# Investigating profitability in the Facilities Management sector

Research for UNISON

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# Introduction

The introduction and subsequent increases in the National Living Wage (NLW) were expected to have the biggest impact on labour-intensive and low-pay sectors. Whilst the labour market effects of the NLW has been studied, there has been less focus on its impact on companies operating within specific sectors. The Office for National Statistics produces high-level estimates of operating surpluses across the economy, but these provide less detail and transparency about profitability by sector.

Among UNISON's membership low-paid workers are heavily concentrated in the social care and the facilities management sectors, both of which have been heavily contracted out to specialist private businesses.

This research focuses in on the Facilities Management (FM) sector to investigate how the NLW has affected the profitability and sustainability of the sector's companies and whether future rises are affordable.

We examined a range of companies over the years 2015 to 2021 to understand how their financial and operating situation has changed since the introduction of the NLW. In addition, we reviewed their commentary and wider industry analysis to understand how the NLW has interacted with other industry trends.

## About the author

Vivek Kotecha is a director at Trinava Consulting. He trained as a chartered accountant at Deloitte, where he worked as a management consultant. He then moved into policy and worked both in government and later in think tanks. He focuses on applying his expertise in accountancy and business to public policy and public interest issues. He has conducted a forensic analysis of how money is spent within the adult care home industry, evaluated options for PFI schemes, and recently examined the profitability of the children's care sector. Vivek has discussed his research and findings on BBC Panorama, on news programmes, and in newspaper articles.

# Summary of Main Findings

- The largest companies in the facilities management sector averaged operating profits of £369m a year between 2015 and 2020.
- Contrary to what many would assume, small and medium sized companies in the sector averaged profit margins double those of the largest companies between 2015 and 2019.
- The Covid-19 pandemic caused profits to dip, but 2021 results suggest profits are heading back to their former levels.
- Among large companies, employee remuneration has lagged behind increases in revenue.
- Small and medium sized companies are making an operating profit of almost £10,000 a year per employee, while large companies are making a profit close to £4,000 per employee.
- Evidence does not point to any slowdown in investment across the sector since the introduction of the NLW. In fact, investment levels have been rising.
- The bidding process characteristic of the sector in which facility management companies operate creates a downward pressure on wages to achieve cheaper bids. Therefore, the NLW provides a vital level playing field to counteract this tendency.

# Methodology

For this research we examined the accounts and financial performance of both the largest businesses in the sector and a number of small to medium-sized companies (SMEs). We identified the largest businesses of interest in the Facilities Management (FM) sector using recent estimates of market share (by revenue) from the Competition & Markets Authority (CMA).[1] Using these estimates we chose service providers with at least 5% market share for FM contracts with national coverage, alongside those providing services to nuclear sites. Based upon our criteria we identified 10 brands/groups that had at least a 5% market share.

For each business we identified the company/ies within their corporate group which best reflected the results of the FM business. For some businesses this involved looking at the results of a number of their companies.

**Table 1** Companies examined for 10 of the largest businesses in the FM sector[2]

| Business/Group name | Company examined | Average turnover 2015-2020 | Average operating profit margin 2015-2020 | Average operating profit 2015-2020 |
|---|---|---|---|---|
| Mitie | Mitie Group Plc | £2,205m | 6% | £141.3m |
| CBRE | CBRE Managed Services Ltd | £1,101m | 4% | £40.6m |
| Sodexo | Sodexo Ltd | £1,217m | 5% | £63.7m |
| ISS | ISS Facility Services Ltd | £780m | 2% | £13.0m |
| ENGIE/Equans | Equans Services Ltd | £552m | 2% | £9.6m |
| OCS | OCS Group UK Ltd | £457m | 1% | £6.2m |
| ISS | ISS Mediclean Ltd | £396m | 5% | £19.7m |
| JLL | Jones Lang LaSalle Ltd | £381m | 14% | £54.1m |
| Emcor | Emcor Group (UK) Plc | £290m | 4% | £11.7m |
| G4S | G4S Facilities Management (UK) Ltd | £249m | 2% | £5.5m |

[1] For estimates of market share for FM services with national coverage (including Total Facilities Management) and those to nuclear sites, please see Tables 1,2, and 6 of the CMA's decision (ME/6895/20) on the anticipated acquisition by Mitie Group Plc of Interservefm (Holdings) Ltd. Available at: https://assets.publishing.service.gov.uk/media/5fdb3357d3bf7f40d2f0a680/Mitie_Interserve_fulltextdecision.pdf (Accessed: 22nd February 2022).

[2] Operating profit margin is measured as EBITDA (earnings before interest, tax, depreciation, and amortization) and a % of turnover. It is a common metric for comparing business performance and is widely used by investors to measure operating profitability. EBITDA is calculated before exceptional items.

| Business/Group name | Company examined | Average turnover 2015-2020 | Average operating profit margin 2015-2020 | Average operating profit 2015-2020 |
|---|---|---|---|---|
| Securitas | Securitas Security Services (UK) Ltd | £269m | 4% | £9.5m |
| ENGIE/Equans | Equans FM Ltd | £240m | -4% | -£7.5m |
| ENGIE/Equans | Equans Buildings Ltd | £84m | 14% | £11.5m |
| JLL | Jones Lang LaSalle Services Ltd | £69m | -15% | -£10.8m |
| ENGIE/Equans | Covion Ltd | £15m | 8% | £1.3m |

Source: Review of annual reports and accounts filed at Companies House

In addition we analysed the financial performance of 356 small to medium-sized companies operating within the FM sector. We identified companies with relevant industry classification (SIC) codes that had operated throughout the years 2015 to 2020 with a minimum turnover of £500,000 and a maximum of £20,000,000.[3] We conducted further cleaning to remove companies that were part of the corporate groups of the largest providers, investment and holding companies, companies which only published a balance sheet, and those where all staff costs were recharged to other companies.

For both the large and small to medium-sized (SME) companies we analysed their financial performance over the years 2015 to 2020, and 2021 when available. In addition we reviewed the years 2015 to 2020 accounts of the largest companies and industry literature to understand the industry's dynamics and the impact of the National Living Wage (NLW).

[3] We looked at companies with the following SIC codes: 43210; 43220; 56210; 56290; 68320; 80100; 81100; 81210; 81229; 81299. These SIC codes matched those allocated to the largest FM companies.

# Key themes identified

Our industry analysis found a resilient sector which has overcome earlier negative publicity and innovated to meet growing demand, despite some staff shortages and new technological requirements. This adaptability had allowed many companies to maintain their profitability despite cost increases and invest in upskilling staff through new training and technological investments. These findings held for both the large and SME companies.

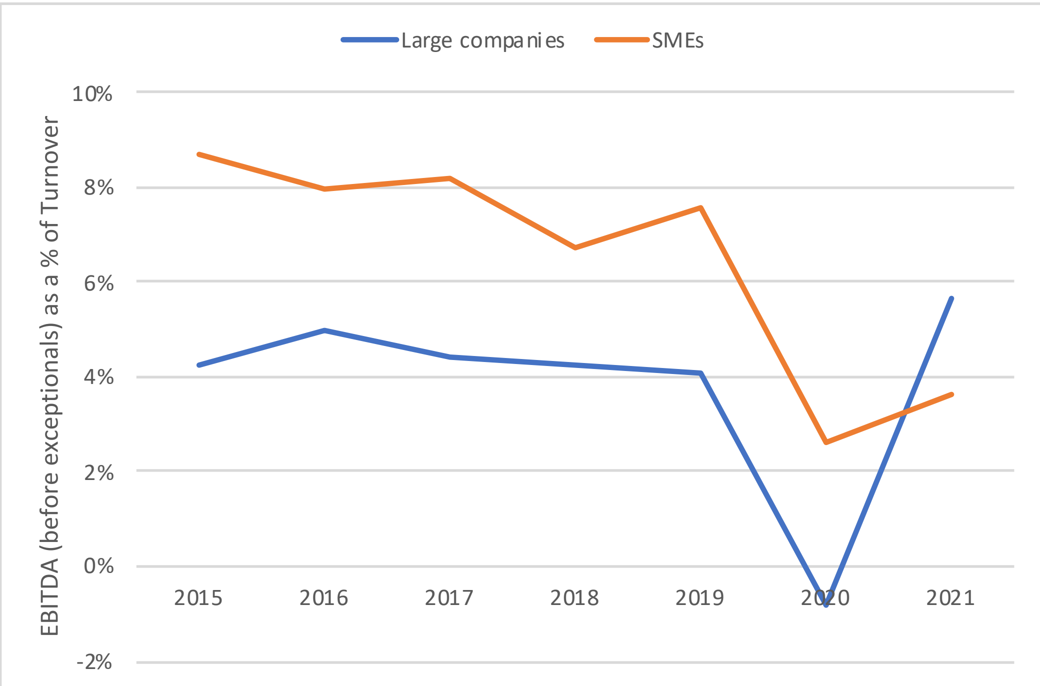
We identified 4 key themes from our analysis, and these indicate that the sector is resilient enough to manage further increases in the National Living Wage (NLW).

## Theme 1: Profitability has been maintained despite cost increases

Since 2015 the FM industry has been able to maintain consistent levels of profitability. This has been due to a growth in revenue, improved cost efficiency, and expansion into higher margin services.

Pre-2020 operating profit margins (EBITDA before exceptional items) averaged 4.4% for the large companies and 7.8% for SMEs. The 2020 pandemic, unsurprisingly, had an impact on these margins but there are signs of a recovery in those companies with published results for 2021.

**Figure 1** Average operating profit margin (EBITDA before exceptional items) for the FM industry split between the large companies and SMEs.[4]




Source: Review of annual reports and accounts filed at Companies House

[4] For the large companies only two had published accounts for 2021 when this analysis was carried out.

Employee remuneration has grown over the years but revenue growth has matched (or outstripped) it.[5]

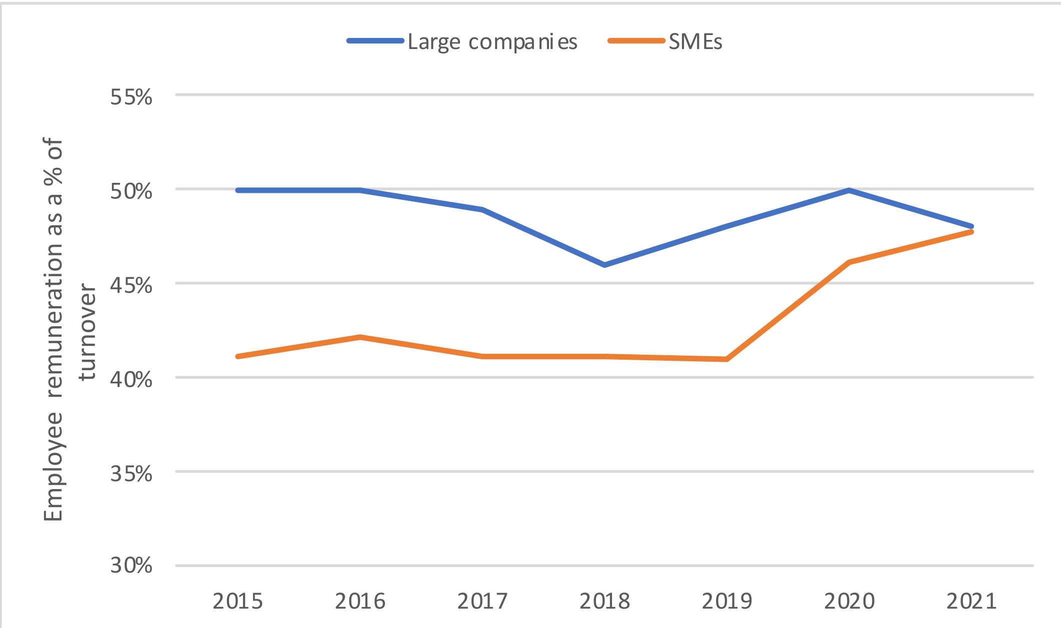
**Table 2** % change in aggregate revenue from 2015-2019 for turnover and employee remuneration for the FM sector split by large companies and SMEs

| % change from 2015-2019 | **Turnover** | **Employee remuneration** |
|---|---|---|
| **Large companies** | +12% | +8% |
| **SMEs** | +20% | +22% |

Source: Review of annual reports and accounts filed at Companies House

In 2020 there was a spike in the proportion of revenue that went to employee remuneration but this growth seems to be slowing down or reversing.

**Figure 2** Average employee remuneration as a % of turnover for the FM industry split between the large companies and SMEs[6]



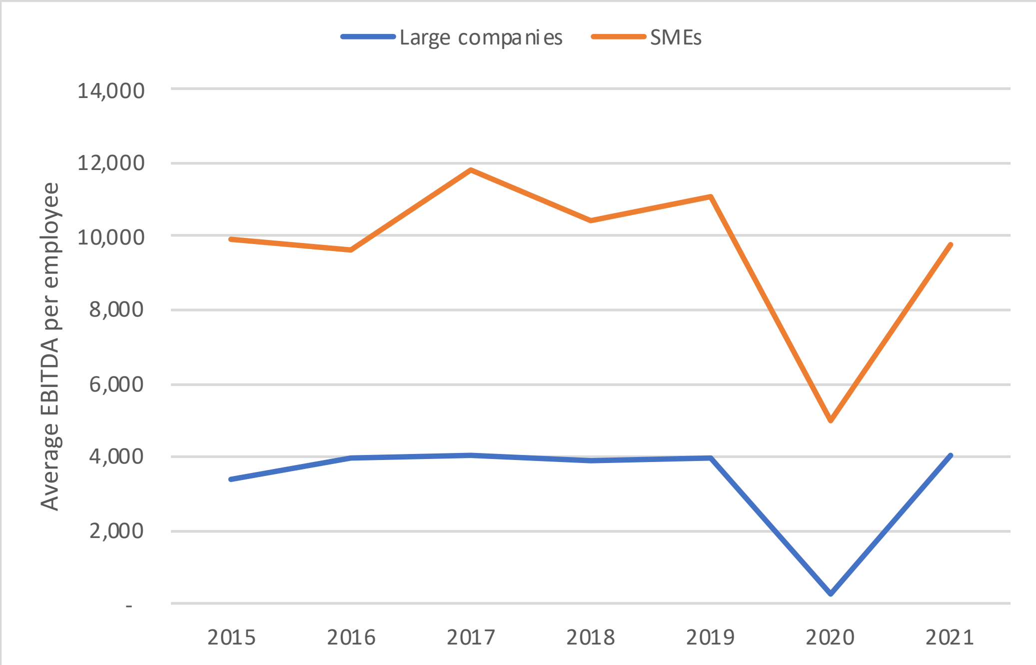

Source: Review of annual reports and accounts filed at Companies House

In addition the FM industry has managed to maintain high levels of profitability per employee. In effect despite increasing employee remuneration, profitability per employee has been steady (aside from the pandemic) driven by rising turnover and higher productivity.

[5] Employee remuneration consists of salaries, pension costs, and social security costs.

[6] For the large companies only two had published accounts for 2021 when this analysis was carried out.

**Figure 3** Average operating profit (EBITDA before exceptional items) per employee for the FM industry split between the large companies and SMEs.[7]




Source: Review of annual reports and accounts filed at Companies House

Overall the industry has been able to maintain its overall profitability and its profit per employee, which suggests that it has been able to generate more value in tandem with rising employee remuneration costs.

7 For the large companies only two had published accounts for 2021 when this analysis was carried out.

## Theme 2: Rising investment levels

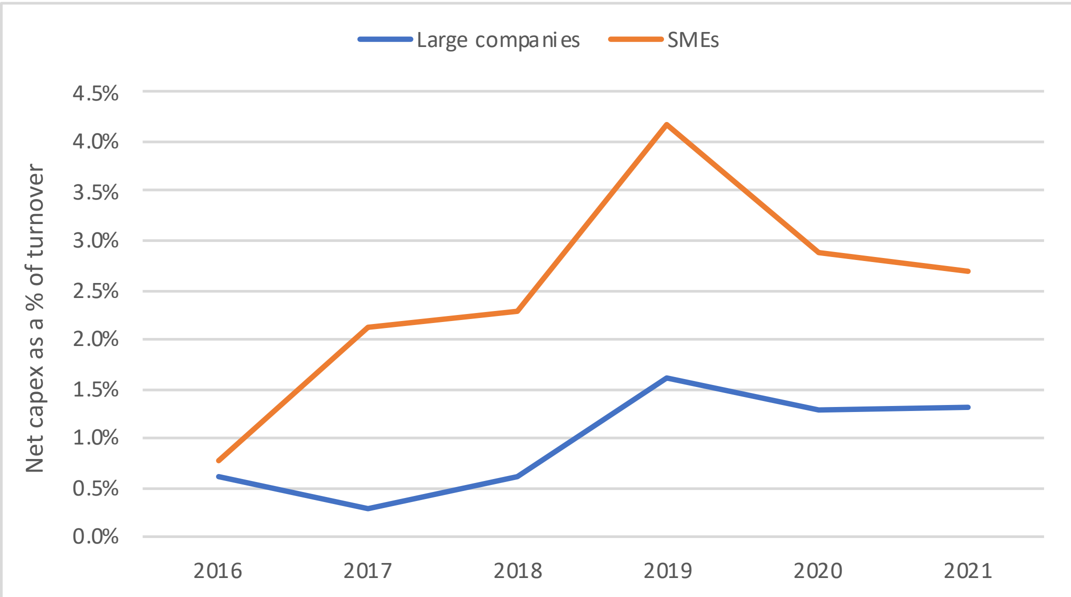
Earlier industry analysis by Deloitte noted that the FM sector was a slow adopter of new technologies and so was not harnessing opportunities to improve. Part of the appeal of investment is increases in accuracy and speed: "*The case for using more technology in business services is evident as it can improve the speed and accuracy of work, better inform the decision-making process and facilitate communication.*"[8]

In addition an improved technology suite offers: "*a range of opportunities for companies to differentiate themselves from the competition and drive efficiency.*"[9]

Reviewing the accounts of the FM industry we can see a trend to increase investments in IT and equipment. One way to measure investment is to look at how much has been spent on tangible assets (such as property, plant, equipment, software) over time, which can be measured through looking at net capital expenditure ("net capex").

For large companies their net capex has been rising since 2017 to reach 1.6% of turnover by 2019. For SMEs net capex has been rising since 2016 to 4.2% by 2019. This suggests that business investment has grown in recent years despite increases in employee remuneration.

**Figure 4** Average net capital expenditure ("net capex") for the FM industry split between the large companies and SMEs.[10]




Source: Review of annual reports and accounts filed at Companies House

[8] Deloitte (2018) 'Smart steps, new opportunities. Business Services Outlook 2018'. London, UK, p10. Available at: https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/bps/deloitte-uk-business-services-outlook-2018.pdf

[9] Deloitte (2018) 'Smart steps, new opportunities. Business Services Outlook 2018'. London, UK, p11. Available at: https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/bps/deloitte-uk-business-services-outlook-2018.pdf

[10] For the large companies only two had published accounts for 2021 when this analysis was carried out.

It's important to note that companies invest in technology and equipment for different reasons. Some were focused on using eLearning software and new processes/equipment to increase the skill and productivity of their employees. It could be that rises in the NLW have encouraged employers to invest more in their existing staff to the benefit of both the company and its customers. For example:

"*The Company is strongly focused on employee retention through strengthening of front line supervision at all levels. During the period a new training platform has been developed … and we have seen strong engagement in launch pilots*".[11]

"*With the backdrop of increasing wages, innovation in technology is imperative to drive productivity*".[12]

Another motive was to bring in technology to enable automation or use artificial intelligence in order to reduce the need for staff.

"*There has been investment in a national and global account structure … based upon providing alternative solutions to traditional guarding. This will allow us to offer our customers better security at the same or lower cost by creating security solutions that combine technology with on-site guarding, mobile services and remote guarding*".[13]

What's notable is that many companies and analysts speak of a labour market where there has been: "*less spare capacity … to fill the growing demand for talent*" and so this investment seems to have been a substitute for vacant positions and not primarily around reducing employee numbers in response to wage increases.[14]

The labour and skill shortages across the UK employment market coupled with a rising NLW seem to have spurred on increasing investment in technologies to enhance the skills and productivity of existing employees, and support them in the absence of sufficient numbers of colleagues. Industry analysts and companies predict that this trend will continue and so a positive spiral between wages, investment, and productivity gains may be in place in the industry for a number of years.

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[11] OCS Group UK Ltd (2018) 'Report and Financial Statements 31 December 2017'. Crawley, UK, p4.

[12] Mitie Group Plc (2017) 'Annual Report and Accounts 2017'. Glasgow, UK, p7.

[13] Securitas Security Services (UK) Limited (2016) 'Annual report and financial statements for the year ended 31 December 2015'. London, UK, p2.

[14] Deloitte (2018) 'Smart steps, new opportunities. Business Services Outlook 2018'. London, UK, p8. Available at: https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/bps/deloitte-uk-business-services-outlook-2018.pdf

## Theme 3: Competing for contracts pushes wages down unless counteracted by the level playing field of the NLW

The majority of the businesses analysed stressed the difficulties in recruiting and retaining sufficient numbers of employees. Increasing remuneration and benefits would seem to be one effective way for a company to help resolve their problems, however the FM industry is highly competitive and companies: "*do not have the ability to unilaterally raise prices in any individual service line, and face significant competition in all service lines*".[15]

Where facility management companies are bidding for outsourced public service contracts, there is a pressure to hold down wages to achieve a cheaper bid. And where businesses offer customers contracts which include the option for pay and conditions greater than the NLW (such as a Living Wage rate offered by companies that are accredited by the Living Wage Foundation as Living Wage Champions), the customer is often likely to choose the cheaper contract option at NLW.

"*The Company has minimum wage obligations as well as pressure for a range of 'living wage' levels, and the Company's ability to win and retain business is dependent upon the levels of wages that clients are prepared to pay. Wherever it can, with client support, the Company pays above minimum wage*".[16]

"*we expect employee wages will continue to be a key area of focus during contract negotiations… Our policy is to offer clients the choice of paying either current market wage rates, which may include the minimum wage rate, or an alternative outsourcing model to adopt a geographically appropriate, fair wage*".[17]

Increases in the NLW allow remuneration (and prices) to rise across the whole industry and side-step the intense downward pressure on prices and costs due to inter-company competition and customer-led pressure.

"*[The introduction of a NLW] was an important move for the outsourcing industry, as it affects all competitors equally and creates a level playing field in terms of bidding*".[18]

Better remuneration and conditions for employees may lead to industry-wide price increases, but customers are unlikely to stop using these services. A recent Competition & Markets Authority (CMA) review of the FM market found that customers: "*are unlikely to bring the services in-house, in part or in full, in response to an increase in price*". [19]

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[15] Competition & Markets Authority (2020) 'Anticipated acquisition by Mitie Group Plc of Interservefm (Holdings) Ltd, ME/6895/20'. London, UK, p26. Available at: https://assets.publishing.service.gov.uk/media/5fdb3357d3bf7f40d2f0a680/Mitie_Interserve_fulltextdecision.pdf

[16] OCS Group UK Ltd (2021) 'Annual Report and Financial Statements For the year ended 31 December 2020'. Crawley, UK, p12.

[17] Mitie Group Plc (2015) 'Annual Report and Accounts 2015'. Glasgow, UK, p15.

[18] Mitie Group Plc (2016) 'Annual Report and Accounts 2016'. Glasgow, UK, p15.

[19] Competition & Markets Authority (2020) 'Anticipated acquisition by Mitie Group Plc of Interservefm (Holdings) Ltd, ME/6895/20'. London, UK, p8. Available at: https://assets.publishing.service.gov.uk/media/5fdb3357d3bf7f40d2f0a680/Mitie_Interserve_fulltextdecision.pdf

This makes a NLW increase the best option to improve conditions in the industry without affecting its overall competitive balance. In addition, the FM sector employs an estimated 10% of the UK's workforce, so any increase in the NLW will have a big impact on some of the lowest paid workers.[20]

[20] Deloitte (2018) 'Smart steps, new opportunities. Business Services Outlook 2018'. London, UK, p4. Available at: https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/bps/deloitte-uk-business-services-outlook-2018.pdf

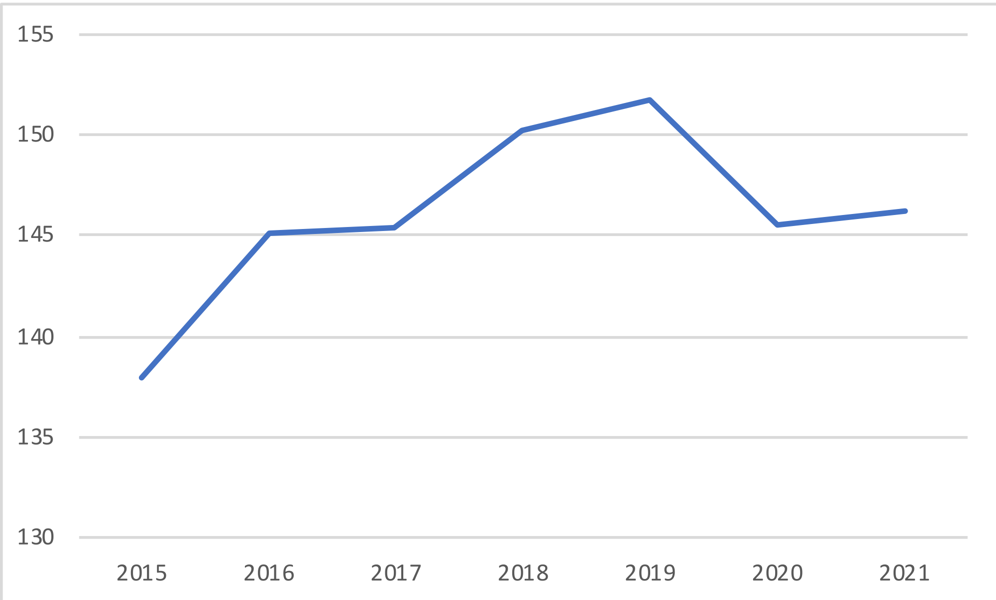
## Theme 4: A resilient and growing SME sector

Our analysis identified a notable distinction between the fortunes of the largest companies and the SMEs. The largest companies had long histories of restructuring in response to contract changes, growing their service offering, and financial difficulties. This meant that average pay per employee has barely grown, employee numbers fluctuated, and debt levels (measured by gearing) fell. In effect the recent history of the large companies has been one of investing in new service lines and cost control, although this has changed in the most recent (pre-pandemic) years.

During this same time period the SMEs have, in contrast, experienced strong growth: rising numbers of employees, higher average pay per employee, whilst still maintaining high levels of profitability.

Average remuneration per employee in the large companies was over £2,000 higher than for the SMEs in 2015 but by 2019 SMEs had an average pay almost £1,500 more than the large companies. For SMEs average pay has risen over those years (growth of 8%) whilst it has fallen slightly (by 3%) for the large providers.

**Figure 5** Average number of employees for SMEs in the FM industry




Source: Review of annual reports and accounts filed at Companies House

SMEs have managed to increase average remuneration whilst maintaining profitability per employee (see Figure 3) and increasing employee numbers. This suggests that this part of the industry has been profitably growing and could sustain further increases in the NLW.

## Conclusion

We find that the FM sector has overcome significant negative publicity to become a more stable and adaptable industry, and has utilized technology to enhance productivity. Increases in wages along with skill shortages has encouraged employers to invest in technology and training to enhance their employees' productivity.

Profitability has been maintained despite cost increases, investment levels have risen, and there are numerous thriving small to medium-sized companies (SMEs). One of the biggest constraints to improving wages has been the pressure placed on companies through competition and customer demands. Increases to the NLW is a way to improve pay (and retention) for a significant number of low-pay workers (around 10% of the UK's workforce) whilst also maintaining a level playing field.

Overall we find that the FM sector has been able to handle and build on previous increases in the NLW and seems able to continue to do so as it recovers from the impact of the pandemic.

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