

THE EVOLUTION OF THE REAL ESTATE BROKERAGE MARKET: THE CASE OF SWEDEN

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ABSTRACT

Purpose – The Swedish real estate brokerage market has experienced a number of major changes since the turn of the millennium. The purpose of this paper is to analyze the most important factors influencing the competition for real estate brokers in the market.

Design/methodology/approach – This paper uses the five forces model put forward by Porter (1979) and complements it with the dimensions of digitalization and innovation (Cliffe, 2011; Friedrich *et al.*, 2011) to analyze the real estate brokerage market in Sweden. The empirical data come from two sources: the Swedish Estate Agents Inspectorate and Statistics Sweden.

Findings – The results show that the most substantial forces shaping the competitive environment within the industry are digitalization and the increased power position of customers. One important trend is the increased use of different business models and elaborate incentive structures. The results also highlight the fact that the Swedish real estate brokerage market is one of the most competitive and, therefore, one of the most efficient in the world. The study also indicates that the real estate brokerage profession has evolved from a male-dominated profession to a profession preferred by women.

Originality/value – This study is one of the first to analyze the development of the real estate brokerage market over time, using the five forces model by Porter (1979). It is also one of the first studies to discuss gender and income within the real estate brokerage market.

Keywords: Real estate brokerage, Competition, Digitalization, Pricing, Innovation

INTRODUCTION

The largest transaction that most individuals carry out in life is buying or selling a home (Case, 1978; Mulder and Wagner, 1998). In many nations, the dream of owning a home is an integral part of the culture (Fisher and Jaffe, 2003; Wu, 2010), and realizing this dream often requires a real estate broker¹. From the buyer's or seller's perspective, the competition within the real estate brokerage market is therefore of great importance (Crockett, 1982; Sirmans and Turnbull, 1997; Rutherford and Yavas, 2012). Previous studies have shown that the brokerage market in the United States has a number of distinct characteristics in comparison to other more competitive markets, such as a high degree of fixed commissions (Yavas, 2001; Schnare and Kulick, 2009), substantial transactional inefficiencies (Johnson *et al.*, 1988; Miceli *et al.*, 2007) and problems with dual agency (Gardiner *et al.*, 2007).

The Swedish real estate brokerage market differs from those of some other countries – namely, the U.S. market, where both sellers and buyers often use their own real estate brokers to help sell or find property (cf. Delcoure and Miller, 2002; Benjamin *et al.*, 2007). The Swedish case is such that only the seller contracts a real estate broker, who in turn has an obligation, by law, to be impartial toward both the seller and the buyer (Jingryd, 2008; Schick, 2012).

The purpose of this article is to analyze the development of the Swedish real estate brokerage industry in the new millennium, with a particular interest being paid to the changing competition owing to some important trends within the market. By employing the theoretical framework on competition presented by Porter (1979), complemented with recent research (Cliffe, 2011; Friedrich *et al.*, 2011), and using empirical data from a number of sources, this paper aims to shed some light on the real estate brokerage market in Sweden.

The remainder of the paper is structured as follows: In the subsequent section, the theoretical framework necessary for analyzing the competition in the market for real estate brokerage is described. Next, the different sources of information used in this paper are presented. An empirical discussion that closely follows the theoretical framework is then put forth. Finally, the

¹ In this paper, the terms *real estate broker*, *real estate agent* and *realtor* are used interchangeably.

conclusions are presented, serving as a discussion of possible policy instruments that could be implemented to help improve competition in the market.

THEORETICAL FRAMEWORK

Analyzing the development of industries has been the focal point for a great deal of research efforts in the past. Over time, different perspectives have been employed in describing the importance of various external and internal forces that shape the development of industries and markets (Forrester, 1997). According to Schumpeter's (1942) analysis, the driving force behind industrial development is innovation, and substantial barriers to entry exist for small firms. Other researchers have also highlighted the importance of barriers to entry and exit (cf. Caves and Porter, 1977). Nelson and Winter (1982) expanded the framework by adding the effects of changing technological and institutional conditions, which might arise from governmental policies, and the impact of these changing conditions on competition. Aldrich (1999) added an evolutionary perspective on industry development in which variation, selection, retention and struggle among firms are important forces that shape competition and development.

The present paper's analysis of the development of the competition within the real estate brokerage industry is based on the five forces model put forward by Porter (1979). The five forces model was influenced by earlier research (cf. Schumpeter, 1942; Caves and Porter, 1977). This paper expands upon the five forces model with the addition of two more forces – digitalization and innovation (cf. Cliffe, 2011; Friedrich *et al.*, 2011). The five forces model has been criticized by some authors as being hard to operationalize (Lee *et al.*, 2012) and for being frozen in time (Grundy, 2006). Although there might be some validity to those authors' claims, this paper supports the claims of other authors that the model is handy, quick to use and, foremost, easy to understand (Spanos and Lioukas, 2001; Song *et al.*, 2002; Schwenger *et al.*, 2014).

In his seminal work from 1979, Porter presented five key elements describing how competitive a market is. The five forces model has been widely used in analyzing the competition in numerous industries over the years (see Fulmer and Vicere, 1996; Blair and Buesseler, 1998; Birkinshaw *et al.*, 2005; Sledge, 2005). In the following subsections, Porter's five forces for analyzing the competition within industries are presented together with the additional forces of digitalization and innovation.

Bargaining power of suppliers

Markets that are dependent on powerful suppliers tend to exhibit more competition (Porter, 1979). There are examples of markets where there is no fallback supplier, which means that the

bargaining power of the supplier will be enormous in these markets. Any excess profits in such a market will be extracted by the powerful supplier, which essentially increases competition in the market.

Bargaining power of buyers

Similarly, when buyers have strong negotiation power, sellers will have to compete for existing customers. This situation is evident in a monopsony market, where there is only one buyer but many sellers. Because all sellers are dependent on selling to the one specific buyer, there is no room for increased prices. Of course, the less bargaining power that buyers have in a market, the less the competition will be between sellers (Porter, 1979).

Threat of substitutes

The threat of substitute products or services is basically seen as the level to which they are exchangeable. Quite intuitively, when a good (or service) has a very close substitute, the price of that good (or service) will be essentially controlled by the price of the substitute. In the extreme case of perfect substitutes, only the substitute will be demanded if the price for one of the goods (or services) is higher than the other.

Threat from new entrants

According to Porter's (1979) analysis, a vital aspect in describing the profitability and attractiveness within industries has to do with the threat of new entrants. If there are sufficiently large entry barriers to a market, already existing actors in that market will be able to see excess profits without new competitors entering. Barriers to entry are traditionally divided into three subcategories, two of which may be of interest to this specific case (Porter, 2008):

1. natural barriers to entry, which are normally present in industries with very high capital costs, such as mining,
2. legal barriers to entry (e.g. licenses, permits) and
3. strategic barriers to entry, which refer to the specific behaviors of already existing actors in the market that deter additional competition.

The mere threat of new entrants to the market, in the absence of other barriers to entry, can induce already existing firms to keep their prices down so as not to earn excessive profits, thereby deterring new firms from being attracted to the market (Porter, 1979).

Digitalization

Friedrich *et al.* (2011) added the concept of digitalization to the original model by Porter (1979), and in their analysis, they presented the following four aspects of digitalization: digital input, digital processing, digital output and infrastructure. Of these four aspects of digitalization, digital processing is perceived to be the most important factor shaping the competition in industries. Digital processing includes customer relationship management, service management and distribution of knowledge within the firm. The digitalization of industries has been considered to be one of the most important game-changers (Frank, 2004).

Innovation

According to the resource-based view of the firm, the resources controlled by the firm represent the determining factor in gaining competitive advantage (Peteraf, 1993; Barney, 2001). One such key resource is the innovativeness of the firm. Previous research has indicated that industry innovativeness is one of the most important factors shaping attractiveness and profitability within industries (Hussain and Ilyas, 2011; Srivastava *et al.*, 2013). Traditionally, research on innovation has focused on the technological breakthroughs, but over time, more and more studies have investigated innovations within services (Hipp and Grupp, 2005).

Rivalry between competitors

The final force shaping industry competitiveness is the rivalry between existing competitors (Porter, 1979). The stronger the previous forces interact, the more competitive an industry is – or in Porter's (1979) words, it is about "jockeying for position" (p. 141), using different tactics, such as price strategies, advertising and innovation. According to Porter (1979, 2008), the five forces model can be applied to every industry. Previous studies have used the five forces model in analyzing a number of different industries such as banking (Siaw and Yu, 2004), tourism (Crouch and Ritchie, 1999) and universities (Pringle and Huisman, 2011).

METHOD

The empirical data of this paper were obtained from two principal sources. One principal source was the Swedish Estate Agents Inspectorate (FMI), which is a governmental authority that is part of the Department of Finance. The FMI examines applications for registration as an estate agent, maintains a central register of estate agents, exercises supervision of the registered estate agents and provides information on codes of practice for estate agents. The FMI employs 16 individuals, including eight lawyers who work full time with the task of supervising the real estate agents in Sweden. Furthermore, the FMI includes a disciplinary board, which consists of members appointed by the government. The FMI issues a yearbook that contains information on disciplinary cases and also publishes reports that include information about wage structure, the

number of registered real estate agents and so on. The data from the FMI are considered to be both reliable and valid.

Another principal source of data for this paper was Statistics Sweden. This administrative agency is responsible for supplying customers with statistics for making decisions, carrying out debates and conducting research. The Swedish government and different Swedish agencies are mainly the ones that assign these tasks to Statistics Sweden, but it also has customers in the private sector and among researchers. In addition to producing and communicating statistical data, Statistics Sweden is tasked with supporting and coordinating the Swedish system for official statistics, including taking part in international statistical cooperation. Today, Statistics Sweden employs more than 1,300 individuals (www.scb.se).

EMPIRICAL ANALYSIS

Porter's (1979) five forces for competition as well as the forces of digitalization and innovation are addressed separately in the following subsections as a way in which to portray and analyze the current situation of competition in the market.

Bargaining power of suppliers

A few decades ago, realtors reached potential homebuyers primarily through newspaper ads. These have, however, drastically diminished in importance and been replaced with specialized webpages. Instead, newspaper ads are an important source for reaching sellers, not buyers, in the Swedish context.

With a market share of around 90 per cent of all transactions, one company – Hemnet (www.hemnet.se) – has been dominating the Swedish market for well over a decade. Recently, some competitors have surfaced, trying to gain market shares; however, they have not yet caught up to Hemnet. To advertise a sale on Hemnet, one has to be a registered realtor, which means that sellers who choose to sell without hiring a realtor are excluded from this service. According to Hemnet, the website has 1.6 to 1.8 million visitors per week and posts approximately 220,000 real estate listings per year. This alone would suggest that Hemnet, as a supplier to realtors, has a relatively large bargaining power. Up until recently, Hemnet did not charge realtors to post their real estate listings on its website. This changed in February 2013 when a fee of 600 SEK (approximately 100 USD) was introduced. Subsequently, it was raised to 1,200 SEK, and today is 1,600 SEK (approximately 250 USD). The reasons behind Hemnet's decision to charge this fee have been technological change and decreasing ad revenues owing to customers' increased use of smartphones rather than computers. This fee has received quite a lot of criticism. To

conclude, this fee is still small in relation to the costs of hiring a realtor, but customers' reactions to future fee increases will be interesting to follow.

Hemnet is owned by four actors: Swedbank, a Swedish bank and real estate agency (34%); Svensk Fastighetsförmedling, a Swedish real estate agency (16%); Fastighetsmäklarförbundet (FMF), an interest organization for real estate brokers (25%); and Mäklarsamfundet, an interest organization for real estate brokers (25%).

Bargaining power of buyers

Choosing a real estate broker is a decision made with some degree of uncertainty. The seller does not know beforehand whether the realtor will be able to sell the property in a timely fashion or whether the realtor will be able to reach the reserve price set by the seller (Olazabal, 2003). Commonly, contracts between sellers and realtors include a period of time when the realtor has the sole right to sell the property; this is typically set to three months (www.fmi.se). If the seller chooses to hire another realtor within this time frame and the property is sold, the first realtor is entitled to compensation. In general, the realtor is considered to have the upper hand when it comes to information regarding valuation of the property.

Because the realtor is considered to be the stronger party in the relationship, a number of regulations have been implemented to increase the bargaining position of the seller (www.fmi.se). Several parts of the Estate Agents Act of 2011 emphasize the importance of transparency; for example, a record must be made of the amount of benefits the realtor receives from other services, and a so-called brokerage journal must also be kept. In a brokerage journal, the realtor writes down all the different elements of the process, from the first visit with the seller to when the keys are handed over to the buyer. There are about 50 to 70 different operations that must be specified, and this documentation will then be distributed to the parties involved. A new part of the legislation is that the bidding list must be distributed with the names and telephone numbers of individual bidders. This new law creates greater transparency and trust in the bidding process and instills confidence in the industry.

Over time, the new legislation and policies adopted by the FMI have focused on the promotion of transparency and the power balance within the industry, and the development seems to suggest that sellers have a greater bargaining power in relation to that of realtors in the Swedish market.

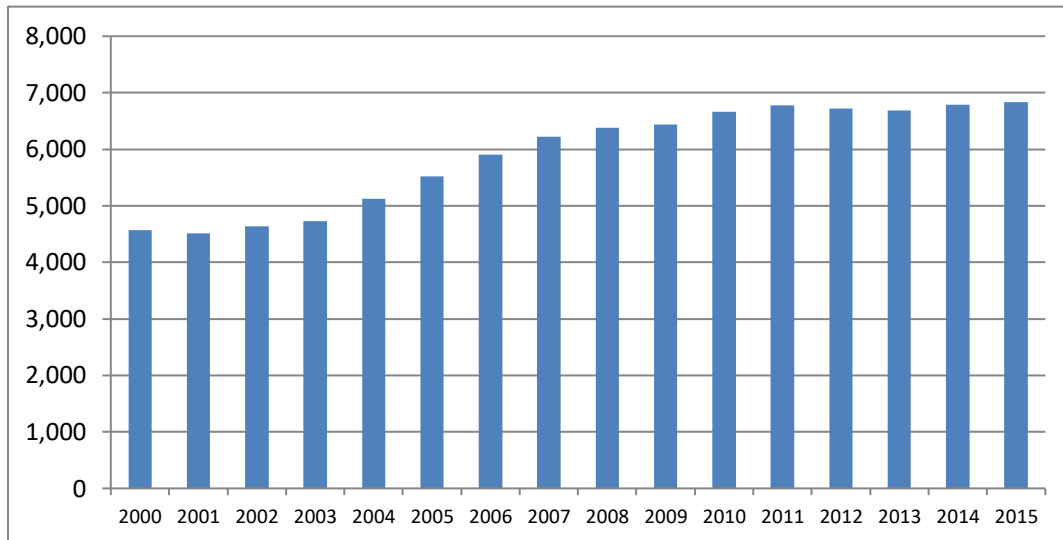
Threat of substitutes

Most services have a substitute. The most obvious substitute to hiring a realtor is relying on oneself to sell one's property; however, as mentioned previously, this option is excluded from Hemnet, thus making it harder for individuals to sell their own property by themselves. In recent years, substitutes to the traditional realtor service have emerged in the form of companies that help with the absolute necessities of the sale, such as contracting. All other aspects – photographing, advertising and showing the property to buyers – are left to the seller. These companies typically charge prices that are substantially lower than those charged by traditional realtors. Few of these companies, however, have been successful in staying in business. Because selling a home is one of the largest transactions most people make, the authors of the present study believe that sellers, in an effort to minimize any risk associated with carrying out the transaction, would prefer to pay the extra cost for a traditional realtor whom they might perceive to be more reliable. Empirical data from the FMI show that 91 per cent of all property transactions in Sweden in 2013 were made through registered realtors (www.fmi.se). In Stockholm (the capital of Sweden), more than 95 per cent of all transactions were carried out by realtors (www.scb.se).

Threat from new entrants

According to the FMI, there were 6,788 real estate brokers registered as of September 1, 2015 (see Figure 1), and 49,000 homes and 90,000 condominiums were sold in 2013. If vacation homes are excluded, this amounts to 21 dwellings sold per real estate broker and year. The number of sold dwellings per realtor has declined in recent years, from 29 dwellings in 2001 to 22 dwellings in 2013. However, the value of homes sold has risen since the late 1990s. The turnover in the real estate sector has doubled since 2002 and is now about 8.4 billion SEK, which would mean that each real estate broker has annual sales of about 1.3 million SEK.

Figure 1. Number of registered real estate agents in Sweden

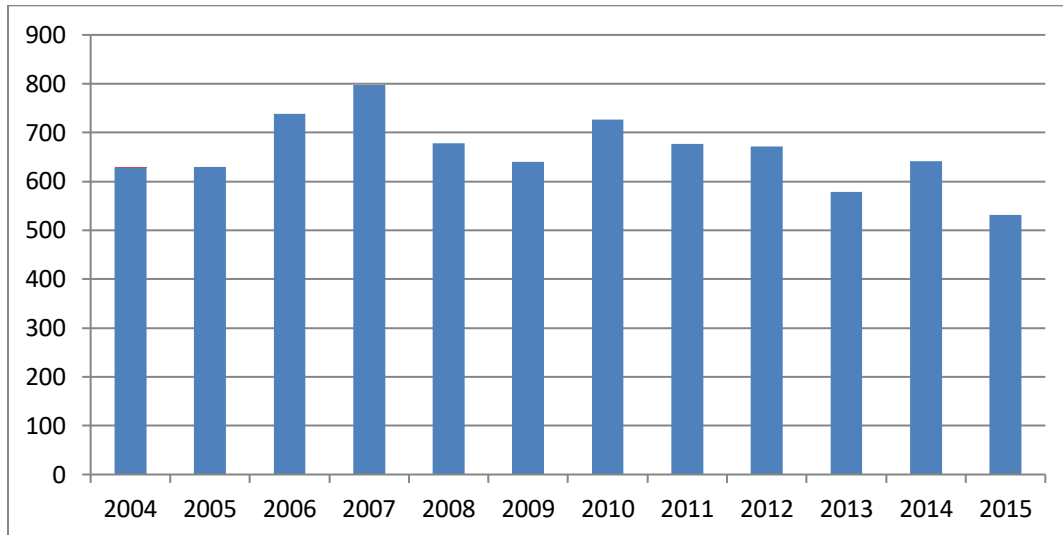


Source: The Swedish Estate Agents Inspectorate (FMI).

The number of registered real estate brokers has not increased at the same proportional rate as the change in the value of homes sold, and the number of new real estate agents entering the market has dropped since 2008 (see Figure 2). It should also be noted that the commissions in the Swedish market are a proportional compensation in relation to the price.

Over time, more and more women are becoming real estate brokers. In 1994, 17 per cent of all registered real estate brokers were women; today, 44 per cent of all brokers are women (www.fmi.se). Furthermore, among the students who are studying toward a degree in real estate agency, 60 per cent are women.

Figure 2. Number of new registered real estate agents in Sweden



Source: The Swedish Estate Agents Inspectorate (FMI).

An ongoing debate in Sweden has to do with service bundling, which is the combining of different services (Guiltinan, 1987). Many real estate agencies receive brokerage compensation from the banks, which they then scale out to brokers in relation to loan applicants supplied to the banks. Previous studies have shown that the consumer has difficulty comparing the cost of the core service supported (Soman and Gourville, 2001; Mankila, 2004). Furthermore, the bundling of services might act as a barrier to entry, thereby creating less competition. Previous research on oligopolistic environments (Nalebuff, 2004) shows that the profit from foreclosing competitors often exceeds the gain from conveying the bundle. Other research findings, such as those of Bakos and Brynjolfsson (1999), have demonstrated the effect of obstacles to establishment even if new players have a more efficient and more effective cost structure. This may also entail the exclusion of competitors. Because these services do not constitute repeat purchases, it is difficult for consumers to compare price levels, which is important when comparisons are made with the research on repeat products.

Digitalization

Digitalization has had a major impact on the real estate brokerage industry. In comparison to earlier times, the use of different types of customer relationship management (CRM) tools is widespread today. In advertisements, realtors continuously market themselves by having a unique customer database. According to earlier research and the present study's analysis, this might be of greater interest to a vendor in a more expensive segment or less homogeneous

housing (Levitt and Syverson, 2008). Real estate agents' use of these "unique" lists to market themselves appears to be an increasing trend.

Apart from real estate agents' use of unique lists, the most important force shaping the competition within the industry is the development of Hemnet, as described earlier. Because Hemnet in practice has a monopoly in the market, other types of digital media have encountered enormous problems establishing a foothold in the market.

Innovation

During the past decade, the industry has experienced rapid development, especially when it comes to specialization and technological advancements. A trend toward more segmentation and specialization is evident. Today, most realtors work with professional photographers, image managers, floor planning designers and marketing experts so as to create a variety of images, ranging from moving images to images captured by drones. Descriptions of the items are processed in line with increased skills in the brokerage corps and the increased requirements for transparency. Furthermore, the real estate agent today offers a wider scope of services, which in turn increases the revenue streams from these services.

An issue related to innovation is branding. One should take into account the ability of realtors to build their personal brand and how this ability may affect the pricing of services. For instance, newly qualified realtors may reduce their fees so as to obtain a foothold in the market. It is also normal for realtors to lower their fees if the dwelling is unique and attention-grabbing or can give an improved market position in a geographical area. Gaining field experience from similar housing improves the probability of being awarded assignments in future competitions. In addition, realtors may lower their fees based on an assessment of the probability of receiving future business from the buyer of the dwelling. The use of different incentive schemes and pricing strategies is also an important part of renewal and innovation within the industry.

Rivalry between competitors

Internationally, real estate transactions most commonly involve an agent who represents the buyer, another agent who represents the seller and a notary who draws up agreements between the parties. This arrangement results in considerably higher transaction costs than the arrangement in Sweden, where there is only one real estate broker representing both parties and no notary is involved. From an international perspective, this designation is relatively unique, in that real estate brokers under the law are independent from buyers and sellers. However, real estate brokers shall strive to optimize the final price so as to serve the best interests of sellers. At present, provisioning levels are between 1.5 and 2 per cent (estimated comparison in Stockholm's

inner city 2015; www.fmi.se), and in real terms, they are still at low levels from an international perspective (Schnare and Kulick, 2009). What is interesting, however, is an assessment of the contribution margin in absolute terms. Rising house prices and changes in the cost structure do not automatically lead to higher margins for brokerage firms. Rather, transaction costs seem to have decreased over time (www.fmi.se).

CONCLUSIONS AND POLICY RECOMMENDATIONS

From an international perspective, the Swedish market for realtors can be considered to be rather competitive. The cost of using a real estate agent is around 1.5 to 2 per cent of the transaction price within the larger metropolitan areas, which is low when international comparisons are made. There is, however, room for improvement when it comes to the competition within the industry. Based on the present study's analysis, there are at least three areas in which policymakers can act to improve the competition within the market.

First, the bundling of services within the sector is problematic from a consumer perspective. Because buying a real estate service is a purchase that the average consumer makes very seldom, the realtor has an informational advantage. It is therefore hard for consumers to compare prices and offerings between realtors. The Estate Agents Act of 2011 targets the increased need for transparency within the sector, but more could be done in this area, especially in terms of how the service is priced (e.g. the incentive structure).

Second, Hemnet in practice has a monopoly when it comes to advertising online. Today, only registered real estate agents are allowed to advertise on the website. Thus, private individuals are excluded from using Hemnet's services. The authors of the present paper believe it would be reasonable to open up Hemnet to other actors so as to break the monopoly.

Finally, the number of registered real estate agents has been rather stable for the past five years in Sweden, but the number of newly registered realtors has declined within the same time period. According to reports from the FMI, many new real estate agents leave the profession after only a few years. The main reasons for leaving have to do with the fact that most newcomers have a salary based on provision only and that working on weekends all year round takes its toll. Therefore, a vital element in creating a more competitive market is to increase the number of students who enroll in real estate programs at university. This is a decision for universities themselves to make, but it does not seem to be a priority at present.

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