

# Issues in disintermediation in the real estate brokerage sector

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## Abstract

This article introduces new models of disintermediation of the real estate broker by the buyer or the seller. The decision to retain a real estate broker is critical in the property purchase/sale process. The existing literature does not contain analysis of: (1) information asymmetry, (2) the conditions under which it will be optimal to disintermediate the broker, (3) social capital and reputation, (4) the impact of different types of real estate brokerage contracts. The article shows that disintermediation of the real estate broker by the seller or buyer may be optimal in certain conditions.

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## 1. Internet-based disintermediation in real estate transactions

In the US, the residential real estate brokerage industry alone has annual revenues of more than \$60 billion. The industry is regulated, is consolidating, and commissions are declining in some markets. Many companies have tried (mostly un-successfully) to shift brokerage operations onto the Internet. These companies have learned to use the Internet as a marketing, information-resource and educational tool [18,94,21,36,92,14].

## 2. Existing literature

The existing literature on the economics of real estate brokerage, provision of online information, and possible disintermediation is extensive, see: [51,72,106,95,31,86,78,39,59,84,69,88,89,79,70,5,91,108,110,100,12,104,9]. On dynamical system, also see: [17,35,45,1,55,98,57,56,76,97,6,54,101,64,46,63,40,26,86,32,37,44,41,58,75,81,83,101,105,18,47,34,7,3,4,11,15,19,50,60–62,67,68,71,74,77,79,96,102,99,103,107,111,109]. On reputation and social capital, see: [29,22,49,20,93,2,27,90,43,8,87,48,80,38,23,33,73,65].

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However, the existing literature omits the following analysis:

- The amount of information that the real estate Broker should provide on the web.
- When the Broker should provide information on the web.
- Relevant conditions under which the buyer and or seller should disintermediate the real estate broker; and quantification of such conditions.
- Quantification of effects of the type of real estate brokerage contract; and constraints imposed by the brokerage contracts.
- Differentiation among different types of customer search costs (physical and Internet).
- The buyer's/seller's decision to retain or disintermediate a real estate Broker within the context of the buyer's and seller's Social Capital and or Reputation Capital.
- Effect of Broker's Social Capital and Reputation Capital.
- Incorporation/recognition of limitations of Rationality in economic analysis/modeling – brokers, buyers and sellers are subject to emotions, regret, risk-aversion, and other psychological effects.
- Analysis of buyer utility gained from interactions with Broker; analysis of seller utility gained from dealing with the Broker. Most studies erroneously equate buyer/seller utility with monetary outcomes for the buyer/seller.
- Elimination of 'equilibrium' in economic analysis [30,53,10,24].

### 3. Models

This section develops theoretical models of real estate brokerage, information asymmetry among the broker, buyer and seller; broker supply of information via the Internet, and possible disintermediation of the broker. The models result in testable hypothesis about:

- When the Broker should provide information on the web. The optimal amount of information that the Broker should provide on the web.
- When the buyer should disintermediate the broker.
- Conditions under which the seller should disintermediate the broker.
- The Broker's objective function.
- The effects of social capital and reputation capital on the decision to disintermediate or hire the broker.

*Assumptions:*

- Brokers do not restrict access to information that they provide on the Internet.
- The only difference in Closing Costs between situations where the broker is used and where the broker is disintermediated, is the Broker's fees.

$P$	estimated/appraised value of housing unit, $P \in (0, +\infty)$ ,
$P_b$	the value of the housing unit to the Buyer, $P_b \in (0, +\infty)$ ,
$P_s$	value of home to the Seller, $P_s \in (-\infty, +\infty)$ ,
$c$	percentage commission rate paid to Broker by Seller, $0 < c < 1$ ,
$B_b$	broker's total fixed cost of providing information to a buyer – this includes rent, utilities, subscriptions to databases, telephones, administrative staff, operating expenses, etc. Most are fixed costs and semi-fixed costs, $B_b \in (-\infty, +\infty)$ ,
$B_n$	Broker's total cost of searching for a new client. Assumes that broker has to prospect $n$ number of prospective clients for each actual new client obtained, $B_n \in (-\infty, +\infty)$ ,
$B_{op}$	Broker's total operating expenses per transaction. Assumes that broker has to prospect $n$ number of prospective clients for each actual new client obtained, $B_{op} \in (-\infty, +\infty)$ ,
$B_s$	Broker's fixed cost of dealing with seller and listing property, $B_s \in (-\infty, +\infty)$ ,

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