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Worked Up: Shared Office Providers Face Rising Pressures

By Alex Wu

WeWork's postponed IPO has raised concerns about whether the Serviced Office Leasing industry's expansion is sustainable.

Rapid expansion efforts have substantially increased costs for shared office providers

The Serviced Office Leasing industry rents furnished office spaces, ranging from a desk, a suite or a whole floor, to businesses on an as-needed basis. WeWork is a major player in the industry and was once the darling among technology start-ups, valued at US$47 billion in January 2019. However, after WeWork postponed its anticipated IPO in September and dropped its valuation to US$10-12 billion, investors are questioning if the rapid expansion of WeWork and the Serviced Office Leasing industry is sustainable.

Flexibility and a sense of belonging to a community have attracted small- to medium-size business owners to co-working office spaces. Rising demand for industry services over the past five years has boosted industry revenue, which is expected to rise at an annualised 2.7 % over the five years through 2019-20. However, expansion efforts have exponentially increased expenses for industry firms as they have sought to keep up with demand. For example, WeWork's rapid expansion led to the company reporting a loss of US$1.25 billion in the third quarter ending September this year. This result is despite the company's revenue doubling to US$934 million over the same period. Similarly, industry player Servcorp Limited (Servcorp), which listed on the ASX in 1999 and has expanded its presence to over 20 countries, recorded an all-time high total revenue of AU$337.2 million in 2018-19, up by 7.9 % from 2017-18. However, the company's total expenses, excluding tax and significant one-time cost expenses, increased by 9.1 % over the year.

Overall positive economic conditions and business confidence are forecast to support the industry's growth over the next five years. As a result, industry revenue is projected to grow at an annualised 7.8 % over the five years through 2024-25. However, many industry firms face substantial risks from the possibility of an economic downturn, which would likely render their current high-expense business models unsustainable. For example IWG, the UK-based competitor of WeWork and the ultimate parent of Regus Australia, shut down its US subsidiaries in the wake of the global financial crisis.

The more traditional Office Property Operators industry has performed well over the past five years. Industry revenue is anticipated to grow at an annualised 2.1 % over the five years through 2024-25. Compared with the Serviced Office Leasing industry, the Office Property Operators industry is more mature and has a lower cost business model. DEXUS Property Group (Dexus), which has operated in the industry since 1984, has reported a 98 %

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occupancy rate in its office portfolio in 2019, compared with a 73 % occupancy rate for Servcorp. Total expenses for Dexus only accounted for 31.5 % of company revenue in 2018-19, compared with Servcorp's 96.3 %. Consequently, although Dexus recorded lower revenue growth than Servcorp, Dexus is more profitable.

On 20 November 2019, WeWork announced its decision to lay off 2,400 employees from its global workforce to focus on its core markets: the US, Europe and Japan. It is unclear how the layoffs will affect WeWork Australia. Nevertheless, the company's postponed public offering has raised questions as to whether the Serviced Office Leasing industry's growth is sustainable, with increasing competition among industry operators projected to constrain profitability. In the wake of WeWork's struggles, industry firms will most likely need to revise their expansion plans and expand their value-added service offerings to remain competitive.

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