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While governments and financial markets are still dealing with the ongoing effects of the worst economic crisis in seventy years, the business of facilities management goes on. In this article, Martin Pickard from The FM Guru Consultancy takes a look at how the recession has affected the buying decisions being made in the FM sector. Has the much vaunted “flight to price” strategy been dominant or are buyers being more discerning?

FM Buying in the Shadow of the Recession

By Martin Pickard

Britain is experiencing its worst financial crisis for more than a century, surpassing even the Great Depression of the 1930s. Economic events around the world have been moving at a speed, pace and ferocity which none of us working in business today have ever experienced before. Commentators agree that the impact of these events on the economy will define business and political strategies for the duration of any current business plan and far beyond.

The recession of 2009 sent Britain's budget deficit soaring to a record level, with net debt now standing at around 62 percent of GDP, its’ highest ever. Insolvency experts Begbies Traynor are predicting a "deluge" of business failures over the next year, saying the UK is in the mid-point of a W-shaped recession with 134,000 businesses showing “material signs of distress”. Unemployment is fast approaching the 2.5 million mark and personal bankruptcies have reached a new record high.

There has been some good news recently as borrowing was found to be lower than expected this year, but if growth is not as strong as expected in the future that will quickly evaporate. Recent forecasts underscore the challenge facing the new Chancellor, faced with tough decisions on how to spread the pain. They also reinforce his need to set out a deficit reduction plan that is not only credible and achievable, reducing government spend across the field but which also kick starts private sector investment in jobs and balanced growth.

Facilities managers in the worst hit parts of the private sector were among the first to feel the pain. As the second largest overhead after staff for most businesses, spending on premises and their operating costs is an obvious early target for any Finance Director anxious to make big savings. Cancelled projects, pay freezes and deferred maintenance were swiftly followed by estate rationalisation and contract renegotiations. Unfortunately for more than 24,000 businesses including the host of household names that went into insolvency in 2009 such cuts alone were not enough.

The immediate reaction of other businesses was to slam on the brakes on both new projects and on buying decisions across the board while everyone waited to see how the recession would affect them and to speculate on what would happen next. For Facilities service providers this was a difficult time. While some pundits proclaimed FM to be “recession proof”, the knock-on effect of such major events was far reaching. Some contractors took direct hits as key customers went under while everyone found their cash flows difficult to manage as revised payment terms cascaded down the supply chain.

For the most part the public sector has come through the crisis unscathed to date. Indeed the Labour governments attempts at fiscal stimulus by accelerating projects and other investment spending has meant a busy eighteen months for many civil service estates teams and their suppliers. The new Coalition government is about to change all that. David Cameron has issued a chilling warning that the extent of the government's public sector cuts will affect the country's "whole way of life" for decades to come. The plans announced in the first months since the election will have a serious impact on all government FM activity and on the service providers who support it.

But has all this doom and gloom resulted in a return to commodity buying and price driven buying decisions? Business development managers tell tales of clients who say they want innovation, service and quality but make decisions based entirely on the bottom line. It is certainly true that margins have been squeezed and year on year growth has been constrained. Research firm MBD says that FM market growth in 2009 was just 1%, down from the 2% of 2008 and significantly lower than the 4-5% growth rates recorded in the three years before.

Strategies for margin enhancement have included a dramatic increase in FM operators delivering services through directly employed staff rather than using sub-contractors. There has also been a marked increase in underbidding, the practice of tendering for a project at no margin or even at a loss. Accounts vary as to whether this has been driven by a cynical intent to boost operating margins through high value project work and post tender negotiations or if a combination of poor client data and incompetent pricing is the root cause.

Meanwhile some operators have found that the demanding market conditions have created opportunities. Several FM players have achieved significant revenue growth through merger and acquisition deals as competitors have gone under (Europa buying Operon after it went into administration) or where parent companies have decided to exit FM (Mitie buying Dalkia UK from its French parent).

Smaller, specialist businesses have seen a surge in activity as well, as some clients decided to cut out intermediary FM management companies. Managing Director of building services specialists Comserve describes the market as “An exciting time for smaller businesses who are able to move faster and operate more effectively than the large corporations.” Those who engage with such businesses seem more intent on sourcing technical expertise and innovative solutions to their financial challenges than in blunt cost cutting.

Discussions with clients and consultants involved in recent FM procurement exercises reveal a mixed picture. Price is clearly a major factor and the frequent starting point for the outsourcing exercise. Financial targets have to be met and most, if not all, have become more challenging over the last two years. Therefore any bid that comes in above those targets is likely to be deemed unacceptable. However the lowest price achievable is rarely the objective as value is being assessed in a variety of ways with heavy weighting given to factors which are of strategic importance to the client organisation.

One recent procurement exercise for a telecommunications company gave heaviest weighting to evidence of a proactive service ownership culture. This was a direct response to failings in the previous incumbent and to reductions in the in-house resource available for to manage the service. However, many of the bidders completely failed to provide any substantive proof that they could operate in this way relying instead on well written but valueless statements of intent. In this demanding market clients are not prepared to accept vague promises and these bidders were marked down accordingly despite having submitted lower tenders than the successful contractor.

A demonstrable track record of success with a comparable client, ideally in the same sector, is proving to be the most important criteria for buyers in this market. Tight financial targets and demanding operational standards mean that clients cannot afford to take risks. The buying activity is therefore very cautious with a great deal of emphasis on filtering out “sales talk” to identify genuine competency.

Nearly three quarters of clients asked said that they we would be unlikely to contract with a supplier who could not demonstrate an ability to operate in an environmentally sound manner no matter what price they had submitted. With heaviest weighting given to evidence of sound environmental management of their own facilities and a track record in operating green facilities and services for their clients rather than the achievement of environmental standards or dedicated “green” products and services.

A financial services client gave the heaviest weighting to the provision of accurate real time management information and the existence of proven systems and processes to deliver it; A retail client rejected all bidders who were unable to provide swift high street responses across the UK using directly employed labour; Each of them being driven by their own circumstances and not solely by price.

Some elements of the supply community have found it difficult to adapt to these more stringent procurement exercises and may, perhaps, be more comfortable with a commoditised market where buying power drives price. There has been a great deal of talk about collaborative procurement models being at the heart of the next wave of public sector outsourcing with the FM forming the new OGC category and the imminent award of the Ministry of Justice framework. If so then perhaps these suppliers will be more comfortable in that market and we will witness a wider division between the public and private FM sectors than we have been accustomed to.

Whatever happens, it is clear that the FM outsourcing industry will continue to evolve and the new market conditions of the post recession depression will have a major impact on the business strategies of those service providers who survive the journey.