Location strategy for US-based office operations: Driving significant financial and workforce returns through best-practice location strategy development

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Abstract

This paper examines the best practice approach for selecting the optimal location for new or relocating business operations. It reviews how to identify functional candidates for relocation, assessing the financial feasibility of relocation, alternative transition strategies, identifying the optimal alternative location for the operation, and on-the-ground investigation of alternative locations, and incentives. The paper notes the importance of human capital and operational excellence as drivers of location strategy.

Keywords: location strategy, demographics, incentives, footprint strategy, location selection, site selection

INTRODUCTION

The Conference Board's annual survey of global chief executive officers (CEOs) reported that human capital and operational excellence are two of CEOs' top five challenges.[1] Human capital challenges can be broadly defined as recruiting and retaining the right labour force for any given operation. The unifying challenge of achieving operational excellence is optimising the value that a company receives from its assets — primarily cash, the workforce and property, plant and equipment (PP&E). The city in which an operation is located has a significant impact on a company's ability to address human capital and operational excellence challenges for three main reasons. First, labour costs — salaries, variable compensation and benefits — can vary by up to 40 per cent across the USA and even more globally. Since labour typically accounts for 80–90 per cent of an operation's total costs, this is a rich area of opportunity. Secondly, the volume, concentration and general quality of talent are highly variable by location, especially for

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specialised skills. Thirdly, municipalities are increasingly competitive in their use of business incentives to attract businesses to their communities.

This paper will share the best-practice approaches that progressive companies are using to capture human capital improvements and operational excellence through location strategies. While there are many approaches for improving human capital and operational returns *in situ*, a new location can be a powerful strategy for rapidly achieving cost-savings, improving access to required talent and recharging an underperforming operation.

IDENTIFYING CANDIDATES FOR RELOCATION

The functions, processes or operations that can be relocated will differ from company to company. Determining candidates for relocation first requires an analysis of how the function contributes to the corporation. As illustrated in Figure 1, functions can be categorised in one of four ways:

- *Transaction processing:* Functions with a well-defined process, often supported by technology, that are not location dependent, eg payroll processing or billing.
- *Centre of expertise:* Functions that provide value-added services or a specific subject matter expertise, but are not location dependent, eg internal management consulting or learning and development.
- *Local support:* Functions that provide defined service levels and are location dependent, eg facilities and administrative assistants.
- *Strategic/decision centre:* Functions that are location dependent and provide leadership, executive oversight or direction for business units or the corporation. The location dependency of these groups is usually driven by desired proximity to an industry cluster, air access (domestic and international) or a legacy affiliation with a city or region.

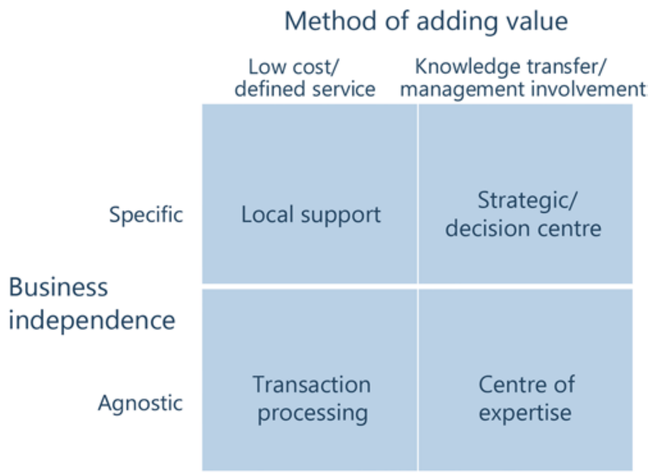

Figure 1 Categorisation of functions

Companies must then assess whether a function is truly ready to be relocated. Important assessments include process standardisation, process stability, degree of process complexity and technological enablement. Sometimes companies use this as an occasion to assess whether it makes sense to continue to in-source the process, or whether an outsourced model would be more optimal.

ASSESSING THE FEASIBILITY OF RELOCATION

Existing operations typically require an extensive analysis to first determine whether it is feasible or not to relocate. This is because, as opposed to establishing a new operation, the relocation of an existing operation will be likely to incur significant one-time transition costs and affect current employees on a very personal level. The first step is to estimate the potential return on investment (ROI) and payback period of relocation, which can be accomplished by assessing four cost categories:

- one-time infrastructure costs;
- recurring infrastructure costs;
- one-time workforce costs; and
- recurring workforce costs.

INFRASTRUCTURE COSTS: ONE-TIME AND RECURRING

These are primarily real estate and technology costs. Real estate costs include recurring rent and operating expenses, as well as one-time design, construction and decommissioning expenses. At this stage of the project, where companies are testing feasibility instead of creating a detailed budget or business case, it is reasonable to use cost estimates by sizing the real estate requirement, reviewing previous similar construction projects and selecting a proxy real estate market. Commercial real estate brokerage professionals are typically pleased to assist with sourcing these types of data. Information technology (IT) costs can vary widely by operation and company. For example, the technology required to run a basic office operation will be less than the technology required to run a call centre or data centre operation. These estimates are best sourced from a company's IT team.

Workforce costs: One-time and recurring

In the author's experience, approximately 80–90 per cent of the costs of any one operation will be workforce related. As such, these are the most important cost items to carefully inventorise, even at this early stage. A key partner for developing these estimates should be the human resources (HR) team, who will have access to employee salaries, HR policies and databases that can help with estimating labour costs in alternative markets. Recurring workforce costs include salaries, bonuses and benefits. Cushman & Wakefield has found that assessing a corporate relocation is often a good occasion for companies to recalibrate their compensation philosophy. For example, after comparing its current labour costs to the spot market for similar positions, one client discovered that it was paying approximately 12 per cent above the market. The company decided that, should it relocate, it would target compensation at the mean in the new location. Therefore, its relocation assessment not only accounted for the organic labour arbitrage opportunity, but also a reset of its current compensation practices. This was the right strategy for this company given its excellent brand and reputation — management knew that talent would be attracted to the company. Other clients have determined that they would actually have to pay above the mean in a new location, at least until their local brand and commitment to the new community become established.

In addition to recurring labour costs, project teams must assess one-time workforce costs — items such as severance, COBRA, relocation packages, training and a dual-staffing period. Costs vary due to average tenure, type and complexity of the operation, level of professionals involved, subjective desirability of the current location versus alternative locations (eg Springfield, MA versus Phoenix, AZ) and the anticipated distance of the relocation. This is almost always the most challenging aspect of assessing the feasibility of relocation. Cushman & Wakefield partners closely with client HR teams in projects to thoroughly investigate all considerations and establish reasonable assumptions across one-time cost categories. These can be agonising conversations for HR and operating teams, often including the following questions:

- 'How many employees do we think will elect to relocate?'
- 'Will the financial incentives we are offering be compelling enough to entice employees to support the transition?'
- 'How long does the dual-staffing period need to last to mitigate the risk of operating disruption?'
- 'What do our severance policies state, and how does that differ from what we think is the right thing to do by our current employees?'

Transition strategy

An important modelling component is the transition strategy. By and large, companies have two options available. A 'lift and shift' strategy contemplates a 6–12-month transition period. This is often most feasible for operations that are supported by technology, documented processes and defined service levels. These characteristics allow for a short, dual-staffing period, which is a recruiting effort that relies on hiring trainable labour and relatively modest infrastructure investments. Many of Cushman & Wakefield's clients engage with the company's team with the intention of standing up the new operation within 12–18 months. This can be aggressive — real estate negotiations alone can require six months — but usually feasible given a focused, cross-functional project team and 'turnkey' real estate options.

Alternatively, companies can employ a 'seed and grow' strategy, in which the transition occurs over a 12–48-month period. This is most appropriate for companies that require skilled labour, have processes that are not well documented and enterprise technology that is either different or not fully scaled across the company. A longer transition period provides companies with the time required to ensure that the operation is ready for transition. Interestingly, Cushman & Wakefield has found that, if companies manage the change management and communications strategy effectively, current employees often will elect to find new employment before they are terminated, thereby saving the company one-time costs. Natural attrition and planned retirements have the same effect. Running cash flow sensitivities against both transition strategies, as well as assessing the non-financial benefits and risks of each, are critical to understanding the feasibility of relocating an operation.

A note on business incentives

Readers will note that business incentives are not assessed during the feasibility phase. This is for two reasons. First, the largest incentives packages are not guaranteed, so typically the initial business case needs to stand on its own. Secondly, incentives vary greatly by state, municipality and site. Unless the company is interested in a specific location, incentives assumptions at this stage would compromise the quality of the analysis.

IDENTIFYING THE OPTIMAL ALTERNATIVE LOCATION

Once the feasibility of relocation has been established, companies should identify the two or three most optimal cities for the operation. This is done through a series of progressive screens against criteria that address the company's human capital and operating objectives. Typical criteria include cost of labour, availability of favourable demographics, availability of required job skills, accessibility, time zone and quality of life. The requirements of the operation will determine how a company weighs these criteria. For example, quality of life will be more important for a headquarters operation in which a large number of executives will be relocating with their families. Cost of labour and demographics will be more important for operations that are well defined, documented and replicable.

To assess labour availability in alternative cities, Cushman & Wakefield typically assesses demographics and job skills. The volume and concentration of target employee demographics are excellent measures of trainable labour, where a company is looking for the right type of person rather than the ability to perform on Day 1. The best demographics data drive to the psychographic characteristics of demographic groups, rather than simple descriptive statistics about age and income level.

The volume and concentration of required job skills, determined through an analysis of job descriptions and business processes, is a measure of a workforce's ability to immediately add value. In the USA, Cushman & Wakefield has found that the optimal approach is to analyse the operation's job skills requirements against the 'standard occupational classification' (SOC) used by the Bureau of Labor Statistics. The Bureau of Labor Statistics uses 840 detailed occupations. Selecting an alternative location based on this level of precision provides a detailed understanding of a location's ability to scale the operation, as well as increasing decision-making confidence.

Capturing the right labour skills and demographics — and improving these over the existing operation — can cause a dramatic improvement in human capital and operations. One Cushman & Wakefield client had an operation in the north-west USA that was underperforming across nearly every important operating metric. Employees were highly tenured, compensated more than their peers, not engaged and acting with a sense of entitlement. A new location provided this company with the opportunity to hire a new workforce, which provided immediate recurring labour cost-savings. As importantly, it was able to relocate to a larger labour market, which provided more labour supply-side competition and demographics favourable to the objectives of the operation.

Having identified the top two or three alternative cities, companies can begin to assess the availability of business incentives, which are especially useful for reducing the significant costs of transition. It is important to select alternative locations based on operating requirements rather than available incentives, because this ensures operational excellence. In short, incentives can make a good location better, but they cannot make a bad location good. Once alternative locations have been identified and incentives estimated, the cost model is typically updated with the more-precise information gathered during this phase.

A note on labour unions

As a general rule, Cushman & Wakefield advises clients to avoid locations with a heavy union presence. The cost of union labour tends to be inflated without much corresponding upside, and union rules, policies and politics place unnecessary constraints on business operations. Due to the general trend of declining union membership in the USA, the prevalence of union activity is more a concern for operations that require 'blue collar' labour than operations requiring 'white collar' labour — eg a distribution centre or e-commerce fulfilment centre. Cushman & Wakefield sources data on union activity from the National Labor Relations Board (NRLB).

FIELD INVESTIGATION

The project team's work up to this point has been primarily at the 'desktop' level. Before making a significant investment in an alternative location and disrupting the operation and employees, it is critically important to visit alternative locations as an executive team to test the desktop analysis and gather further data to make an informed decision. Travelling to cities under consideration is the single best way to understand what it would be like to operate a business in the city. Furthermore, there is no substitute for primary data, ie the information, context and commercial insight that only an in-person visit can provide. These 'field trips' often include a few components. First, interviewing peer employers — especially HR executives — is an excellent way to gather more precise data on labour costs, the depth and quality of the talent pool and the hierarchy of companies currently operating in the market. Secondly, meeting face to face with economic development corporations to discuss the operation formally begins the incentives process. Thirdly, meeting with municipal, educational and civic leaders provides the opportunity for meaningful qualitative assessments. If executives are relocating, a tour of residential neighbourhoods is also part of the field-trip itinerary. Finally, a real estate broker can begin to introduce the executive team to representative properties and business districts.

When field investigations have been completed, the financial model is updated again, this time with the labour cost calibrations and incentives data that were gathered on location. Executives can then assess with more confidence the financial and non-financial trade-offs of alternative locations, thereby determining the optimal strategic decision for the company.

NEGOTIATIONS

Negotiations assume two primary work streams, but both must be carefully coordinated to ensure optimal leverage. The first negotiation is business incentives. Available business incentives typically involve some combination of those listed in Table 1. It is important for companies to understand the type of incentives that will be especially helpful given the proposed operation, life stage of the company and financial metrics. For example, a company that values cash may find grants especially important — and local economic development corporations can craft packages in response to that. Other companies may prefer tax exceptions and abatements. Incentives can either be statutory (as of right) or discretionary. Discretionary incentives are subject to a project's overall economic and fiscal impact, economic characteristics of the candidate location and site-specific development requirements. Subjective factors also will be considered in the evaluation of discretionary benefits, ie strategic value of supporting the project with assistance: Is the project an industry leader or classified as a target

Table 1: Business incentives

Category	*Description*
Grants	Grants can come in the form of cash up-front or cash once defined project milestones (headcount and/or investment) have been reached. Grants also can come in the form of a reimbursement to a project.
Tax credits	Tax credits are calculated based on certain job creation and/or investment thresholds and can be used to offset up to 100% of a company's stated income tax liability and, in some cases, other applicable business taxes. Tax credits are generally not refundable and unused credits can be carried forward for a certain number of years.
Tax rebates	Tax rebates generally come in the form of a rebate of up to 100% of payroll withholding taxes that a company has paid on behalf of its employees.
Tax exemptions	Tax exemptions are available for specific types of goods and services.
Tax abatements	Tax abatements generally apply to real and/or personal property taxes; however, abatements also are sometimes applicable to sales and use taxes. Tax abatements provide for a reduction in taxes paid for a defined period of time.
Workforce development	Workforce development incentives can come in the form of grants up-front: as reimbursement, tax credits or as cost avoidance altogether, ie a company makes no sort of cash outlay for the benefit.
Utilities	Incentives provided by utilities service providers come in the form of reduced consumption or demand rates based on a certain amount of projected utility usage. The reduced rates would be made available for a defined number of years. In some cases, utilities service providers can provide grants based on certain job creation and/or investment thresholds.
Miscellaneous	Includes any potential benefits that do not fit the other categories outlined above, eg land cost write-downs, building permit fee reductions/exemptions, special financing options, expedited permitting, etc.

industry? Will the project be a catalyst for other jobs and investment? Another critical factor is the amount of competition that exists for the project from competing jurisdictions. Discretionary incentives require a case-by-case analysis and approval by the relevant state and local stakeholders. Generally, discretionary incentives will help to offset a project's start-up costs while statutory, or non-discretionary, programmes are made available over longer terms. Offering discretionary incentives enables governments to have more flexibility in targeting limited resources towards companies that are most important to a community and controlling the terms and conditions of the incentives granted.

Real estate negotiations are also a critical component at this final stage. As noted above, it is important that real estate negotiations do not get too far ahead of incentives negotiations, which would increase municipal authority leverage. For both negotiations work streams, it is critical to maintain the illusion of multiple options — cities and facilities.

SUMMARY

Relocating an operation to a new city involves a complex set of considerations. In the author's experience, only about 10 per cent of projects are actually implemented. The primary causes of inaction include low ROI, a high payback period, cultural barriers and the significant person impacts that relocation would entail. But, as CEOs mandate cost reductions, improved talent acquisition and retention strategies, and operating efficiencies, relocating operations to more-favourable markets continues to be a powerful arrow in the corporate quiver. If readers would like to learn more about this topic, please feel free to contact the author.

Reference

(1) Conference Board report 'CEO Challenge 2014'.