



A Better MLS for Business Brokerage

Summary

This white paper is recommended both for business buyers and brokers. All but the final three sections provide introductory material on MLS.

The purpose of this white paper is to compare the market for small businesses against the market for residential real estate ("RE") to show why traditional multiple listings services ("MLS") work for real estate, but often not for business brokerage ("Biz Brokerage"). The paper will also present a model for MLS suited for Biz Brokerage.

Let's first walk through the buying process in both markets.

Real Estate Buying Process

A typical RE buyer will contact a RE broker, who will help the buyer select listings from an MLS that are listed by other RE brokers. Then the buyer will see a number of houses with the broker. Finally, the buyer purchases a house.

Business Buying Process

A typical business buyer will somehow reach a number of business brokers ("Biz Brokers"). Each will introduce the buyer to some of the businesses he has listed for sale, but because there are few MLS's for Biz Brokerage, typically none will introduce the buyer to businesses listed for sale by other Biz Brokers. Finally, the buyer purchases a business from one of the brokers.

The Key Difference: MLS

RE buyers need to build a relationship with just one broker due to the existence of MLS in RE Brokerage, whereas business buyers need to build a relationship with many Biz Brokers due to the virtual non-existence of MLS in Biz Brokerage. These relationships are costly to build (in time and money), both for the buyer and the broker, which is one reason that Biz Brokerage commissions are higher than those for RE Brokerage. In addition, the costliness of these relationships often stops good deals from ever being considered.

Clearly, MLS has benefits. So why does MLS exist in Biz Brokerage to a much smaller extent than in RE Brokerage?

What is MLS?

First, let's get clear on what MLS is. Many think of MLS the same way they think of the yellow pages, as simply a place for listings of different offerings for product X, but MLS is much more than that. MLS manages the market in which a broker representing a seller of X ("Seller's Broker") pays a broker representing a buyer of X ("Buyer's Broker") in exchange for causing that buyer to purchase X ("Co-Brokerage Market"). The Co-Brokerage Market is truly a market because it brings together buyers and sellers and enables the systematic pricing of a service. That service is causing a buyer to purchase X.

How does MLS Work?

Second, let's get clear on how MLS works. Within the Co-Brokerage Market managed by an MLS, the Seller's Broker makes an offer publicly to share a certain portion of his commission with a Buyer's Broker in exchange for causing a buyer to purchase X. The governing rules of an MLS typically prevent or impede negotiation between the Buyers' Brokers and Sellers' Brokers in the MLS's Co-Brokerage Market. (Don't misunderstand: Buyers' Brokers and Sellers' Brokers can negotiate on the price of the product – i.e. on the price of the house – but that occurs separate from the Co-Brokerage Market.) For example, if a RE Seller's Broker in a RE Co-Brokerage Market offers to share 50% of his commissions for a particular RE deal, then the Buyer's Broker for that deal will generally accept that 50% without negotiation.



Why Does MLS Work in RE Brokerage?

MLS works for RE Brokerage because within a given RE market the expected cash costs and opportunity costs of Buyers' Brokers and Sellers' Brokers are relatively stable from one brokerage firm to the next, from one deal to the next, and from one buyer to the next. (Note that the reference is to expected costs, which influence decision-making, and not to actual costs, which do not influence decision-making and vary widely.) Because of that stability, there are few situations that would benefit from the Buyer's Broker and Seller's Broker being able to negotiate their commission split in order to accommodate an unusual cash cost or opportunity cost of one of the two parties.

We can illustrate the lack of need for negotiation in RE Co-Brokerage Markets with an example of an exception: Say a RE Buyer's Broker were representing Lady Gaga. The opportunity cost to the Buyer's Broker of doing a RE deal with Lady Gaga would be unusually high because many RE Sellers' Brokers would be willing to pay the Buyer's Broker a premium for the publicity associated with doing a deal involving Lady Gaga. Therefore, the Buyer's Broker might refuse to work with a Seller's Broker offering him only a 50/50 commission split. Such a Seller's Broker would benefit from being able to negotiate with the Buyer's Broker.

Finally, to explain the lack of need for negotiation in RE Co-Brokerage Markets in another way, most RE Buyers' Brokers and RE Sellers' Brokers will on average be able to cover their costs with something near a 50/50 commission split for most deals – and that is good enough to make RE MLS work sustainably.

Why Does MLS Not Work Well in Biz Brokerage?

The situation is vastly different in Biz Brokerage. The root reason is that small businesses vary much more from one to the next than houses do: this makes sense because, after all, people buy houses to fit fixed social norms but succeed in business by differentiation. As an indirect result of businesses' variety, there are massive differences in the expected cash costs and opportunity costs of Buyers' Brokers and Sellers' Brokers from one brokerage firm to the next, from one deal to the next, and from one buyer to the next. Because of these massive differences, in a Biz Brokerage Co-Brokerage Market, there would be many situations in which the Buyer's Broker and Seller's Broker would need to negotiate their commission split in order to agree on one that accommodates the unusually high cash cost or opportunity cost of at least one of the two parties ("Negotiation-Required Situation"). In a Biz Brokerage MLS, because negotiation would be prevented or impeded, in Negotiation-Required Situations no transaction would occur in the Co-Brokerage Market. As a result, the Co-Brokerage Market and the MLS would tend to fail due to lack of market participation. This is why Biz Brokerage MLS is uncommon.

Why Not Have a Biz Brokerage MLS that Allows Negotiation?

If the main reason that a Biz Brokerage MLS would tend to fail is that MLS prevents or impedes negotiation in the Co-Brokerage Market, then why not design a Biz Brokerage MLS that allows negotiation? Unfortunately, the problem with allowing negotiation to occur is that it would add such high transaction costs to the Co-Brokerage Market that the market would fail due to lack of market participation. In other words, negotiation in the Co-Brokerage Market would take brokers away from serving their clients to such a great extent that they would simply not participate in the market.

The Solution: MLS with Automated Negotiation

A Biz Brokerage MLS could work if the transaction costs related to negotiation in the Co-Brokerage Market of the MLS could be minimized. This can be accomplished by creating an MLS that accepts bids from Buyer' Brokers and Sellers' Brokers and automatically arranges relationships between them based on those bids. Similar concepts are employed by Google AdWords and eBay.

A solution called MLS-1, which will allow such automated negotiation, is being developed by Alignment Acquisitions.