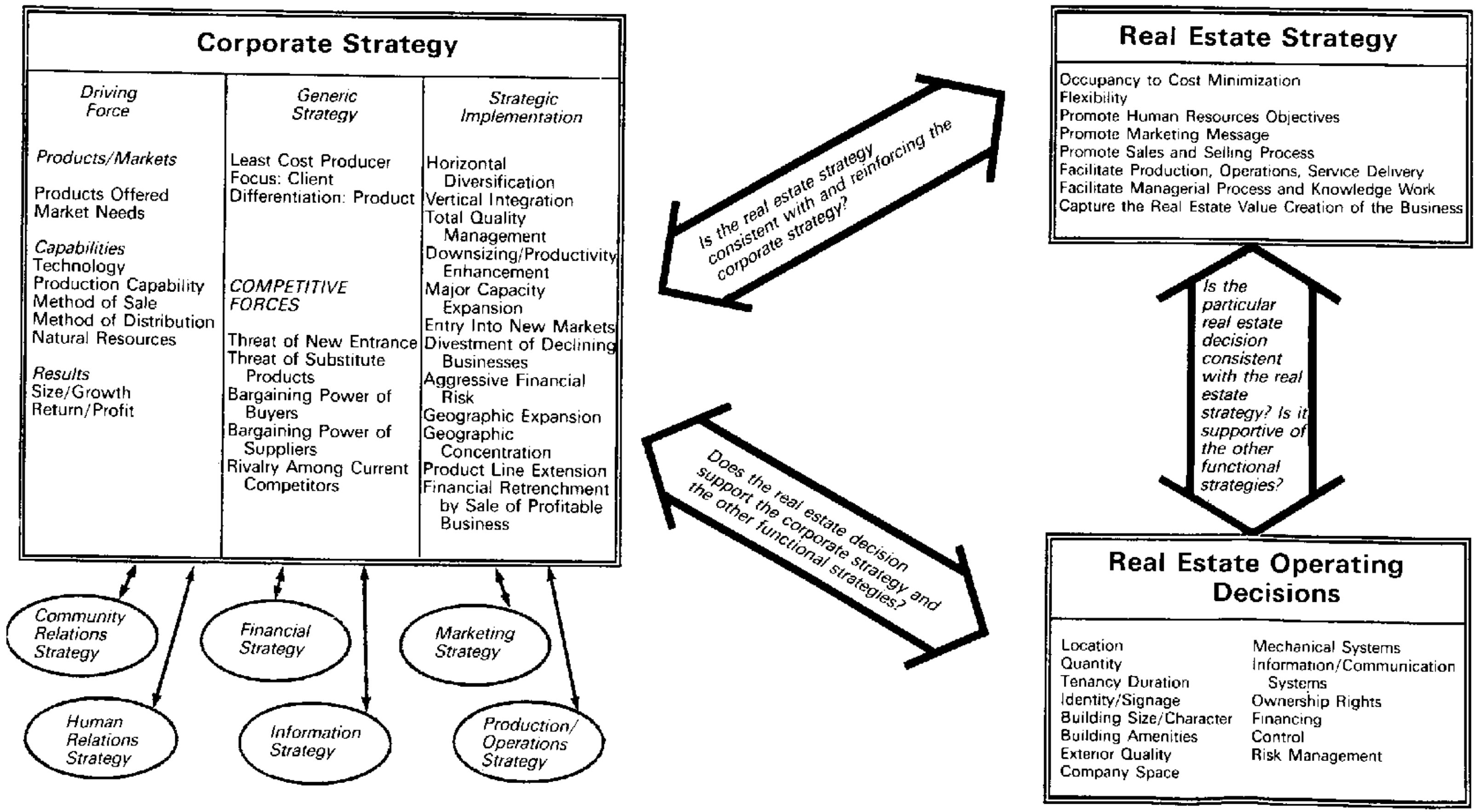
Exhibit 4
Dominant Considerations in Linking Real Property

Real Estate Strategies	Location	Quantity	Tenancy Duration	Identity/ Signage	Building Size/ Character	Building Amenities	Exterior Quality
1. Occupancy Cost Minimization	remote, less popular regions and sites	minimum space per worker			general purpose building	less important	less important
2. Flexibility	less prime location		short-term leases—options				
3. Promote Human Resources Objectives	accessible to where workers live/want to live	more space per employee	long term			high priority	
4. Promote Marketing Message	prestige and high visibility: very important		own or long-term lease	critical	landmark structure		very important
5. Promote Sales and Selling Process	prestige and/or high traffic location		lease for flexibility	critical			consider selling
6. Facilitate and Control Production Operations, Service Delivery	access to customers and suppliers		own or long-term lease		appropriate for primary purposes		
7. Facilitate Knowledge Work		sufficient to promote effective work			important	contribute to effective work	
8. Capture the Real Estate Value Creation of the Business	consider impacts on demand of location decision	secure more space/land than needed for own use	longer terms		dominant tenant		

Operating Decisions to Real Estate Strategies

Company Space	Mechanical Systems	Information/ Communication Systems	Ownership Rights	Financing	Control	Risk Management
lesser priority			minimize financial responsibility	cost-of-capital trade-offs drive decision	inconsistent with cost minimization	minimize financial exposure
construction to favor easy modification					important	
premium ambience and furnishings	comfortable working ambience				high priority	
consistent with marketing message			important relative to continuity of marketing message		priority	
critical impact on selling environment		important			significant re impacts of adjacent uses	
specialized facility	appropriate temperature	priority			significant re impacts of adjacent uses	
critical priority	positive working environment	priority				
			critical	critical strategic priority	critical	aggressive value creation involves more risk

Exhibit 5
Business Real Estate Decisions in a Strategic Management Context



identify their real interests. These interests become the measure of whether the deals constructed meet the needs of all parties.

Strategy ultimately is a consistent network of linked agreements (Lax, 1986). To guide the corporation in making consistent networks of linked agreements, it is necessary to consider explicitly real estate strategy, which can be grouped into eight primary strategies. Corporations often pursue multiple real estate strategies, with selection of the appropriate collection of real estate strategies being a function of the driving force of the overall enterprise.

Conclusion

Too often, corporate real estate transactions are approached from a predominantly deal-making rather than strategic posture. While many involved in corporate real estate transactions recognize that the process involves a *negotiation* to optimize competing interests, their focus unfortunately is predominantly on economic issues, all too often at the expense of other important strategic priorities. Although there is some implicit recognition that there are trade-offs involved in how the fourteen operating decisions are packaged in a particular transaction, the dominant emphasis tends to be on the financial goal of cost minimization. Lacking a context of how a particular real estate decision fits the organization's overall real estate strategy and ultimately links to its business strategy, the transactions involving corporations' use of space may frustrate rather than promote the realization of overall corporate business objectives.

An organization's real estate decisions will be effective to the extent such decisions support the enterprise's overall business objectives. This result can be achieved only by the explicit consideration of how the real estate strategy supports the corporate strategy and the substrategies for component elements of the corporation, and then in turn how specific real estate operating decisions support the real estate strategy. The essence of these interdependency relationships is depicted in Exhibit 5, which presents Business Real Estate Decisions in a Strategic Management Context. This approach provides a context for negotiating the competing interests and increases the likelihood that a specific real estate decision will be consistent with the enterprise's overall real estate strategy and thereby support realization of corporate business objectives.

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