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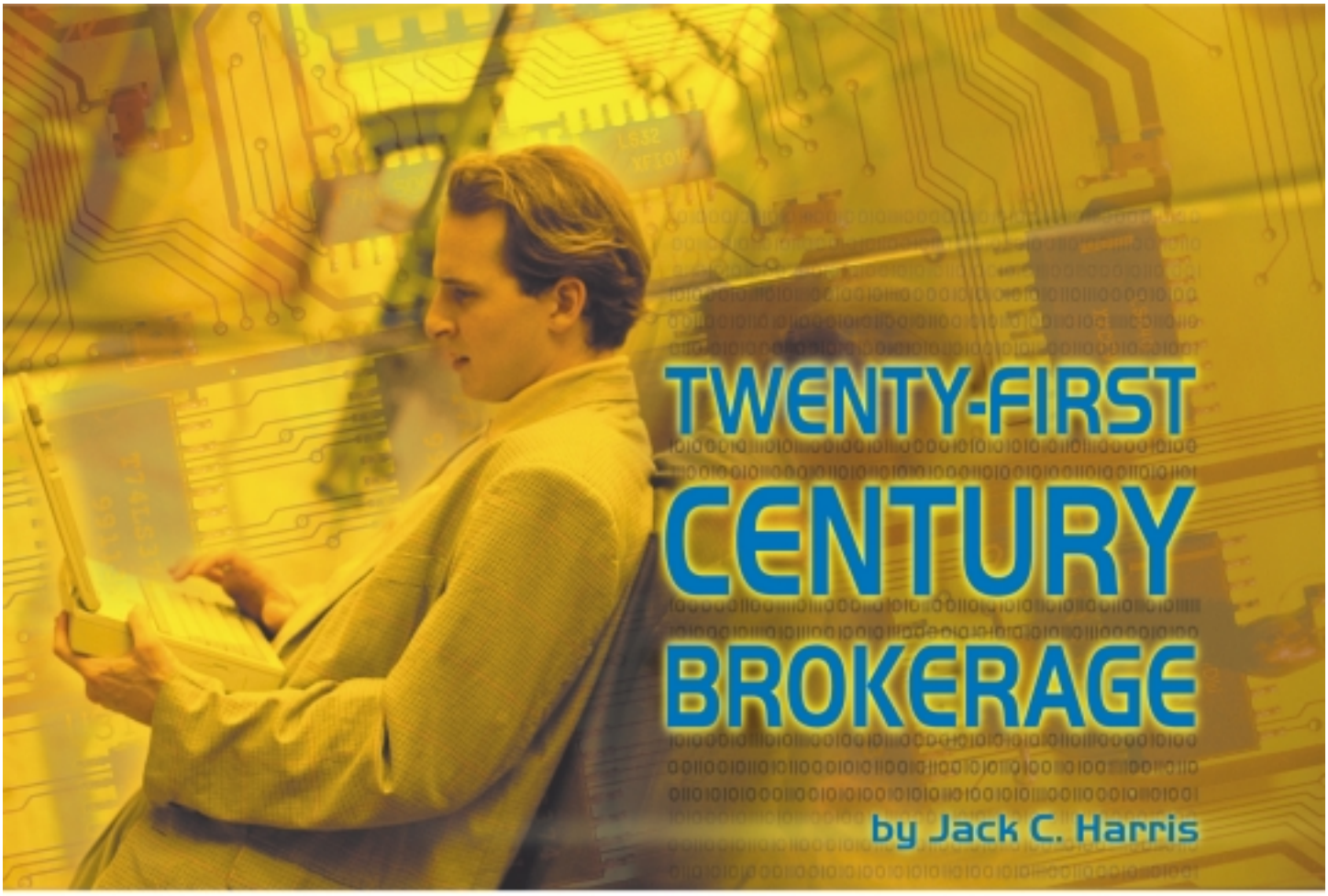

TWENTY-FIRST CENTURY BROKERAGE

by Jack C. Harris

Editor's note: This outlook is based on recently published articles and research papers presented at this year's meeting of the American Real Estate Society. For details, see the sidebar "Research Resources."

Although the transition to the new millennium began with few of the predicted professional and personal disruptions, the business world is reeling nonetheless from changes in the way business is being done. The secure position once enjoyed by established firms is being challenged by upstarts in sync with new technology.

Real estate brokerage, though not particularly high tech, is being affected as much as any business. Three major trends are responsible for most of the change.

- **New technology is being incorporated into brokerage operations.** The Internet has changed how prospective buyers enter the market. A recent National Association of Realtors (NAR) survey revealed that 37 percent of homebuyers used the Internet in their search (up from 2 percent in 1995).

  More real estate brokers also are embracing technology. In another NAR survey, three-fifths of brokers reported that they maintain websites, and more than 60 percent use e-mail to communicate with clients.
- **The domain of the independent brokerage firm is shrinking.** Franchises burst on the scene in the 1970s and grew to represent about one-quarter of the industry. After maintaining that share for years, they appear to be on the upswing. NAR officials report 38 percent of firms and 42 percent of agents are affiliated with a national franchise. Those who remain independent are often associated with referral networks and affinity programs.
- **The agency relationship is changing.** More buyers are demanding agents who represent them exclusively. New forms of agency such as transaction brokerage, in which the agent serves primarily as an intermediary, are being created.

Fewer, Larger, More Interconnected Firms

In a competitive market, the most successful firms operate most efficiently. In other words, they produce the most with the least. There are two components to efficiency. First, resources must be allocated in the most efficient manner. How a firm distributes its budget among advertising, salaries, agent compensation and other expenses determines how efficient it will be. Second, the firm also must get the most out of those resources to maximize efficiency. The most efficient firms get better results from the same allocation of resources.

THE RELATIONSHIP *between agent and client may be different in the future. Exclusive buyer representation and transaction brokerage are increasingly popular.*

The extent to which a business operates at less than maximum efficiency, which is defined as the highest level of output possible for a given set of resources, is known as *X-inefficiency*. A firm's X-inefficiency is measured by how much it differs from the optimal operating level. Researchers analyzing the X-inefficiency of real estate brokerages using NAR statistics from the mid-1990s found that as a group **franchised firms were significantly more efficient.**

Researchers found that franchises tend to add market share during active markets. In slow markets, their growth is arrested, but they manage to hold their market share. As market activity increases and it becomes easier to sell a home, firm affiliations and firm-name advertising become more important because the big fight is to get listings.

In an active (seller's) market, differences in service quality are harder to distinguish. Sellers know that their house is likely to sell quickly but use an agent to guide them through the process. One implication of this study is that the efficiency of franchise relationships contributes to their growing importance in the industry. (Note: the study did not consider profits, so franchisees are not necessarily making more money.)

Researchers repeatedly note the trend toward consolidation in the industry, which is explained as the result of significant **economies of scale and scope in today's brokerage market**. *Economies of scale* mean that as a firm's volume of sales increases, the cost of selling each additional property decreases. The larger the firm, the more profit it makes from each sale. *Economies of scope* mean that as additional services are added, their costs per client are lower, making it a matter of good business for a firm to provide a wide array of services, rather than specialize.

The benefits of economies of scale and scope suggest that **in the future, the industry will be dominated by a small number of large firms.** Until now, small, independent firms have been able to survive by developing expertise in narrow market segments (affordable housing, upscale housing) or by farming specific neighborhoods. In a highly active seller's market, this expertise is not as important as it is in a buyer's market, when salesmanship is crucial. Some small firms are merging, selling out and dissolving in the face of this pressure.

As a result, **the industry is becoming more monopolistic,** with relatively few firms doing most of the business. Researchers see this trend continuing, although they also see the Internet as opening the door for smaller firms to compete and giving consumers more information that can be used in dealing with an increasingly monopolistic industry.

A third trend is the **change in the relationship of agent and client** (both seller and buyer). Researchers cite the growing popularity of exclusive buyer representation and the emergence of transaction brokerage, in which the agent serves as an intermediary to arrange the transaction without representing either side.

Researchers surveyed Alabama real estate agents during a period when agency disclosure was made mandatory. The percentage of agents serving as buyer agents dramatically increased following the mandate but topped out and then declined in subsequent years. The drop was concentrated in the smaller firms.

The implication is that **changes in agency are a product of disclosure and possibly do not change significantly the manner in which an agent conducts business**. Likewise, they found limited long-term movement toward transaction brokerage.

Probably of greater importance to the way agents will operate in the future is the way the industry is changing. **The importance of marketing networks and affiliations make the agent a part of a larger system**. This could narrow the agent's role as a specialist within a team of financial service providers. The economies of scope previously noted give support for further expansion of "one-stop shopping" business plans and widen the array of services provided within the brokerage firm. Whether this acts to marginalize or empower the individual agent depends on how much the agent is able to and cares about participating in these supplemental areas.

Possible Futures for the Industry

Researchers have constructed alternative scenarios for how the brokerage industry may evolve, based on two presumptions:

- Changes will be market driven and will reflect what consumers want. Technology gives consumers the power to force service providers to comply.
- Viability of small, independent brokerage firms is highly questionable given the advantages of size and affiliation.

The scenarios are presented in order of the least to most change from the way real estate agents operate currently.

Product extension. This scenario extends what many brokerage firms are doing already — broadening into complementary service areas such as mortgage brokerage and insurance. The number of auxiliary business arrangements and partnerships with specialized service providers would grow.

Alternate delivery. Taking securities brokerage as a model, this scenario gives consumers a choice between traditional full-service brokerage and discount brokerage packages. Consumers who wish to rely on their brokers to handle entire transactions will choose full-service firms. Those who wish for a more limited set of services — listing, showing or contract

negotiation — can choose a firm that lets them select from a menu of "unbundled" services. Agents working for these firms will become specialists in various aspects of the business.

Financial supermarket. Brokers who offer point-of-sale mortgage origination encroach on the loan officer's turf. Conversely, suppose that lenders move into the area of property brokerage as part of the creation of a financial supermarket handling a broad range of services. In this scenario, brokers would be closely affiliated with lenders, perhaps even working as employees. The real estate transaction would be viewed by the firm as just another way to attract customers to the bank. Agents would be even more narrowly specialized in marketing property.

Unbundled services. If most consumers wish to control the home selling and buying process themselves, armed with Internet-provided information and selected professional services, then the unbundling portion of the *alternate delivery* scenario will dominate. Brokerage firms will offer services for a fee as demanded by consumers, which may also shift some of the cost explicitly onto the buyer. Agents will become more like consultants and will be involved in a more limited way in the home search process and the closing transaction details.

FSBO. This scenario pushes the broker into a much smaller role. Buyers and sellers interact via the Internet with no assistance from agents. Much of the marketing function is taken over by Internet listing firms. As services are needed, they can be contracted individually, as in the *unbundled services* scenario. The difference is that in this scenario agents compete against other service providers for the market. This is the most drastic transition for the traditional broker and assumes that the typical homeseller and buyer have the time, knowledge and inclination to do most of the work themselves.

These are unsettling thoughts for real estate professionals but cannot be ignored. Recognize that each of those scenarios is based on a different concept of the consumer. In a society of growing affluence, will most people want to take more control of the home-selling process? Or might they prefer to let a professional handle it as long as they are kept well informed?

Survival of an Industry

Those who view the real estate brokerage profession primarily as a dispenser of proprietary data will see technology advances as a definite threat to the industry. The Internet has made available a vast array of data and information. If that is all the real estate industry has to offer the public, the profession probably is in trouble.

If, however, the profession is instead viewed as a specialized services provider, technology is not a threat — deregulation is. There is a movement away from legislation that protects specific segments of commerce for particular professions. The latest example is the Gramm-Leach-Bliley Act, which repealed Depression-era restrictions on the kinds of business financial institutions can do. In the future, real estate agents may find other professions doing things they used to do exclusively.

If the real estate agent is seen as someone who guides and advises the consumer through a complicated process, the profession's future appears more secure. No matter how much information is at hand, or how many professions are competing to provide needed services, some consumers will desire experienced professionals to put everything together. Will there be enough consumers like these to support the industry? The biggest sales job today's agents face is providing an indispensable service that will continue to be highly valued in the marketplace of the future.

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Research Resources

- **Future scenarios.** "The Future of the Real Estate Brokerage Industry" by G. Donald Jud, University of North Carolina at Greensboro and Stephen E. Roulac, president, the Roulac Group.
- **Industry structure.** "A Panzar-Rose Analysis of the Residential Real Estate Brokerage Industry" by Randy I. Anderson, Seton Hall University, Leonard Zumpano, University of Alabama and Danielle Lewis, Southeastern Louisiana University.
- **Listing versus selling.** "Optimal Economies of Scope in the Residential Real Estate Brokerage Industry," by Anderson and Lewis.
- **Implications of franchising.** "Residential Real Estate Brokerage Efficiency and the Implications of Franchising: A Bayesian Approach," *Real Estate Economics*, fall 1999, by Anderson and Lewis.
- **Future industry prospects.** "The Residential Real Estate Brokerage Industry: An Overview of Past Performance and Future Prospects," *Journal of Real Estate Research*, January 2000, by Anderson, Zumpano and Harold Elder, University of Alabama.
- **Agency disclosure.** "Agency Disclosure to Consumers and its Effect on the Marketplace: An Empirical Study of Alabama Real Estate Agents," by Bruce Gordon and Keith Absher, University of North Alabama.

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