

3

The impact on government business

Summary

This review provides fresh evidence of the gains in efficiency and service quality which can result from locating government activities out of the overheated South.

- Recruitment and retention of staff in London is difficult: the Government has had to take measures to deal with shortages of key workers. Housing is a particular problem, with average house prices in London about double the levels in many other parts of the country.
- London business costs are high. Public sector wages are 26 per cent higher in central London than the UK average. The average cost of a workstation in London was more than £13,000 in 2002: nearly twice as expensive as the rates outside London and the South East.
- Organisations moving business out of London have recorded annual savings of 20-30 per cent, sharp reductions in staff turnover – in one case from 23 per cent to four per cent – and improvements in service quality, productivity and business processes. Cost modelling by this review suggests that the savings over 15 years could be very considerable.

Building the business case for relocation is a complex process, with many factors to consider, including the impact on staff. The evidence points to four factors in particular being vital to maximising the business benefits:

- Moving location is a critical opportunity to make fundamental changes in business processes, working methods and culture.
- Leadership and good management are critical to the execution of a relocation and its subsequent success.
- Relocation entails up front costs and risks, but coordination across government will lower the costs of early exits from London leases, reduce the need for redundancy and contain the risks of overheating property and labour markets in regional locations.
- Aligning pay with local market conditions will increase the cost savings, while helping to maximise the economic benefits for receiving locations.

Introduction

3.1 This chapter reviews the factors that build up the business case for relocating out of London and the South East, and considers the lessons learned from earlier relocations – the benefits and the problems – drawing on the research which I commissioned from *Experian Business Strategies*¹.

¹ 'The Impact of Relocation – a report for the Independent Review of Public Sector Relocation', Experian Business Strategies, January 2004 available at www.hm-treasury.gov.uk/lyonsreview

3.2 The starting point, of course, is London – a global city with (despite some fluctuations) a robust and growing economy and GDP per head substantially in excess of other parts of the UK. Alongside this success comes problems of overheating: high business and living costs; skill shortages in essential public services; and congestion. I was keen to flesh out this familiar picture with recent evidence.

Staffing costs, recruitment and service quality

3.3 London is a difficult place to find and keep staff, especially key public sector workers. 84 per cent of public sector respondents to a 2003 survey² reported staff recruitment and retention problems, compared to 72 per cent in the private sector, with problems worst in London. A 2002 Treasury³ survey highlighted recruitment and retention difficulties in professional occupations across the public sector. Experian observed that recruitment and retention difficulties were one of the factors that motivated several prominent government relocations.

3.4 There is a surprising lack of good data on staffing problems, systematically collected and categorised by sector, region and occupation group – a problem that has been noted by the Treasury and the Audit Commission. I was particularly dismayed to discover that, with very little exception, government departments did not seem to be rigorously tracking vacancy rates or other indicators of staffing difficulty, despite the requirement to produce pay and workforce strategies. This is a deficiency which needs to be addressed.

3.5 There is, however, no doubt of the problem and the extent to which the Government has needed to intervene, for example to improve access to affordable housing for key workers. London and the South East are the most expensive regions to live, and Table 3.1 illustrates the high costs of London housing. There are also problems with transport and congestion as set out in more detail in chapter 7.

Table 3.1: Average house prices by region, 2003

Region	Average house price (£)
Greater London	260,658
South East	205,109
South West	176,092
East Anglia	155,364
West Midlands	139,227
East Midlands	132,893
Yorks & Humber	112,350
Wales	111,272
North West	110,135
North	102,074

Source: HM Land Registry, Q4-2003

² 'Recruitment and Retention 2003' Chartered Institute of Personnel and Development, 2003.

³ 'Cross Cutting Review of the Public Sector Labour Market' HM Treasury, November 2002.

3.6 Considerably higher pay, reflected in London weighting and underlying wages, is necessary to recruit staff of suitable quality and to counter the higher costs of living in London. Table 3. 2 illustrates the premiums that are paid in London against UK average salaries, while table 3.3 gives a more detailed regional comparison.

Table 3.2: London premium in the public and private sectors⁴

	Public Sector (per cent)	Private Sector (per cent)	Private Sector Excluding City (per cent)
Central London	26	41	37
Inner London	24	37	33

Source: National Statistics/University of Warwick Institute for Employment Research

Table 3.3: Regional wage relativities

Region	Wage Relativity (per cent, Oswald, using 1996-2001 data)	Wage Relativity (per cent, Frontier Economics, 1997-2001 data)
Inner London alone	37.8	36.3
Outer London	23.6	23.5
Rest of South East	13.2	13.7
West Midlands	5.0	5.2
Greater Manchester	4.5	4.6
West Yorkshire	4.3	5.2
East Anglia	3.5	4.5
East Midlands	1.8	3.1
South West	0.9	3.4
Tyne and Wear	0	0
Merseyside	-1.4	0.0
South Yorkshire	-3.6	-0.2

Note: All estimates are relative to The Region Tyne and Wear

3.7 While the private sector can seek to benefit from differentiations in local and regional pay, the public sector – relying on national pay agreements – has had much less flexibility. One consequence is that it is difficult to match private sector London premiums – as table 3.2 shows. This may help to explain the particular recruitment and retention problems faced by the public sector. *Experian* noted that the public sector sometimes adapts to London conditions by filling posts at a higher grade than would be necessary in the rest of the country.

⁴ Average standardised spatial wage differentials from New Earnings Survey for 1999/01 rounded to the nearest percentage. ‘Central London’ is Camden, City, Islington, Lambeth, Southwark, Tower Hamlets, and Westminster. ‘Inner London’ is Central London plus Kensington and Chelsea, Lewisham, Newham, Haringey, Wandsworth, Hackney and Hammersmith.

3.8 Pay flexibility is obviously also key to maximising the efficiency savings available by employing staff outside London and the South East. There is considerable evidence that public sector pay, tied to national frameworks, is higher than in the private sector outside London, for comparable jobs at junior grades. The Government is now emphasising the need for public sector pay to incorporate the local and regional responsiveness that is necessary to deliver efficient public services. I shall show in Chapter 4 that regional economic considerations also point to the need for more flexible public sector pay policies.

“It is by requiring reform as a condition of resources, by measures[ranging] from more flexible labour markets ... to public sector pay linked to performance... that we will be able in the next spending round to ensure money is well spent and deliver new resources to our front line public services.”⁵

3.9 But there is a bigger prize than capturing wage differentials alone. By moving into less overheated labour markets employers can reduce turnover and make additional savings in recruitment and training. Crucially, reduced turnover can also improve service quality. *Experian* has highlighted this effect in practice, and I shall come to it shortly.

Accommodation costs

3.10 Rents, rates and service charges are materially higher in London than in the rest of the United Kingdom and this holds true for much of the South East, although it is important to recognise that there are significant disparities within these regions. *King Sturge* property consultants provided a comparative analysis of office rents, rates and servicing costs that highlights the disparities across the UK in 2003.

Table 3.4: Prime office costs in major UK cities

Location	Prime rent £'s per sq/m	Service charge £'s per sq/m	Rates £'s per sq/m	Total occupation cost £'s per sq/m
London: West End	710	81	194	985
London: City	511	81	183	775
Birmingham	280	54	92	426
Bristol	248	54	75	377
Manchester	269	48	81	398
Glasgow	248	48	75	371
Edinburgh	269	43	108	420
Cardiff	194	43	54	291

Source: King Sturge Global Industrial and Office Rents Survey, Q2-2003

3.11 For the lay person the total cost per head of providing work space is a more understandable measure. A 2002 survey revealed that the average cost of a workstation in London was £13,134 compared with an average outside London and the South East of £7,934⁶. The Department of Environment Food and Rural Affairs, which is pursuing a programme of estate rationalisation, provides a similar picture for its own accommodation costs, with a workstation in London at £10,230 per annum against a country average (including London) of £6,800.

⁵ Speech by the Chancellor of the Exchequer at the CBI national conference in Birmingham: 18 November 2003.

⁶ ‘The Total Office Cost Survey 2002’, City University Business School, Actium Consult and Cushman & Wakefield Healey & Baker, 2002.

3.12 The potential savings on premises could be larger if the relocated activity is transferred to an out of town location rather than being based in prime city centre space, or indeed to certain smaller towns (an issue addressed by *King Sturge* in their locational comparisons described in chapter 7).

3.13 Again, there is a bigger prize on offer than cost differentials alone. By using relocation as an opportunity to improve the use of working space – for example through open plan working, hot desking or hoteling – employers can reduce the per capita accommodation requirement, making additional savings and improving productivity (and, if it is well managed, also improving working conditions). British Telecom provide an example of such an approach, which is in the box below. Relocation also offers an opportunity to achieve greater environmental sustainability in the use of buildings and estate.

In 1993 British Telecom began a programme of estate rationalisation and modernisation to reduce the inefficiencies of maintaining a property portfolio that included 95 buildings in London alone.

British Telecom used the programme as an opportunity for organisational transformation through the adoption of flexible working practices such as hot desking and wireless working. By October 2003 British Telecom had been able to reduce its reliance on London desk space by two thirds from 10,000 to 3,000 and had seen a material reduction in absenteeism amongst those who use remote working for at least some of the time to 3.1 per cent against the United Kingdom average of 8.5 per cent.

3.14 A number of respondents to my consultation commented that London property prices were at near record levels and questioned whether significant disparities in office costs across the United Kingdom would be sustained. I conclude from the evidence that such differentials are likely to be enduring. Firstly, the history is of high, persistent differentials, as table 3.5 illustrates. The table expresses London rental costs as a multiple of those prevailing in other cities over time. For example in 2002 a building in Birmingham that cost £1 million per annum in rent would cost £1.9 million in London.

Table 3.5: Victoria/Westminster office rents as a multiple of regional rents

	1976	1980	1984	1988	1994	2000	2002
Birmingham	3.2	2.6	2.4	3.3	1.2	2.2	1.9
Leeds	2.0	2.5	2.5	3.4	1.3	2.5	2.3
Manchester	2.3	3.0	2.8	3.9	1.5	2.5	2.2
Nottingham	3.6	5.0	4.6	6.1	2.4	3.7	3.5

Source: *Experian Business Strategies*

3.15 London's commercial property market is cyclical and the snapshot for 2002 captures data from close to the peak market period. At this point one might expect London office rents to have been an unusually large multiple of rents in other cities; but the table shows this is not the case, and that London office space has persistently been more expensive, despite some cyclical fluctuations. The past is not an infallible guide to the future, but the optimistic forecasts for economic and labour market growth in London highlighted in the next chapter are reasons for thinking that demand for London office space will remain high in the coming years, helping to keep prices up.

Modelling costs and savings

3.16 *Experian's* research explored the potential cost saving for departments. They found that reductions in overhead costs were an important motivator for relocations, and that savings of between 20 and 30 per cent per annum were common, as a result of the absence of London weighting; lower underlying wage rates; more appropriate grading; lower accommodation costs; and the economies of scale produced by centralisation and rationalisation of property. The findings are set out more fully later in this chapter.

3.17 There are, of course, also up front costs associated with relocation, including the costs of moving staff, acquiring and fitting out new premises and recruiting local staff. Large penalties can be incurred by vacating premises before leases expire or reach break points, and staff who do not relocate may need to be made redundant. Many of these costs can be avoided if the model of dispersal adopted is one that emphasises the location of new activities outside London and the South East, rather than the relocation of existing activities.

3.18 My review developed a model to illustrate the likely costs and savings associated with dispersing 20,000 posts from London, assuming the dispersals were spread evenly over seven years. Details of this model and the underlying assumptions, which reflect the factors discussed in this chapter, are at Annex C. Though they do not draw directly on the cost information that departments themselves provided (which was incomplete and difficult to aggregate), the results are broadly consistent with the business cases emerging from departments.

3.19 The model suggests that the upfront costs of removing 20,000 posts from London and carrying out the activity elsewhere in the United Kingdom would be approximately £940 million over the seven years. Savings generated by relocation over that period offset these costs to a significant extent and the costs are fully paid back after six years. The permanent annual savings in the longer term would be £377 million. Over a 15 year period cumulative, discounted net savings would be in excess of £2 billion. The additional savings as a result of greater coordination across government are presented later in this chapter. There has been no attempt to model the additional impact of moving towards more market-sensitive local pay rates, but undoubtedly there would be further savings.

Lessons learned from earlier relocations

3.20 *Experian* looked at ten public sector relocations, and seven in the private sector. A summary of their research is in the box below. *Experian* noted that these relocations had not been well documented at the time, and tracking the relevant material for my review was a considerable task. They concluded that the evidence base underpinning current relocation practices is small: academic literature in this area is limited, and few organisations conduct rigorous post-occupancy evaluations to determine whether the projected benefits are delivered and then maintained in practice. This is a deficiency to which I return in my recommendations.

Experian on lessons learned from relocation

The work was based on a series of interviews with senior staff from ten public sector bodies and seven private sector companies, these were:

- In the public sector: the Benefits Agency; Customs and Excise; Defence Procurement Agency; Department for International Development; Department for Trade and Industry; Department for Education and Skills; Department for Work and Pensions; Highways Agency; Inland Revenue and Patent Office;
- and in the private sector: Abbey National; Amersham International; Barclays Bank; London Electricity (now EDF Energy); Thames Water; Unilever and GUS.

Key findings on the lessons learned were:

- Savings in operating costs, especially pay and accommodation, were a key driver, and annual savings of between 20 and 30 per cent were typical.
- Organisations benefitted from improved labour markets outside the South East. At more junior grades particularly, there was a good supply of able staff. This drove up service quality; reduced turnover and associated recruitment and training costs; and facilitated the introduction of new working practices and new cultures.
- If benefits were to be maximised, relocation had to go hand in hand with changes to the way the business was done ('process re-engineering').
- Strong and committed leadership at the very top of the organisation was crucial to success.
- Rigorous planning and monitoring, and good communication were vitally important.
- Successful relocations could be undermined, although the problems were largely avoidable with good planning, use of ICT, and measures to combat cultural resistance. The main issues were: the erosion of cost savings; the development of 'them and us' cultures between relocated staff and the centre; frequent travel back to London for meetings; and the reluctance of senior staff to relocate.

Service improvements

3.21 A number of key themes are worth picking out of the *Experian* findings. Firstly, it is clear that moves out of London generated not only cost savings but service improvements for customers. Organisations including the Department of Health, Thames Water, Overseas Development Agency (now Department for International Development) and the Patent Office experienced this effect.

Patent Office case study⁷

In 1988 the Patent Office announced that they would relocate from London to a new building in Newport, Gwent to obtain savings on accommodation, staff and running costs. The relocation was consistent with the Government's announcement in March 1988 that departments should review the location of their work to secure cost savings and wider benefits.

In 1994 the National Audit Office analysed the benefits that the Patent Office had begun to realise from their relocation. They reported that the Patent Office achieved accommodation savings of £3.1 million per year and annual staff savings of £2.9million.

These staff cost savings were twice as great as the Patent Office had hoped for. The local labour market proved to be both wider and deeper than anticipated, allowing more posts to be filled with local candidates and more quickly than forecast.

The key factor in the significant staff cost reductions proved to be the material improvement in staff retention levels that the Patent Office experienced, with a sharp fall in recruitment and training costs. In 1987, the last full year in which the Patent Office was wholly based in London, staff turnover at service grades was 23 per cent. In 1992-93 turnover for the equivalent grades for Patent Office staff in Newport was four per cent.

The National Audit Office conducted a post occupancy survey of the Patent Office's key working contacts to determine whether relocation had impacted on the quality of service delivered to customers. They found that response times and quality of service delivered were both perceived to have improved. This was partly as a result of changes in the way that customers contacted the Patent Office, shifting away from face to face meetings toward email and the telephone, and also through the introduction of a standardised method of dealing with the Patent Office.

Gains from wider re-engineering

3.22 One of Experian's most important findings was that relocation could secure maximum benefits when savings in overheads were pursued alongside measures to re-engineer processes, introduce improved ICT, develop new working practices, and change the prevailing culture. This approach has been particularly well exemplified by the big service departments: the Inland Revenue, Customs and Excise and Work and Pensions, and in the private sector by firms like Thames Water.

3.23 The Defence Procurement Agency showed how the relocation of a number of disparate functions to a single location allowed for an investment in information technology and a corresponding radical change in working practices that would have been much less likely without the initial relocation.

⁷ Report by the Comptroller and Auditor General, 'Relocation of the Patent Office', 16 February 1994.

Defence Procurement Agency case study

The creation of the Defence Procurement Agency brought 6,000 staff from all branches of the armed forces and locations including London, Bath, Portsmouth and Portland together on a single site in Abbey Wood, Bristol.

The relocation to a single site led to a reduction in accommodation costs and lower staff turnover. However, more importantly, the relocation provided an opportunity for Defence Procurement Agency to introduce new information technologies and fundamentally redesign business processes to improve the way procurement took place and ensure that the acquisition process became faster, cheaper and better.

The introduction of a completely new IT system that integrated project, contract, financial and personnel management functions allowed the Defence Procurement Agency to implement a Smart Procurement Process with Integrated Project Teams consisting of MOD civilian and military acquisition staff, representatives of industry, the Service customer and those responsible for the support of the equipment through life. This new way of working has increased flexibility, allowed the earlier recognition of risks and a clearer understanding of the lifetime costs of a project and has transformed the acquisition process from an adversarial relationship between supplier and contractor to a collaborative approach.

This transformation of the procurement methodology could only occur with the structural and information technology improvements, and the Abbey Wood relocation was key to that investment.

3.24 *Experian* felt that a narrow focus on cost reductions had limited the eventual relocation benefits for some organisations, and that it was important to view relocation as a potential spur for much wider improvements:

“failure to approach relocation with a view to securing business change is tantamount to ignoring very material benefits in terms of cost savings, improved efficiency and customer service”.

Managing problems

3.25 *Experian* identified a number of risks to sustaining a successful relocation, emphasising that they could all be largely overcome with careful planning and management. Each of these risks raises fundamental issues which I explore in later chapters. I set them out here, along with *Experian's* views on how they should best be mitigated.

3.26 First, there was the problem of overheating. If a number of employers converged on a single location where there was a limited labour market and limited office accommodation, the increased demand could push up the cost of labour and office space, and over time, the initial savings could be eroded. This was more of an issue in junior grade work, and particularly true of call centre operations, where staff were quick to switch employer for a marginal increase in pay. In relation to policy work, *Experian* concluded that locations with a high proportion of managerial or professional jobs would act as a magnet for graduates, and that supply and demand would be more balanced.

3.27 The benefits of clustering and associated risks of overheating are also relevant to the economic impact of relocation and I consider them in chapter 4. *Experian* judged that “*good local market intelligence, coupled with coordination of public sector relocations at the centre, would help avert the risk of localised overheating caused by a large number of jobs moving to the same location.*” The importance of coordination is a theme to which I return later in this report.

3.28 *Experian* also noted the risk of ‘twin cultures’ emerging. Staff at new sites could feel marginalised, and this reduced motivation and commitment. As one interviewee put it: “*We were treated like a lost tribe – and started to behave like one*”. Matters were likely to be worse if few senior managers were located at the new site. The problems were not confined to the new sites. The investment and senior staff time put into the move could cause others to feel neglected, while variations in standards, for example in office space or equipment, could also cause problems. One company found that the success of the relocated team bred jealousy elsewhere in the organisation because of perceptions that the relocated team were receiving preferential treatment.

3.29 ‘Twin cultures’ could be mitigated through strong and visible leadership, investment in links and networks, and consistency of treatment across all sites. Managers needed to recognise the extra effort needed to ensure that distance from the centre does not weaken the unity of the organisation. It required sustained attention from senior staff, with a strong focus on visibility. A number of organisations emphasised the importance of visits from Board members, to communicate key corporate messages and values. *Experian* also stressed the value of shared events, such as seminars, joint training and away-days, to build a sense of shared objectives and corporate values.

3.30 A key lesson to draw from this is that to be viable, sites outside the centre need sufficient senior presence. This can be difficult in the civil service, where the culture is one in which senior careers are developed in London. *Experian* also found that if there were too few senior staff, they could feel isolated and “out of the loop”. This is issue which I explore later in the report.

3.31 Finally, *Experian* highlighted the burden of travel to London by those located in the new site. Excessive travel to London is time consuming and reduces productivity. It places a physical strain on those who do it regularly, and it is difficult to reconcile with a family friendly approach. *Experian* found that, in planning moves, organisations regularly under-estimated the cost and impact of travel. The problem was not just one of forecasting but a Whitehall meetings culture which *Experian* felt, despite the adoption of videoconferencing by some departments, had not been exposed to sufficient challenge: “*There is little evidence of any concerted effort to reduce the number of meetings or to make them more convenient to staff who are not based in London. The travel burden is in no way equally divided.*”

Conclusion: building the business case

3.32 This chapter has highlighted some of the key business benefits that can arise from dispersing activities away from London and the South East. Building the business case is complex and there are many factors.

3.33 I have shown that departments need to consider:

- cost differentials in staffing and accommodation, taking account of improved recruitment and retention opportunities outside London and the South East, and the scope for greater pay flexibility to enhance the benefits;
- the possibility of service delivery improvements and the rationalisation and re-engineering of business processes;
- management issues associated with ensuring organisational coherence across physically distant sites.

3.34 Departments must also consider timing issues. There are arguments for and against proceeding slowly and taking a “big bang” approach. Relocation may risk disrupting wider organisational changes or alternatively be a way of hastening them. A phased dispersal may get costs down by taking advantage of lease breaks to avoid exit penalties, and of natural attrition to avoid making people redundant. But a phased dispersal is also more at risk of becoming bogged down. A key point is that dispersing activity can be achieved not only by relocating existing functions, but by taking care to locate new functions outside London or the South East to start with. This may take longer, but will avoid many of the costs associated with relocation.

3.35 In later chapters I explore the relevance to the business case of decisions about who, and who not, to relocate and about the choice of alternative locations and sites. A key conclusion of this report is that the ability of the Government to coordinate decisions on location will determine how successfully the further dispersal of functions will serve the Government’s objectives, including efficiency. The departmental business case will be improved to the extent that coordination of moves reduces lease exit penalties and redundancy costs, and allow a more joined up approach to office procurement out of London.

3.36 By factoring cautious assumptions about the impact of better coordination into the financial model described above, it is possible to illustrate the likely improvements to the business case. Upfront costs in the review’s model are reduced from **£940 million** to **£650 million** and the payback period is reduced from **six** to **five** years.

