

## **Outsourcing decision-making process of real estate department functions in Finland**

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### **Abstract**

In Finland, the real estate business is going through a fundamental structural change, which has brought forth a need to develop new ways of managing real estate. One indication of the change is an increasing interest within organisations to outsource real estate related activities. However, the culture of buying and providing management services is rather immature in the country. Further applied research in the real estate discipline is needed in order for outsourced real estate management to be able to advance as a business.

This paper presents insights into outsourcing market conditions in Finland and the level of real estate management related activities outsourced in Finnish corporations. Companies acting in this field of business in Finland are categorised and leading professionals are identified.

Based on literature review, experiences in the real estate sector and interview study among companies participating in the project, a theoretic modelling of outsourcing decision-making process is sketched. The outsourcing process is based on the core business strategy of the company, and finding an optimised boundary between core business and activities to be outsourced. The next steps are to define the desired characteristics of the outsourcing relationship, analysing the effects of outsourcing to the organisation's business and performance, planning the implementation and negotiating the outsourcing contract. The paper proposes some critical success factors in the process, and assesses outsourcing as carried out within companies in Finland.

### **Background**

VTT Building and Transport, in co-operation with KTI Finland (Institute for Real Estate Economics), is carrying out a two-year (2001-2002) research project on "outsourcing as a potential means of strengthening real estate management". The starting point in terms of multidisciplinary research is to look into the subject from both the perspective of corporate real estate and that of a service provider, aiming at an optimised outsourcing contract and partnership benefiting both parties, as well as tools to manage and monitor the outsourcing relationship.

The goal of the first phase of the research project was to outline different outsourcing decision processes in the Finnish market conditions and to develop an outsourcing decision-making model, that the organisation can use when considering outsourcing as an option in arranging the real estate department functions. This paper summarises the outcomes of the first phase of the project

In this research, some twenty companies, representing the users, owners and service providers, were studied. The companies are large, considering the scale in Finland, and manage a significant mass of property. The turnover of the real estate departments varied

from tens to hundreds of millions FIM. The real estate department functions were outsourced diversely. In some organisations, The real estate department entirely outsourced except for one contact person. In some of the real estate department, outsourcing was only considered as an option. The biggest real estate department employed over a hundred people.

### **The current state of the real estate sector in Finland**

In Finland, owning real property hasn't traditionally been considered as means of conducting active business; the real estate sector has been looked at from a rather construction-oriented perspective. It is fairly common for the companies to own the facilities they operate in: less than half of the premises are leased. The focus of the real estate business has been on the activities concentrating on the technical characteristics of a building, such as construction, maintenance, services installations and finance. Very often the cheapest offer is chosen, as means of the quality-based competition aren't well managed. Real estate management has been primarily looked at from the point of view of property management (PM). PM as a concept clearly exists in Finland. Service providers have been doing business in quite an old-fashioned way: contracts and service descriptions have been carried out conventionally, and little integrated networks have existed.

As generally more clear profit requirements concerning property are presented, asset management (AM) is gradually developing into a more independent function. An example of this is the property investment companies that have entered the Finnish market. The business has been somewhat weak in the beginning; for example one stock issue failed as there wasn't enough interested investors.

There are only a couple of service providers that are actively developing and offering services related to asset management: some companies, traditionally concentrated on real estate maintenance services, have extended their services to new areas, and there are few international companies, that have entered the Finnish market with international contracts. Typically each supplier has only a few customers and the activities are just shaping up. The service providers are usually developing their own management concepts for different kinds of real estate owners and users. The services are usually marketed to the largest property-owners that are already active in the real estate sector; perhaps a better market potential could be found within the not-so-active real estate owners like associations.

Facility management, the user perspective, has been rather immature and dispersed business. Technology centres such and technology buildings (e.g. ABB and Nokia) have developed more accomplished services. Facility management is often understood as more narrow a concept than elsewhere in the world.

Real estate management decision-making strategies and calculation and evaluation methods are starting to develop. A part of the property owners are strongly developing their business. Listed companies have emerged, but their actions have been so far rather weak. The real estate departments of construction companies are becoming more active in real estate business as well as in maintenance. Within real estate maintenance, the competition is quite tough in Finland. Big companies aim to overcome particularly the property maintenance market of the premises of the public and private sector.

### **The challenges and problems in modelling the outsourcing decision-making process**

In the literature, many different definitions of outsourcing can be found. For the purposes of this paper, outsourcing is defined as turning over to an external service provider the control of an in-house activity, or an activity for which an immediate ability exists to perform internally.

Typically, real estate department functions are considered to be services, not products or manufacturing processes. The services of a real estate department are, however, of a different nature and looking at the property from different perspectives. Therefore, the decision making process may vary according to the specifics of the real estate function in question.

In evaluating outsourcing of services, the evaluation criteria typically are more ambiguous than in the outsourcing of a manufacturing process. Often, when considering outsourcing of manufacturing products or sub-products, the goal variables can be determined and the decision criteria measured more easily and explicitly.

In Finland, the terms concerning real estate and facilities services are incoherent, particularly concerning management related services. Service providers have developed their own service concepts that consist of somewhat different activities.

In the literature, outsourcing seems to be looked at from two different starting points. One perspective is to consider a certain activity or process and its potential of outsourcing. The other is to consider outsourcing as a strategic tool to organise the core business and the support functions of an entire organisation, when for example the focus of the business is changing. In this situation, a group of activities are evaluated for outsourcing, best outsourcing candidates are identified, and only then the attractiveness of outsourcing is considered for each activity.

In the literature, a majority of the outsourcing process models developed represent outsourcing as a series of strategic decisions based on analyses and evaluations. However, some previous studies, for example Lacity and Hirscheim (1993) have showed, that outsourcing decision-making, as carried out in practise, may not be a rational process after all, which makes explicit modelling the process difficult. We discovered this to be true in the organisations participating in this research as well. Although the outsourcing decision is, almost always, described by the decision makers as being based on a strategic analysis, the evaluation methods behind the decision couldn't be specified and the calculations were ambiguous, if any were performed at all. Furthermore, an effective decision process breaks nearly all the rules for rational decision making.

### **Outsourcing decision making - a theoretic model**

Outsourcing real estate department functions will have positive and negative long-term and short-term effects to the business of the organisation. Here is presented an outsourcing decision-making model that can be used by functionaries of an organisation that is considering outsourcing real estate related functions – general management, real estate management or outsourcing consultants (picture 1).

The model is built based on examples found in literature, particularly a model for information systems outsourcing decision making by de Looft (1997), augmented with the findings of the interview study carried out.

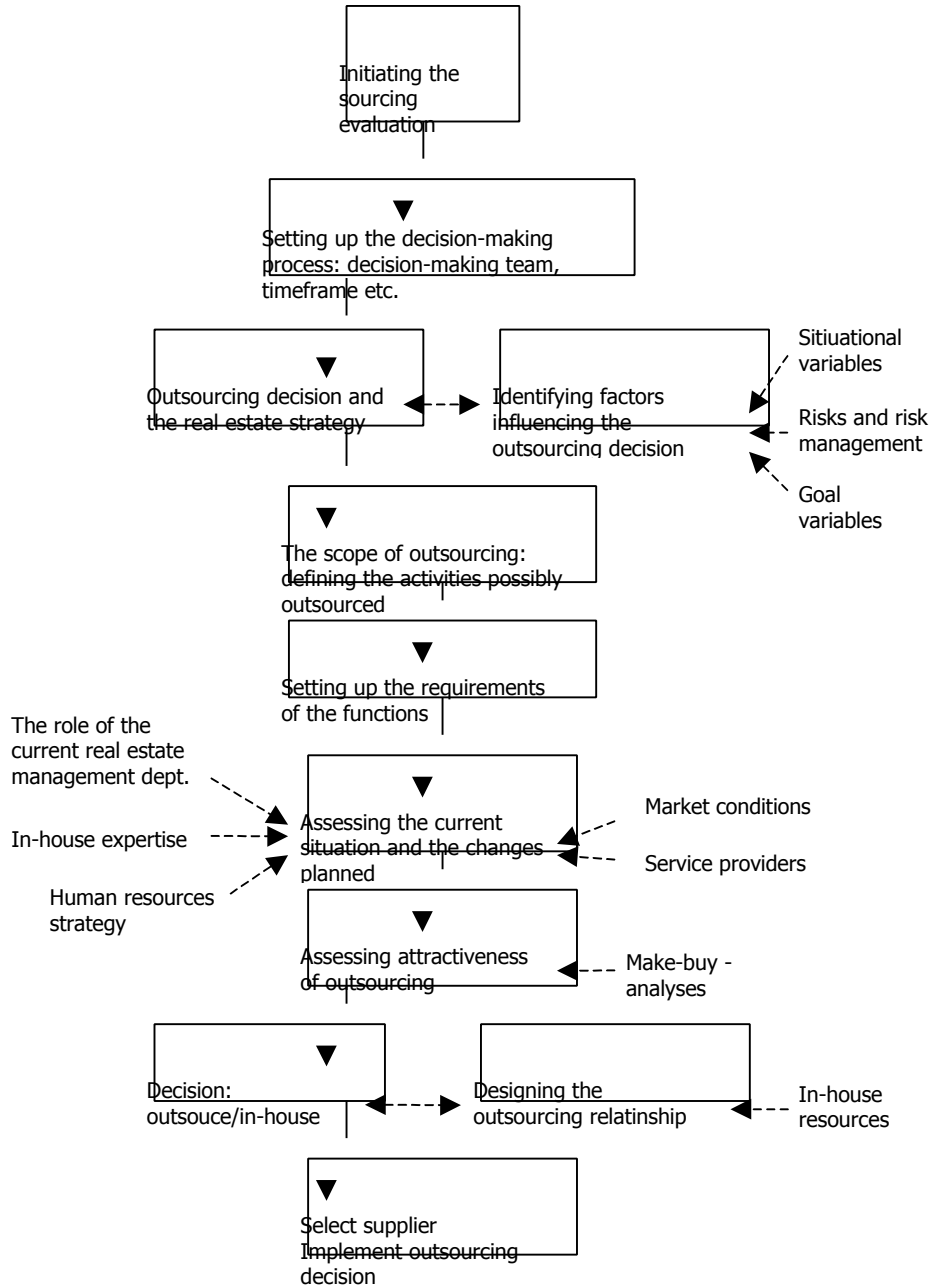
The phases identified in the outsourcing decision-making are:

1. Decision to initiate the evaluation of outsourcing
2. Setting up the process of the decision-making
3. Identifying the factors that influence the process: goals, risks and situational variables
4. Establishing the link between corporate real estate strategy and outsourcing decision
5. Defining the outsourcing scope: potential functions that could be outsourced
6. Setting up the requirements of the functions
7. Assessing the current situation and the changes planned
8. Assessing the attractiveness of outsourcing a certain function
9. Designing the outsourcing relationship
10. Sourcing decision

As each decision making process is individual and unique, the decision making phases presented in the model will not necessarily follow each other in a pre-determined order, as some of the phases are interdependent, but nevertheless each phase will take place during the decision-making process. Furthermore, for example Wasner (1999) states that considering the inherent complexity of outsourcing and the recognition of individualistic behaviour, it seems unlikely that decision making and implementation can be clearly

separated. It is possible, that the boundary between decision and the implementation may become blurred: transfer is initiated before the explicit decision is conceived, and thus potentially influencing the decision-making. It is equally possible, that action may even proceed initiating the decision-making: other events or decisions may lead to outsourcing even though no explicit outsourcing decision has been made. In this case, the decision may actually be just a confirmation of the action that has taken place.

In any case, outsourcing is a multi-phase process that is affected by both internal and external situational factors, which are in part interdependent and thus should be evaluated parallel. Each phase is shortly described below.



Picture 1. Modelling of outsourcing decision-making of real estate department functions

## **Initiating the evaluation of outsourcing and setting up the decision-making process**

First phase of the outsourcing decision making is to decide whether to start evaluation outsourcing as an option in the first place. The evaluation of outsourcing takes often a lot of time, costs and puts pressure on the personnel as well as the management. Therefore outsourcing evaluation should be initiated only, when the dissatisfaction with the current situation and the potential improvements achieved by outsourcing, are expected to outweigh the costs and risks of the evaluation process. It is also important to recognise the reasons, why outsourcing is considered as an option in the first place.

In the organisations that were studied, the initiative to outsource real estate department functions has commonly come from the management or the owner, in some cases from the real estate management as well. The history of outsourcing typically originates from the general development of business life and the arriving of the outsourcing trend in 80's in Finland. The public sector follows behind the private one.

In initiating the outsourcing evaluation, the history of the organisation seems to be a significant factor. Outsourcing has come along when, in many companies, the organisational structures have changed with mergers or other similar arrangements; outsourcing as an option has been a natural development in arranging the real estate department functions. Outsourcing is seen as a useful tool in developing or re-aligning the core business focus.

For example Manning et al. (1999) stated, that decisions about whether, why and which real estate department functions could be outsourced, could be enhanced with help from a knowledgeable third-party consultant. An outsider may look at the issue from a broader perspective – the internal decision-makers may be influenced by the organisation's internal politics. In Finland, however, the culture of using a consultant is rather immature. Marketing of such services is also weak. Within the companies studied, a couple of cases, where an outsider consultant had been used, were found. The experiences had been positive.

When it is decided, that the outsourcing evaluation should take place, the decision-making process has to be set up. This includes appointing the decision-making team. The team must include enough expertise and authority to make the decision, and the power and commitment to implement it. Therefore top management, real estate management and representatives of real estate department staff – especially the people whose tasks are considered, as they know they best how the service is actually carried out - should be included in the team. In practise, this hasn't often been the case.

Outsourcing decisions have both long term and short term consequences, so the time scope of the decision and the time scope of consequences included in the evaluation should be determined. The consequences of the decision should be evaluated beyond the contract period.

## **Establishing the link between corporate real estate strategy and outsourcing decision**

As outsourcing can be means of arranging the non-core functions of an organisation, an internal strategic analysis should be carried out. The aim of this analysis is to clarify the strategic goals of the business and the boundary between core business and real estate related functions.

The starting point is that the organisation should determine what it wants to do and how the core processes are arranged. Only then can be evaluated how possible outsourcing of non-core business processes could affect the core business. The outsourcing decision will implement an important alignment of the organisation's activities: to be an expert or to buy services from an expert; to give up the control of maintain the control but give up the possible benefits, that could be achieved.

Outsourcing decisions are a part of real estate management, and therefore should be integrated with the planning of the real estate strategy. If outsourcing is critical for an organisation to implement its business strategy, and the strategy changes, the outsourcing

deal may not fit the strategy anymore. In this situation, the outsourcing deal must be reshaped or terminated.

For example Corbett (1998) proposes, that when considering real estate department functions outsourcing, one should consider if real estate functions might, in some way, be core business. There are many examples presented in the literature, as to how to distinguish different levels of business processes in an organisation. The research typically shows that the closer the core business an activity is, the more important it is to maintain control over the activity. For example corporate real estate strategy, investment strategy may be these kind of strategically important activities, particularly to a large company with a large real estate portfolio. For example Glagola (1999) states, that the goal typically is to outsource activities, for which the company has neither a critical strategic need nor special capabilities.

In this study it was found as well, that outsourcing has become obvious: the strategy of the entire organisation is based on concentrating on the core competence – outsourcing has become a politically correct answer to arrange also real estate activities. The listed benefits of outsourcing arrangements are no longer questioned.

The link between outsourcing and real estate or business strategy varies; the historical role and status of the real estate department and its functions has a great impact. In all the companies participating in this study, the in-house real estate department is questioned. Particularly property management functions are outsourced to a great extent, except for few, typically formerly public organisations, that have outsourced hardly any activities. Most of the companies claim to be concentrating on the core business and therefore keeping in-house only the functions that are strategically important. Defining a strategically important activity is faltering: merely the views of top management and real estate department management seem to more or less solve the question. Decision-making tools couldn't be named: profound calculations, risk analyses etc. had rarely been carried out.

If an organisation has an own corporate real estate department, its role should be evaluated. In this study, the role of the corporate real estate department was diverse in the companies interviewed. Usually the mission of the department is to support the core business by organising the best possible facilities. However, the financial significance of the real estate department in practise varied. In some organisations the real estate issues play an important role because of the special requirements of the core business processes. Others considered real estate merely a support function that can easily be transferred to an external supplier. Outsourcing of real estate department functions had been carried out to some extent in every organisation – some to the end so that the real estate department only employed two people, some have outsourced only few maintenance activities.

### **Identifying factors that influence the process**

Categorising of the factors influencing in the outsourcing decision-making is difficult, either becoming too general and vague or too detailed and situation specific. The categories of factors are linked and to greater or lesser extent interdependent, which does Wasner (1999) suggest for example. Identifying and evaluating the factors however is important, to understand the underlying agenda, aims and objectives of the decision. One way to approach the factors is to determine their role: which factors can be influenced, which have to be taken as they are, and which are to be optimised. The factors, that can not be influenced, can be called situational factors. The ones, that should be optimised, are goal variables.

Outsourcing, as well as other sourcing options, will often fulfil well certain goal variables and poorly others. Therefore the relative importance of the goals must be determined: it can be derived from the organisation's strategy and from the role of the real estate department function that is considered. Weighting the different goal variables should not however lead to a one-sided emphasis on few goals. The stakeholders in an outsourcing decision will often have different opinions on the relative importance of the goal variables. The goals can be related to strategy, costs, quality, functionality, flexibility, controllability, and so on.

Before deciding to outsource based on one or more of the previous reasons, a manager should consider the underlying reasons why outsourcing is being considered in the beginning with. It may be due to one or more of the goal mentioned, but for example Bragg (1999) suggests that a deeper problem can be, that the function in questions is not doing a good job of presenting its benefits to management.

In outsourcing evaluation, in addition to goals, the potential risks must be identified: both the risks concerning outsourcing, and those of an in-house function. The risk-objective relationship should be understood; this includes evaluating risk mitigation and management possibilities. In general, the risks related to outsourcing are well known, but each outsourcing situation as well as its risks is unique, as the history and conditions within the organisation, as well as the significance of the activity in question.

### **The scope of outsourcing and defining the activities to be outsourced**

Defining the scope of outsourcing is essential. The objectives must be bounded by an understanding of the intended scope of outsourcing within the organisation. The interdependencies of the functions have to be taken into consideration. The co-ordination of the functions becomes difficult, if some functions are outsourced and others kept in-house.

The scope can be addressed at two levels:

- 1) The scope of the proposed outsourcing within the organisation – which functions could be outsourced
- 2) The potential boundary between buyer and supplier responsibility at the level of the individual contract

Setting the scope is linked to the internal strategic analysis of the organisation, but in addition to analysing the organisation's core competence, the core competence of the service providers, the potential outsourcing partners, must be assessed as well. Disadvantage to outsourcing occurs when marketplace competition is limited and there are few choices of service providers. The potential for the scope may and usually does change, even during the outsourcing contract, as the real estate or business strategy changes or the services offered in the market will develop.

General criteria to a function that could be outsourced are:

- the function is routine
- the function is well delineated
- the function can be measured and managed at arm's length
- the function can be readily provided by established vendors
- the function is offered in a competitive environment

Which real estate functions should be outsourced for a particular company varies depending on the company's industry, size, locations and business strategy. It is generally true, proposed for ex. Manning et al 1997, that property-specific real estate services as brokerage, construction and property management, can often be outsourced with better results than strategic, company-wide real property process management. However, some phases of an outsourcing decision-making process are the same for all kinds of activities

### **Setting up the goals and requirements**

When the outsourcing scope is defined, the goals and requirements must be set up for the functions potentially outsourced. In order for outsourcing to succeed, clear goals must be set: requirements to the service provider, business goals, and a clear conception of the outsourcing process. Outsourcing is a tool for implementing corporate strategy. The performance of this tool must be measured across the organisation but effective performance indicators can only be applied when the objectives and requirements of the function are clear. The outsourced and in-house function can be compared and evaluated only if the requirements are explicit defined.

When the goals and the requirements of the services are clearly defined, one can start to look for a service provider that can meet the requirements. The service provider doesn't necessarily know what the goals are, if they can't be explicitly described. The customer organisation has to realise that in some situations, the services offered at the market won't meet the goals that are set. When this happens, either the requirements must be changed, or the function should be kept in-house.

### **Assessing the current situation and the changes planned**

The purpose of assessing the current situation is to evaluate the current situation in relation to the goals that are set, to be able to identify the areas that should be improved.

In assessing the current situation, the tasks included in the function are defined. If a group of functions is considered at the same time, the interdependencies between the functions has to be identified. As outsourcing usually aims at long-term partnership: therefore the future developments and future significance of the functions should be evaluated as well.

All the costs and their allocation should be included in the evaluation of the costs. In the costs of an internal function, all the indirect costs, fixed costs, transaction costs and also costs incurred by non-real estate department personnel. The finance departments, however, don't usually have information specific enough, and different allocation systems may be used. In the costs of an external function, the internal costs of market research, negotiations and management of the outsourcing relationship.

Quality can be measured by comparing the performance to the pre-determined requirements. If requirements haven't been set, or they are constantly changing, the quality can't be objectively measured.

When evaluating the flexibility of an internal activity, the possibility of re-training and using flexible employment arrangements should be considered. The flexibility of an external service can be evaluated by, for example, possibilities and constraints in changing the requirements.

The problems and what's causing them in the current situation must be identified. However, if there have been problems in performing the function internally, outsourcing should be evaluated with caution. The decision-makers have to bear in mind, that outsourcing won't automatically solve any problems.

Comparing the internal and external possibility is useful only if both the services are truly similar. This may be difficult sometimes as the service providers develop their own products and concepts that consist of different entities. Benchmarking to other organisations should be made carefully.

### *Human resources strategy*

Managers that define the process as a one-dimensional strategy will be doomed to failure. Outsourcing must be a part of an overall corporate strategy and management must ensure that all employees are aware of the overall situation.

The outsourcing decision affects always the personnel in a way or another. An important part of the strategic analysis is to define the scope of HR policy and staff structure, and define the HR requirements. Sometimes the human resources issues are an essential factor in the outsourcing decision. In every outsourcing situation, they raise some problems.

Nearly every organisation that was studied had experienced problems with the resistance of the change and in motivating of the in-house people and those to be outsourced. On the other hand, specially the service providers reminded, that the people that are transferred to the service provider, would achieve better opportunities professionally as the organisation of the service provider is specialised in the real estate issues. Developing skills and knowledge, re-education and state-of-the-art knowledge can be reached more easily. In an organisation,



whose core business isn't real estate and facilities, the real estate personnel is always in a supporting role.

For example Khosrowpour (1995) found that in some cases evaluating the possibility of outsourcing might cause more harm than benefits. The evaluating process affects negatively to the working moral and insecurity of the personnel. Productivity and quality of the service may decline as a consequence.

In this study we found also, that the commitment of the personnel to the outsourcing decision is an essential challenge in the outsourcing process in the organisation. By involving the people in an early phase of the decision making, a company takes a conscious risk of losing the people and a low working morale. Some organisations have chosen to take the risk; some think it's better to keep them in the dark until there's a final decision that can be presented, specially, if the function in question is of an operational level. According to some views, it's up to the service provider to worry about the commitment of the people; it's more important to carry the outsourcing process through as efficiently as possible.

#### *Outsourcing management expertise*

The outsourcing organisation should develop an organisation-wide outsourcing strategy, that defines what kind of functions and expertise should be kept in-house and what kind of functions can be outsourced. The strategy should include the outsourcing objectives, means of monitoring the relationship and risks that the organisation is exposed to in general and within each outsourcing contract.

More bounded and focused expertise is needed to manage each outsourcing relationship on the level of an individual contract. Therefore every organisation need somewhat expertise in real estate management. Outsourcing management skills are equally important.

The organisation participating in this study considered the internal outsourcing management expertise to be the most critical criteria in addition to setting clear requirements and definitions of the functions that are outsourced.

#### **Assessing the attractiveness of outsourcing a certain function**

Make-buy analyses and other decision-making tools can be used, when the attractiveness of outsourcing is evaluated for a certain function. Basically, outsourcing decision is about how much decision-making power will be transferred to an external service provider. In evaluating the attractiveness of outsourcing, the companies studied here didn't have any consistent methods.

#### *Asset management services*

In Finland, it is fairly common that asset management related functions are managed internally, especially in organisations, which have an established and strong real estate management department. In some companies, parts of AM had been outsourced, particularly when the core business was related to IT or telecommunications. The organisations see little added value that a service provider could offer to asset management. Therefore few organisations expect to outsource asset management services in the future either.

#### *Real estate development*

In real estate development related functions, the operational tasks are typically outsourced, but the strategic decisions and planning stay in-house. No changes are expected in the future.

#### *Technical property management services and facility management/user-related services*

Real estate maintenance services have been outsourced to some extent in all the organisations studied. Most of the organisations had outsourced almost the entire activity. Typically the co-ordination and overall responsibility is still kept in-house, but the operational tasks outsourced. A majority of the organisations have a couple of strategic buildings, for which own maintenance staff is wanted. The service professionals are considered to have generally better expertise and better resources.

The situation within facility management services is quite similar: operational tasks are outsourced.

### **Designing the outsourcing relationship**

Designing the outsourcing relationship and selecting the supplier, are means of achieving the goals set to outsourcing arrangement. In designing the relationship, it is determined how much control is transferred to an outsider company. The internal decision of the intended relationship is influenced by the market analyses, and the final outsourcing decision may depend on the relationship design.

At the moment, a majority of the real estate related service contracts in Finland are fixed for 1-3 years, or continuous with a couple of month's period of notice. The nature of the relationship varies according to its goals. Longer-term contracts are considered to advance and facilitate the co-operation, thus usually the aim is to find longer-term partners. Some see, that with routine, operative tasks no partnership is necessary. The argument is that as there are a lot of supply in the market, the level of costs and quality should be tested ones in a while.

The concept of partnership is somewhat difficult in practice: no explicit definitions exist on what are the criteria of a genuine partnership. The organisations, however, seem to be able to identify the service providers, that are considered to be partners. The whole idea of partnership looks suspicious to some companies still: although partnership is aiming at an optimised result for both, the service providers are still doing business, not charity.

CRE-executives have been seeking to reduce the number of outsource service providers. The trend toward fewer and longer-term service provider relationships will increase the need for companies to carefully monitor and control service provider's opportunistic behaviour.

In asset management services, the outsourcing contracts have been longer, typically 3 years is considered a minimum period, and the relationship is a partnership in the beginning with. These arrangements are relatively new in Finland, so only after a few years can we look back and assess the deals.

Management companies' expertise is doubted to a certain extent, thus some companies don't want to outsource extensive service combinations. An argument behind this is also that companies don't want to become dependent of one service provider. Therefore one-stop-shopping is doubted.

Real estate management service providers have typically developed their own service concepts. The customers, however, may have different needs or views. The service concepts and the customer needs should meet better. The service providers shouldn't claim, that they know better the needs of the customer: services should be defined according to the customer's requirements.

Real estate management services providers have broadened their scope to new service areas, particularly construction companies have established property service providing companies. Thus the construction companies are aiming at being able to manage real estate during its entire lifecycle.

Some problems may occur, if a company offers management of services, but also provides the services – how the impartiality and control is guaranteed in such a situation.

In some cases the service set a company offer is so diverse that it remains unclear what the company actually is concentrating on. When new services are adopted, the customer organisation may start to suspect the expertise of the service provider. Therefore the service providers usually are strongest at their "traditional" businesses.

## Conclusions

The outcomes of an outsourcing decision-making are foremost depending on the situation. An arrangement, that is appropriate to one organisation, might not suit another organisation in different circumstances. This being said, common elements in the outsourcing decisions can be identified.

Clearly, outsourcing decision should be based on the core business and the real estate strategy of the organisation. Yet in Finnish companies, the strategic analyses and decision-making tools behind the outsourcing decision aren't well developed in the real estate sector. Any thorough outsourcing decision-making models specially developed for the real estate department functions, couldn't be found internationally either. Compared to Finland, in some other countries outsourcing of the real estate department functions is surely more advanced and an established activity to greater extent, but there's yet place for improvement everywhere. Particularly, attention should be paid to the underlying reasons to outsource: outsourcing should not be carried out as a habit or because others are doing so; the decision should be based on defining clear objectives and understanding of the process and the factors that influence to it.

Within real estate department functions, particularly in Finland, the definition of the services is essential, as it was found out, that management concepts are ambiguous for the time being. It is not explicitly known what in practise is offered, and what acquired. Sometimes management function and a full service package are confused.

In this research project, we aim to tackle these questions as well as other challenges that implementing of the outsourcing decision and management of the outsourcing relationship, bring about.

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