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THE FUNDAMENTAL FLAW AT THE HEART OF ESTATE AGENCY

AND HOW TO FIX IT

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INTRODUCTION

The old guard of estate agency may often be heard state "don't negotiate on fees". This is an understandable approach where most agents have little defensibility to their businesses. However, it is the wrong attitude.

Negotiating on fees isn't a problem; it's how estate agency fees are structured in the first place that is the problem.

BACKGROUND

This matter goes to the heart of assessing whether the offline or online model is "correct." As things stand in respect of fees today, it seems obvious that even the new breed of online agents cannot ever truly be loved by the public.

Now, the clamour of people pointing to Trustpilot's unbelievably positive ranking of Purplebricks is deafening at this point. But hear our argument out.

We contend that the rise of online agents is more about innovation than true disruption, which is the subject of a future blog, but perhaps true disruption ought to come from a different approach to fees.

Traditionally, agents have sold properties for a percentage of the final selling price. No upfront fee, just a commission on success. That makes sense in broad strokes but the question has always lingered – "is the agent truly incentivised to push for an even higher price on behalf of their vendor?"

Take, for example, a £200,000 apartment in any regional city. With an average fee of 1.3% (according to Which) that is a gross income for the agent of £2,600. If the sales price is £190,000 then the fee is £2,470 and if the sales price is £210,000 it is £2,730. That is a range of £260 – hardly the difference between life or death for the business. Indeed, this is amplified by the fact that the individual responsible for handling the sale – namely the negotiator in branch – is likely to be on no more than 10% commission (at a generous agent), meaning the marginal difference between achieving a sale price of £210,000 versus £190,000 is £26. Hardly motivational, even assuming hard cash is why they go to work in the first place!

The online agents have a different approach. They are paid on listing, not on a sale. While their fee is lower than traditional agents, the consumer must then accept the fact that the agent is not necessarily incentivised to sell the property at all. Once the listing is taken, that is job done. Cash banked, as it were.

MISALIGNED INCENTIVES

Regular readers of these musings will know that we are students of Freakonomics and won't be surprised to hear that this issue has been covered in great detail here.

It will be even less surprising to hear that the Freakonomics authors concluded that the traditional commission based real estate model doesn't incentivise agents to achieve the best price. We further contend that the new breed of agents is even less incentivised to do so.

In the traditional agency world, the difference between significantly higher or lower sales prices is often immaterial to the agent. In the online agency world, achieving a listing is what matters, not selling a property.

This misalignment of incentives is the fundamental reason why people distrust estate agents. Sellers want to achieve the highest price for their property as quickly as possible. Neither model is structured to achieve this.

THE SOLUTION

So, how can it be fixed? Simple.

Eventually, a market participant will offer a fee structure that aligns incentives. In broad terms, this will have three criteria:

1) A very low (or zero) listing fee;
2) A sales price set by the vendor; and
3) A 50/50 share of upside, between agent and seller, over and above that asking price

In this scenario, everyone's incentives are aligned. The seller doesn't have to pay to list but is encouraged to be realistic with their asking price because they will want their agent to work hard to sell their property, while the agent is encouraged to work hard for the best sales price for their client due to the potential for much greater fees.

Nested are close to getting this right, but the fundamental issue with their model is that they are incentivised to bring properties to market at a below-market-value price. This is still a misalignment with vendors.

It seems clear that online agents, with their historic data, should be best placed to build a pricing model that ought to mean greater revenues than they achieve today, but even a traditional agent could take significant market share by adopting this approach.