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The UK Facilities Management Sector

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The UK facilities management ('FM') sector is a relatively new sector and has witnessed exceptional growth over the past 10-15 years. From a sector focused predominantly on 'hard' services, such as property maintenance and repair, the broad spectrum of offerings now encompasses 'soft' services that could include almost any activity an organisation deems non-core or secondary – including cleaning, security, catering, office services, IT management, document handling, and even specialist functions such as finance and HR. The sector is estimated to be worth over GBP 100 billion and continues to grow, not least because the business trend to focus only on core activities continues to prevail; there has been some reversal of this trend, however, with a few companies taking various FM activities back in-house. The major change in the market has come from a maturing of the market and increasingly sophisticated procurement processes, which are driving down margins. The tightening of the public purse and current public sector austerity measures only add to this pressure, at a time when the private sector is struggling to weather the economic downturn. In the longer term, growth will depend on the extent to which both private and public sector retain confidence in the FM approach, as some believe it to be too inflexible.

Market overview

- The total UK facilities management sector was worth around GBP 117 billion in 2008 and is forecast to reach GBP 127 billion by 2013.
- By value, contracted-out FM continues to dominate the sector, with 60% market share, worth GBP 70 billion supported by companies and public sector bodies continuation to simplify operations in specific areas.
- Total Facilities Management – where full responsibility for FM services is contracted to a third party company who undertakes the work or subcontracts the work to other companies – accounts for 8% of the value of activity, with the remaining 32% representing the in-house provision of their services.

Cleaning and catering services are the highest volume services, with security, mechanical & electrical, energy and environmental services seen as growth 'hot spots'. The sector is seen as one of the largest contributors to the UK economy with each FM job worth over GBP 50,000 in output. Private investment in public sector initiatives such as the Public Finance Initiative and Public Private Partnerships have benefited the sector (eg security, property management, building and construction services), but these contracts are now becoming highly complex to manage efficiently and profitably. The future of these initiatives under the present government is in question and this will have a clear impact on future earning for FM providers.

On the stock markets, FM companies are highly rated by investors as they are perceived to have defensive qualities, good prospective earnings visibility and fairly resilient end-markets. The sector has a strong base and is underpinned by some immunity to cyclical pressures; long-term contracts and earnings. Taking Support Services as a whole (which includes the FM market), the sector marginally outperforms the market in terms of price and PE ratios, although performance varies between the different support services sub-segments.

The recession has slowed growth in the sector with lower contract values, fewer Public Finance Initiative deals, cutbacks in non-essential services and reduced activity in some segments (e.g. cleaning and catering). At a more detailed level, the recession has had both a positive and negative impact on the FM sector. A number of companies have actively chosen to

Notes

1 The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. The views of the author are his own and do not necessarily reflect the views of his firm.

outsource services as they perceive it to be the most cost-effective option, and those already outsourcing have developed closer relationships with their FM providers. Conversely, with an ever-increasing emphasis on cost-cutting, FM contracts have suffered and companies are looking to squeeze more value from their FM partners and existing contracts. There is also a developing trend for some companies taking previously outsourced services back in-house. A recent example was in January 2010, when Barclays chose not to renew a GBP 400 million IT outsourcing contract with Accenture in order to improve resource flexibility and lower the cost of developing and maintaining software.

Sector risks

The sector is experiencing mixed fortunes with some players continuing to grow and return decent margins while others are struggling to survive. An early casualty was Connaught, which has gone into administration.

Although each FM business will have its own specific circumstances by sector and by client base, some of the common areas of risk across the sector include:

– weak business development activity with poor hit rates and ill-defined procedures for Pre-Qualification Questionnaires and bid activity, with a consequent impact on the sales pipeline;
– management focus on sales not cash;
– underperforming contracts both in terms of missing Key Performance Indicators and failing to meet contract profit targets;
– poor supply chain management, with weak procurement processes and an inability to pass on increased or rising costs;
– claims for underperformance;
– poor cash flow management both of the business as a whole and for specific projects – in particular having high value and ageing debtor and work in progress balances; and
– highly geared balance sheet and stretched creditor terms.

Also, in the event of an insolvency procedure, recoveries can be very poor. There are very few fixed assets as property; vans and equipment tend to be leased. The major assets are the contractual debtors and work in progress. The impact of insolvency on contractual debtors in this sector includes the following:

– many standard forms of contract in this sector terminate automatically upon insolvency or are terminable by the contracting party;
– these contracts allow set off of reasonable costs incurred resulting from the breach of contract;
– the contracting party may incur significant costs as a result of a discontinuation of service such as, the costs to engage with a new contractor, the disruption caused by lack of service, claims from unpaid specialist sub-contractors and suppliers who are required to continue service, liquidated damages incurred due to delay in delivering the services;
– these costs incurred will be set-off against any outstanding debtors and work in progress balances and may also trigger a call under a performance bond.

An insolvency event can provide the contracting party with the commercial opportunity to renegotiate or re-tender an existing contract to obtain a more attractive deal.

In addition, if the contracting party is a public sector body they may feel that the EU procurement regulations governing contract tender and award requires a new competitive tendering process.

Sector investment

The past 10-15 years have seen a significant development in the sector, both in terms of revenue growth and in the sophistication of the buyers and sellers of such services. Until recently, the potential margins from operating within the sector have been very attractive, not least because procurement methodologies have taken a while to mature. Now that outsourcing and FM are understood more fully, we are seeing more appropriate and more balanced pricing mechanisms, which are beginning to impact the margins for FM providers.

Despite the FM industry already being highly consolidated, there is likely to be further consolidation in order to reap further economies of scale, particularly when bidding for and operating large-scale and complex public sector contracts, and to add service lines or new territories to existing offerings. There is also increased demand for regional (e.g. pan-European) or global FM solutions.

The FM businesses most likely to survive and prosper in the longer term will be those with many of the following characteristics:

– effective business development and contract-retention functions;
– strong cost, supply chain and capex control systems for every aspect of the business;
– attention to cash flow and focus on cash recovery;
– innovative value-sharing arrangements with clients to secure ongoing business and to incentivise performance;
– viable contracts and a track record of meeting performance criteria.

Looking further ahead

As we go forward, the market still anticipates growth but, as we have examined above, there are a number of factors around the corner that we have yet to fully incorporate.

The major users of FM services are large corporates and public sector bodies. Therefore, this sector is likely to face significant challenges following the public sector austerity measures and the general economic climate.

There may still be an appetite for organisations to outsource non-core activities to save costs which may provide some growth opportunities for the sector, however, the significant pressures on cost-reduction are reducing the attractiveness of FM service contracts and reducing margins.

Going forward, the industry is likely to see further pressure, the number of bidders for each tender is increasing and margins will continue to suffer in this competitive environment. The ability for businesses to control mobilisation and operating costs will be key. For growth, the challenge will be to add service lines or new territories to existing offerings through acquisition or partnership.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

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International Corporate Rescue has been relied on by practitioners and lawyers throughout the world and is designed to help:

- Better understanding of the practical implications of insolvency and business failure – and the risk of operating in certain markets.
- Keeping the reader up to date with relevant developments in international business and trade, legislation, regulation and litigation.
- Identify and assess potential problems and avoid costly mistakes.

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