BUILDING A REAL ESTATE BUSINESS BASED ON CORE COMPETENCIES

by Thomas H. Bomba

It is no secret that the real estate industry has undergone dramatic changes, and is likely to continue changing. Rapid consolidation within the industry, an evolution in occupants' real estate needs, and many other factors are catalyzing the change. Such factors are driving real estate executives towards taking a more strategic – and fluid – competitive stance with their companies.

The future competitive environment is uncertain, but a real estate executive can take steps to better understand it. The organization itself can be designed to serve the uncertain future needs of customers by structuring it around core competencies.

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HOW DO YOU DEFINE YOUR FIRM'S MARKET SEGMENT?

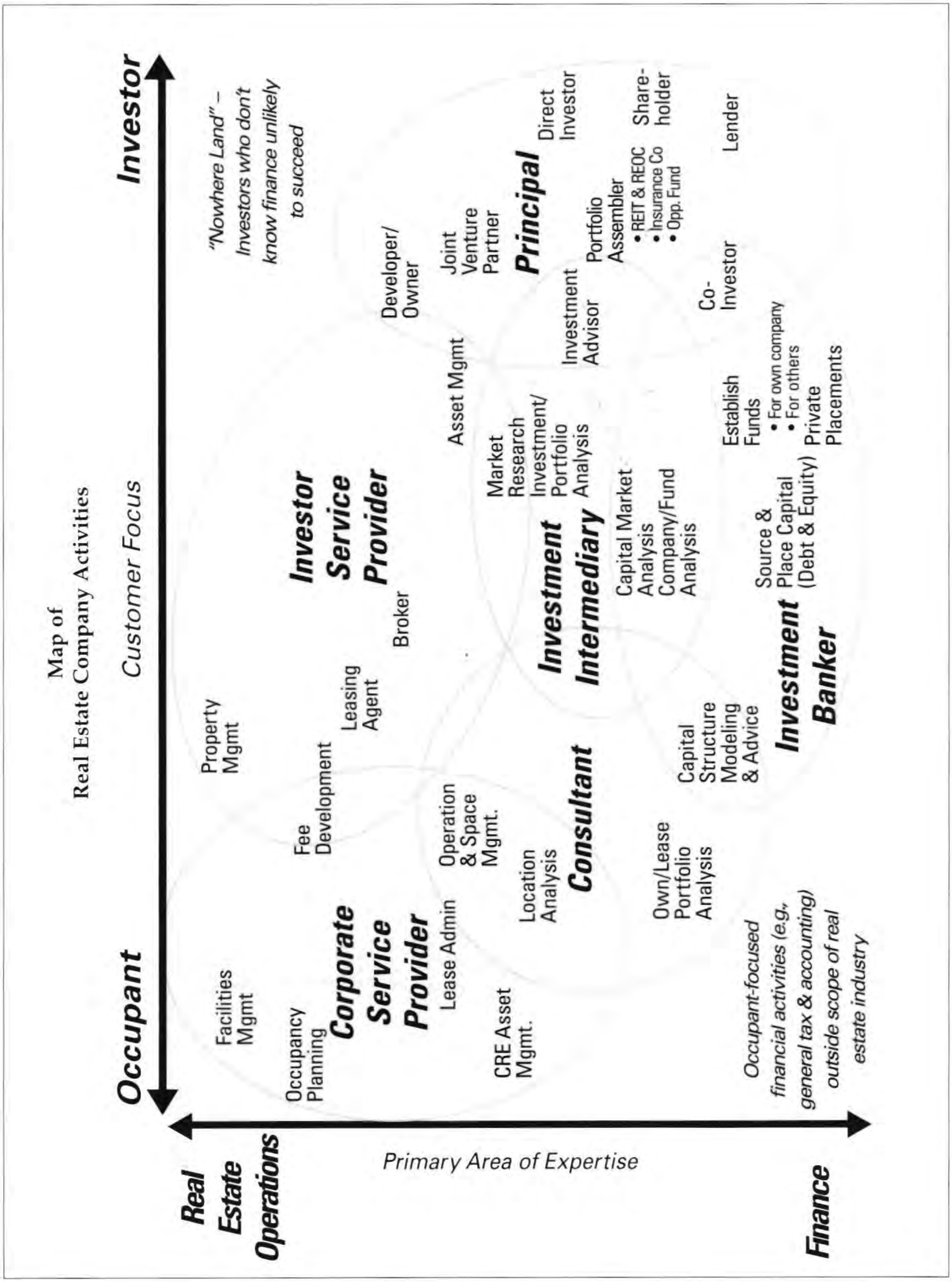
The real estate industry as a whole is too diverse and fragmented to be considered a single industry. Real estate firms have historically operated on a local scale and have only in the recent past become focused on operating in a more expanded way. Real estate firms compete in different parts of the industry or different parts of the globe. As an example, firms that manage corporate facilities do not compete with real estate opportunity funds.

Real estate activities are primarily differentiated by:

- the primary expertise needed for the function (real estate operations vs. finance), and
- customer focus (occupants vs. investors).

Using these as the axes, various types of real estate company activities can be mapped out as in *Exhibit 1*.

Exhibit 1



Map of
Real Estate Company Activities
Customer Focus
Occupant
Investor
Primary Area of Expertise
Real Estate Operations
Finance
"Nowhere Land" – Investors who don't know finance unlikely to succeed
Occupancy Planning
Facilities Mgmt
Corporate Service Provider
Lease Admin
CRE Asset Mgmt.
Fee Development
Property Mgmt
Leasing Agent
Broker
Operation & Space Mgmt.
Location Analysis
Consultant
Own/Lease Portfolio Analysis
Occupant-focused financial activities (e.g., general tax & accounting) outside scope of real estate industry
Capital Structure Modeling & Advice
Investment Banker
Investor Service Provider
Asset Mgmt
Market Research
Investment/Portfolio Analysis
Investment Intermediary
Capital Market Analysis
Company/Fund Analysis
Source & Place Capital (Debt & Equity)
Establish Funds
• For own company
• For others
Private Placements
Developer/Owner
Joint Venture Partner
Principal
Investment Advisor
Portfolio Assembler
• REIT & REOC
• Insurance Co
• Opp. Fund
Co-Investor
Direct Investor
Share-holder
Lender

Each activity can be a potential area of competition between firms, but many companies compete in more than one area. As an example, Jones Lang LaSalle and CB Richard Ellis offer a wide range of real estate services for a diverse group of clients cover almost the entire map. Conversely, Commercial Net Lease Realty, a firm that specializes in freestanding net leased retail, offers services to a small segment of the overall industry.

Using such a visual helps a firm understand its market position vis-à-vis other real estate companies. Benchmarking and best practice assessments allow you to improve your company's efficiency in the competitive environment. However, most environments define the landscape that currently exists, and most benchmarking compares your performance to that of existing competitors. When the competitive environment changes as rapidly as it does today, you can find yourself being a very efficient buggy-whip manufacturer in an automobile-driven society. While more difficult to do, competitive environments of future business spaces (which may not even currently exist) should also be developed.

Some companies appear to have an uncanny knack for successfully entering new competitive business spaces, even when they don't appear to be directly related to existing lines of business. Such business spaces may not even appear on the competitive landscape. These companies are "shape-shifters."[1] They analyze changes in the marketplace in unique ways, and build profit centers around opportunities that others might not detect.

The competitive question therefore goes deeper. It depends on understanding what value you bring to your customers, and how your company can provide new or better value as opportunities and customer needs change. As a result, you can lead the market rather than mimicking the success of others. Even the best mimic is always a step or two behind the leader.

WHAT VALUE DO YOU PROVIDE TO CUSTOMERS?

The main value that a real estate asset has to an investor is in providing sufficient financial returns to make the asset a better investment than other opportunities. Since the future is uncertain, the risks involved with achieving the projected returns must also be acceptable at both the asset and portfolio levels.

Ideally, each activity performed by investor-oriented real estate companies provides some value towards reaching these two goals. For instance, the first three activities in *Exhibit 2* provide the value of the empty building plus the initial cost of the land. This could be broken down further as needed; for example, as the land's value rises when it is rezoned.

In the first four steps, the value rises as investment risk drops because the future cash flows become known with more certainty. Only in the final activity, "Manage Property and Collect Lease Payments," is the promised value (the cash flows) actually delivered.

The final activity is where real estate occupants and investors actually receive value from the real estate. In the end, the value you provide investors (your customers) is based on the income derived from occupants (your customers' customers). The value you provide occupants is more complex since it is based on their business needs, which may vary.[2]

Exhibit 2

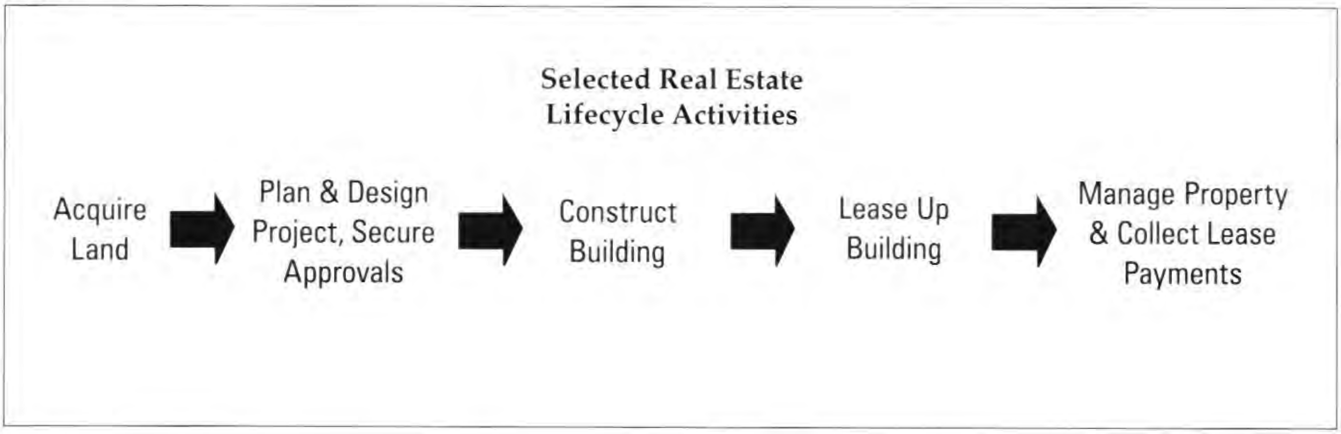


Exhibit 3

Occupants' Value Chain Activities & Their Real Estate Implications

Sources: Porter (Value Chain), Roulac (Implications)

A "value chain analysis" is a more formal analysis than the simplified approach just discussed. It is similar in purpose because it disaggregates a business into its value activities to understand such things as the behavior of costs compared to value, and the existing and potential sources of differentiation *(see Exhibit 3)*. Although too detailed to include in this manuscript, learning how to perform the analysis can be of benefit when examining your own and other companies' product and service delivery activities.[3]

HOW ARE CORE COMPETENCIES USED TO CREATE VALUE?

Core competencies enable an organization to excel at the various activities it does to provide value. They are also what will enable an organization to adapt to changes in existing value chains, or to conquer new ones in the future.

According to Prahalad and Hamel[4], the core competencies of a company are the real roots of its competitive advantage. Products and markets change over time, but competencies are the basic building blocks for everything the company undertakes.

Viewing the corporation in terms of core competencies is quite different from viewing it in terms of business units. Business units are an organizational structure geared towards producing products or services according to a specific set of delivery activities. They are less fluid, and in fact can be at odds with the successful use of core competencies if they hinder the competencies' movement within a company.

Core competencies result in the ability to produce a set of core business products that provide value to customers. Core business products for a real estate company include the areas outlined in *Exhibit 1* such as service provider, principal, investment banker, etc. (Most companies, of course, define their business products more specifically than in this generic example.)

Ultimately, the value to customers impacts the price you can charge for a product or service. In some market spaces, prices may be driven almost entirely by value to customers rather than by competition. This is particularly true in new or quickly changing market spaces.

HOW DOES A REAL ESTATE COMPANY IDENTIFY ITS CORE COMPETENCIES?

Real estate companies require many competencies to operate, but what makes a competency "core"? First, a core competency should significantly contribute to the benefits a customer gets from the end product or service. Jones Lang LaSalle has a strong finance, tax, and accounting competency that is essential in advising corporate clients on structuring the ownership of the real estate they occupy in order to manage the balance sheet and P&L impacts on the company.

Ideally, a core competency is difficult for competitors to imitate. CB Richard Ellis has invested some research funding and time to develop their knowledge of commercially-available real estate software applications. Their competitive position is enhanced by this knowledge base. It can be made more defensible by continuing to build it and develop a market image around it. However, with software quickly evolving and competitive cooperation between real estate firms growing in the area of technology, this may become a difficult way for CB Richard Ellis to differentiate itself.

Finally, a core competency should provide potential access to various products or markets. Why is Johnson Controls even in the facilities management business? Because its core competency in building systems gave them a competitive edge in building operations and maintenance, particularly in complex technical environments such as the Kennedy Space Center. The broader facility management competency grew from there.

Ultimately, a company's competitive advantage often relies on those things that it does better than other companies.

The lesson to be learned is exactly what your parents told you as a child: If you're going to do something, do it well. A company can achieve success as a boutique firm known for one or two core competencies. It can be a large player with many competencies. Players who don't particularly excel at anything are the ones most likely to be squeezed out in the long run. You compete on your strengths, not your mediocrity.

COMPETING ON YOUR CORE COMPETENCIES

Based on the definition of competing on your core competency, three examples are discussed based on the concept of refining an existing core competency, evolving core competency to meet your customers needs, and evolving your core competency to meet the changing trends.

Refining An Existing Core Competency

Some companies successfully follow a strategy of "sticking to what they're known for." Cushman Realty Corporation is an example of a real estate services firm that is focused on representing tenants in lease transactions. While the firm does offer other related services, tenant representation is generally acknowledged as the core competency of the firm. The general view from the street is that the firm's focus is not to add additional service lines but to continue to refine its core competency by improving its client value.

Today, your toughest future competitors are thinking through two crucial questions: "What value will my company provide our customers?" and "What products or services will we be capable of producing to provide that value?" Delivering value is key to bringing that future vision into focus. Core competencies are key to delivering that value.

Evolving to Meet Your Customer Needs

Although it's outside of the real estate industry, Ryder Transportation Services provides a good example of evolution. Ryder exemplifies a company that is divesting its non-core businesses and building its strategic core competencies.

The company states that it has three competitive priorities, which are "to help businesses improve customer service, reduce inventory, and speed products to market." Ryder's core competencies are global integrated logistics, truck leasing and rental, and public transportation services. Ryder Integrated Logistics is the largest third-party logistics company in the U.S.

Ryder has continually disposed of businesses that were once core to the company (such as Ryder Freight Systems) and acquired or developed businesses it sees as necessary core competencies (such as LogiCorp, a logistics management company). It established a strategic logistics and technology relationship with Andersen Consulting and IBM Global Services. As a result, its supply chain management system has grown dramatically in the last 10 years to equal approximately 1/3 of Ryder's revenues. Ryder's strategy is a major shift away from commodity services such as hauling freight into higher value-adding services.

Evolving To Meet The Changing Trends

AMB Property Corporation views itself as a proactive operating company. The firm has recognized the potential impact that the advent of the Internet, just-in-time inventory management, and e-commerce could have on retail properties. AMB has sold the majority of its retail centers and refocused its efforts on High Throughput Distribution™ facilities.

AMB's view is that supply chain management in the new economy stresses speed and efficiency, not storage. The retail business is transforming from the tradition storefront to the distribution focus of e-commerce. They understand the dynamics of transport and logistics, and can deliver nationwide facilities solutions to customers.

They are expanding efforts in this area, both through the redeployment of capital from existing assets and by exiting smaller markets, to further concentrate their holdings in hub distribution markets.

In this case, AMB has made the decision to migrate from traditional retail oriented real estate to e-commerce focused retailing. They have seized an opportunity adapt their core competency to meet the needs of the changing real estate industry landscape.

HOW DO CURRENT TRENDS IMPACT THE CORE COMPETENCIES REAL ESTATE COMPANIES WILL NEED?

Many factors are impacting the real estate industry today. Some we've seen before, such as economic cycles and capital availability. Some are new, for example in the "virtual world" retail economy where certain occupants may ask, "Why do I even need real estate?" By looking at these trends in terms of their impacts – particularly impacts to value chains – companies can gain important clues as to which competencies are core to their future success.

As already noted, e-commerce is one such trend. By listing its overall impacts and then brainstorming and analyzing how they affect real estate-related value chains, you can start seeing what types of competencies companies may need in the future. Such a chart (see *Exhibit 4* for a partial chart) creates a laundry list of competencies that might be appropriate to develop, depending on the firm's market segment and strategy.

As with e-commerce, other trends can be examined in the same manner for their competency

Exhibit 4

Some Competency Implications of Real Estate Occupants' Move into E-Commerce

Overall Impacts	Real Estate Impacts	Competency Needs
• Product sales moving from retail space to virtual space	• Impact on retailers' value chain to their customers resulting in: • More emphasis on "entertainment experience" and less on efficient product delivery • Logistics needs of increased direct product delivery	• Tenant due diligence • Logistics and distribution facilities • Entertainment facilities
• Radically changing industry economics – impacts differ by industry but overall trends of • Lower margins • Disaggregation of value chain	• More cost-consciousness of items not adding value to end customer (including real estate) • More focus on core activities and less on non-core (such as self-managing corporate real estate)	• Knowledge of technology's impact on tenants' industries • Micro and macro economics • Outsourcing capabilities (various types)

implications. Such trends might include:

- a broader adoption of e-commerce by the real estate industry itself
- the trend toward corporate disposition of real estate ownership
- real estate company mergers
- shifting demand patterns as baby boomers and echo boomers age
- the long-term, mature U.S. economic boom
- the lowering of trade barriers

The core competency impacts of these trends cover a wide gamut, for there is no magical "standard set" of core competencies that a real estate company will need. It depends on who your customers are, and how you will need to provide them value.

HOW DOES A COMPANY STRATEGICALLY MANAGE ITS CORE COMPETENCIES?

How do you implement? In this case, there is a three-step sequence to develop your own core competency strategy. To be effective, each of the three steps requires quite a bit of work – investigation, analysis, and planning. The sequence itself is quite simple.

Step 1: Understand what value you currently bring to your customers. Examine the value you provide to investors, your building occupants, any customers of theirs that you significantly impact, even for yourself and the other owners of your privately-held company. Examine and understand what your current core competencies are across the activities you perform to deliver that value.

Step 2: Determine what types of value your company *should* provide in the future. This involves researching and developing your ideas on future customer needs and competitive trends. Understand which types of value your company could potentially impact based on current core competencies as well as those you might acquire. Especially important: some creative thinking on new ways to deliver value, particularly if they can replace existing ways of doing things.

Step 3: Planning and communication are crucial. How will you acquire the competencies and enter the markets you'll need in the future? You might buy, build, hire, or take on strategic partners. How will you communicate your intent internally, to the capital markets, to customers, and to competitors?

Today, your toughest future competitors are thinking through two crucial questions: "What value will my company provide our customers?" and "What products or services will we be capable of producing to provide that value?" Delivering value is key to bringing that future vision into focus. Core competencies are key to delivering that value.$_{\text{REI25}}$

NOTES & REFERENCES

Special thanks to John McMahan and The McMahan Group for providing input and contributing examples. Mr. McMahan is the founder and executive director of the Center for Real Estate Enterprise Management, a non-profit group that provides research, conferences, publications and management training on strategic real estate issues.

The views expressed are those of the author. While much of the information was obtained from individuals at the firms identified prior to the writing of this article, it does not reflect the official position of any of the companies mentioned. Please consider the examples as being illustrative.

1. See Marlene Piturro's article in the September, 1999 *Management Review*, pp.25-30.
2. For a discussion of factors affecting occupants' value chains, see "Real Estate Value Chain Connections: Tangible and Transparent" by Stephen E. Roulac, *Journal of Real Estate Research*, Vol. 17, No. 3, 1999, pp.387-404.
3. See *Competitive Advantage – Creating and Sustaining Superior Performance* by M.A. Porter, New York, NY: The Free Press, 1985.
4. Prahalad and Hamal, "The Core Competence of the Corporation," *Harvard Business Review*, May-June 1990, pp. 79-91.

ABOUT THE AUTHOR

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