CHAPTER ONE

1

THE CHALLENGE OF CHANGE

What did you learn about doing business in the recent economic environment?

What will the real estate business look like in the future?

There are no magic answers in business—only some that are better than others, depending on the situation. Guarantees are few. But change is certain.

If you don't like the headlines today, wait. On the other hand, if you do like today's news, that can change, too.

Business management is as much about the situations as it is about the money. The money is the end result of making wise decisions that suit the circumstances, not just today's but those we assume for the future. Any business, a real estate company included, is at the mercy of a number of forces over which it has little control. What separates those that succeed from those that don't is the ability to deal with the realities of change.

The "Challenge of Change" sets the stage for the pages that follow with some poignant lessons about doing business in that environment. Think about what were, what are, and what will be the events framed in the big picture that create opportunities and challenges for businessowners and their companies.

THE BIG PICTURE

> Our nation continues its struggle to secure peaceful coexistence among differing cultures. The stock market loses value, corporate profits diminish, and older workers are forced to rethink retirement plans for their golden years. Corporate leaders are forced to explain their deception that cost investors mighty amounts of money.

Does this sound like life after 2007?

Actually, these words are extracted from commentary written in 2003 for the 6th edition of this book when our nation was struggling to regain its footing after 9/11, investors were trying to repair the damage after the "tech bubble" burst, and corporate executives were making headlines for appearances in court and jail sentences for fraud.

The sequel to that story is low interest rates played a major role in fueling consumer spending and corporate growth. The stock market regained its stride and reached unprecedented highs, and an exceedingly robust housing market reached new heights, too. Until subprime mortgages made headlines in 2006, and then life changed once again.

We were sitting on a dangerous precipice in 2007 when the 7th edition was written. The editors cringed over commentary (that was eventually stricken) about the brink of a depression or at least major turmoil that would upset multiple sectors of the marketplace worldwide. The words were too pessimistic to print. But we wouldn't have been wrong.

As the magnitude of the subprime mortgage problem came to light, the stock market plunged, credit markets seized, and thousands of people lost their jobs. The investment market was in shambles, having worldwide implications. Consumers dramatically curtailed their spending. Housing prices dropped 30% and wiped out over $7 trillion of homeowners' equity. The economy did plunge close to a bottom that hadn't been touched since the 1930s.

Few people are still alive to share firsthand stories about the Great Depression that began on Black Tuesday in October 1929 and left thousands of people destitute and homeless. But people *are* alive who grew up with parents who endured those times and remained ever wary that history could repeat itself. They can tell about rationing during World War II and the scarcity of goods that are so easily taken for granted. But that war also mobilized a huge amount of material and manpower that solidified the recovery from the Depression and set us on a path of growth after the war years.

Out of that Great Depression came banking regulations and amortized mortgage loans to protect depositors from bank failures and families from losing their homes. Out of the war came prosperity that fueled great optimism and instilled a rosy, almost fearless view of the future, despite economic ups and downs along the way. In fact, today's younger generations have never had any view but that rosy one.

How easy it was to expect that the real estate market, which drove the economy to record heights into the middle of the 21st century's first decade, couldn't possibly lose steam, let alone plunge to such miserable lows. Or that the mortgage loans that provided financial wherewithal for thousands of homeowners would be the undoing of their American dream. We took credit for granted because it was always there, and saving was something we'd get around to after we lived for today.

Optimism fuels our strength and determination. It also causes us to lose perspective and fail to prepare for the inevitable change along the economic seine waves. There's also an element of greed that craves more in the good times and drives desperation in the bad, not always with praiseworthy results.

These words can be written for any business enterprise or industry. It just so happens that banks, investment houses, and mortgage companies were front and center in the drama that played through what came to be known as the Great Recession.

Profit motives do interesting things. When the economy is good, the real estate market is thriving, and everyone is making money. The banks fuel the market with more money and make loans easier for borrowers to get. Buyers purchase more houses and more expensive ones than they could afford in stricter lending times. Sellers make more money and move up into even more expensive homes. Real estate companies sell more properties, make more money, and salespeople earn better livings. The market is on a roll, real estate prices (values?) rise, and there's no way but up—until it falls down.

The real estate market crumpled, but no one said yes, that was always a possibility. The banking and real estate industries rode the wave but when it was over, few owned up to the part they played in buyers sitting with houses in foreclosure and mortgages that were upside down. Everyone took a risk but not everyone knew how much risk they were taking.

Waves always break.

The Next Wave

Then new waves come along, and we climb on another one.

The next wave was jumpstarted with the government's bailout of the banks and auto industry and the American Recovery and Reinvestment Act of 2009, commonly known as The Stimulus or The Recovery Act. The objective of the stimulus was to save and create jobs and invest in infrastructure, education, health, and renewable energy. The rationale was based on a macroeconomic theory which argues that during a recession, the government should offset decreases in private spending with an increase in government spending to save jobs and stop economic deterioration.

The cost of the stimulus package was estimated to be about $830 billion between 2009 and 2019. That expenditure, however, was subject of considerable debate, with critics arguing that the stimulus did not do enough to improve employment to warrant the expense and increase in the nation's debt.

Since June 2009, the date the National Bureau of Economic Research benchmarks as the official start of recovery from the Great Recession, the pace of economic growth has been much slower than after previous recessions. In some respects, the critics had been right because slow growth in employment and accompanying wage scales were significant factors.

Catching the recovery wave has been a long and fragile process. Clearly, the wave had more momentum in some sectors of the economy than others. Housing prices started to recover in 2012 according to the Federal Reserve, with rising values contributing to increased household wealth, particularly for the middle class. Some data suggest that about 61 million owners had at least 25% equity in their homes in 2016, while the number of houses with "underwater" mortgages decreased to 4.4 million from 12 million in 2009.

But housing prices remained below pre-recession levels in 2016 in many parts of the country. And household wealth, which is measured by real estate, stocks and other assets minus mortgage and credit card debt and other borrowing, doesn't necessarily translate to increased consumer spending. Consumers did have less debt, payoff having been a necessity to weather the recession. But concerns about the labor market—unemployment, underemployment, and job creation—and softness in the business sector, especially in the energy and oil sectors, stifle consumer confidence. The stock market that has always cycled on the feet of the bulls and the bears also sends mixed signals about their next moves on any given day.

The global terrain is rockier than it's been in recent decades. Although our economic woes had global consequences, those pale in comparison to the brink of bankruptcy some countries face and the diminishing number of strong ones that can rescue their debt. The myopic view says we can't make that our problem but with global capital at risk, the problem can easily become a domestic one, as the stock market indicates with drops on each headline of bad news.

The geopolitical environment is as unstable as it was (if not more than) in the first year or so after 9/11. The off-shore venues have changed and political powers have shifted, but threats rooted in cultural differences persist. This has also changed the tenor of immigration policy, fueling our nation's domestic and global agenda. Only time will tell how well all the many moving parts, which also include the nation's debt and tax policies, will align to propel the economy on a sturdy and enduring growth trajectory. Of course, ideologies in power can change and shift the course of the economy. But we do know that mortgage lending, appraising, and settlement procedures will continue to live under a critical eye that views real estate through the prism of subprime mortgages, which were blamed for tipping the economy into recession in the first place.

THE FUTURE PICTURE

Once we think about the *then* and *now*, we can appreciate the significance of the decisions that come next. The challenge, of course, is that the barometer on current events changes daily and little about the economic and political climate is the same for very long. But one thing is timeless—the fundamental theories of management are the framework that gives business managers the tools to manage in any climate.

One of the axioms in business management (of several you'll read in this book) is—*companies can't continue to do the same things the same way and expect different results*—especially when the world around them is different.

The smartest thing we can do is challenge our thinking, with no "sacred cow" or "way we always do it" being off limits, and see what surfaces as the best way to do business in the future, regardless of the ups and downs in the economy. Sometimes we have to think way outside the box to decide if we're building the right box. There's no risk in asking the questions.

What Will a Real Estate Company Be Doing?

The fundamental business since its inception has been to bring together real estate properties and users. Those could be properties for sale or rent and users to purchase or lease, and then we dressed this up (or complicated it) with agency representation and fiduciary duties. Unlike other business enterprises, real estate companies don't make any products or have any control over the products they sell. So, companies claimed rights to products with listings and vigorously controlled that information.

How relevant is that model today? The real estate industry organized early in the 1900s when brokers banded together in pursuit of professional business practices. Out of that came a unique alliance of competitors who work together to help one another. In the earliest days, that business alliance was the only way brokers had to share information about their properties for sale. The alliance evolved into a formal structure that came to be known as a multiple listing service (MLS). Before long, numerous such services formed in many geographic areas. MLSs became a controlled conduit for the broker-members' property information.

More than 100 years later, technology gave us the internet. There's still a need to bring properties and users together, and there's still a need to circulate property information. But gone are the days when brokers relied on the MLS's weekly delivery of paper listing sheets. Technology gave us a far more efficient way to distribute that information, but even that pales in comparison with what the internet has done for consumers, who now have direct access to information and the ability to drive their own real estate transactions. *What role should the real estate company play?*

Businesses operate on traditions, which are perpetuated by generations of businessowners and their models for work. The great divide in today's companies is just that, the generations. The majority of real estate companies are run by the over-age-50 crowd, which is confronted by the Gen Ys who are the ages of their children and grandchildren. They are less steeped in tradition and often frustrated by the "old" that seems irrelevant today. *How will the company deal with tradition versus change?*

What Is the Role for MLS?

Information has become the hot commodity in the marketplace. It can be warehoused, delivered, and exchanged for something of value in return, which has moved the real estate industry into the information business, more than a brick and mortar one. The industry's hot commodity, of course, is property listings—an asset brokers have considered proprietary information, to be shared only among MLS members (as permitted by the property owners).

Information is power—the MLS has the power and those desiring the information must join the fraternity of members. The introduction of the internet challenged the MLS's information management model. As MLS members posted their own listings on their websites, consumers demanded access to more listings. The MLSs formed Internet Data Exchanges (IDXs) which gave consumers access to an MLS's entire database through a member-company's site (within the limits of MLS policies).

The IDX model provided landing places for consumers and served the purpose of promoting listings. But this was purely an informational model and did not provide an interactive business setting for the consumer and broker. That led to the development of Virtual Office Websites (VOWs), which added an e-commerce component to the IDX model, again administered according to MLS's policies.

In the information-is-a-hot-commodity scheme of things, a number of internet-based companies formed to distribute real estate information, listings included. The growing power of web-based sites such as Zillow makes them attractive venues for real estate companies to promote their listings as well. The Real Estate Transaction Specification (RETS), which is a standardized digital format, makes it easy for companies to update that listing information.

One lesson the internet teaches, though, is that once information is cast in digital form, there's very little way to control where data circulate and how it's used. This has resurrected the debate over ownership of information, especially when third-party internet companies sell leads to real estate companies that were generated by the companies own listings. In the process, the number of skirmishes (and litigation) over MLS rules has increased.

MLSs generate revenue (often for local REALTOR® Associations), but that revenue is threatened by the increasing challenges to their business models. The conversation has already begun about MLSs consolidating (perhaps statewide), especially because the real estate business is no longer defined by narrow geographic boundaries. Decisions will ultimately have to be driven by what's in the best interest of the owners whose properties are for sale.

What Will Consumers Want?

For decades company businesses were based on a supplier model—the supplier controls the selection of products and services offered in the marketplace, essentially a take-it-or-leave-it model. But today's companies serve the marketplace with a consumer-driven model, which creates products and services tailored to suit consumer demand, essentially answering the question about what consumers want.

Their wants today are rooted in the cyber economy that gives consumers access to most any product, service, or sliver of information with the stroke of a finger on a tablet, laptop, or smart phone. This means delivering products and services in a "one-stop shop" in front of their devices and with vendors who can link them with other services.

A once geocentric business has no geographic boundaries and serves a very culturally diverse population. The domestic Hispanic and Asian populations are growing at three times the rate of the overall population, with Hispanics now being the "majority minority." And the global population is increasingly more mobile. The multicultural market has huge buying power, which represents a host of opportunities to tailor products and services to capture that diverse clientele.

For real estate, the meaning of *core services* has expanded beyond brokerage in many companies to include an array of services that seamlessly take buyers and sellers from doorstep to settlement. In some companies, that includes linking consumers with job placement for a spouse, day care for a child or elderly parent, or housecleaning, yard care, or handyman services.

The industry has also provided alternatives to the one-stop-shop and one-size-fits-all service models to appeal to more selective consumers who want to purchase and pay for only selected services from a real estate company. This has pressured companies to unbundle their services, shed transaction-based fee structures in favor of alternative pricing models, and offer a menu of options from which consumers can choose and then pay only for the services they use.

Consumer wants also represent their diverse ages as well. The over-65 age group, which is now outnumbered by the 20- and 30-year-olds, will continue to be a force in the marketplace as people live longer. This will add to the need for alternatives to the one-size-fits-all service model.

Because more business is done with little personal interface today, some wonder why any commodity can't be traded the same way a sizable investment portfolio can—online without intervention of a person and without paper, too. A few websites already give buyers the ability to make offers online. *Will the day come that real estate will be fully traded online that way too?*

Where Will the Real Estate Office Be?

The traditional measure of market share has been tied to brand recognition in geographic or physical locations, with location also being the draw for foot traffic. The industry began in single real estate offices comprised of the broker and perhaps several associates. Then, companies grew market share by growing into multiple-office organizations, some staffed by hundreds of personnel who offer a wide range of services.

Large companies got bigger, often by assimilating midsized companies for their command of an appealing share of the market. Megabrokers merged with other megabrokers to further strengthen their presence. They also formed brainstorming groups, such as the Realty Alliance, to enhance their competitiveness as independent companies. Outsiders entered the business, becoming parent companies of organizations such as Coldwell Banker and franchises such as Century 21® and ERA®.

Despite the trend of "bigness," the majority of our nation's businesses are small enterprises. There's still a place for small real estate companies, their appeal often being their smallness and more personalized or specialized services. Internet-based companies are also proving there's a place in the market for small, independent enterprises.

In the world of e-commerce, companies (not just real estate ones) are learning that cyberspace is more important than office space. The physical site plays a supporting, rather than starring, role in the great multi-act play of today's business enterprises. There will always be a supporting role for a company's headquarters and for branch or satellite offices, as long as state regulators hold on to requirements for fixed office locations. But consumers are much more interested in *what* they consume than in where they consume it. The same can be said for how the sales force works.

What Will a Real Estate Company Look Like?

Real estate companies have merged, divested themselves of previous affiliations, and forged new alliances with other real estate enterprises or enterprises offering complementary products and services. Some have been drawn under a single corporate umbrella along with a number of diverse or even non-real estate-related corporate units. The companies restructure in the same ways our nation's major corporations restructure theirs, and do so for the same reason—to achieve more profitable operations.

Downsizing and *reengineering* are terms commonly heard in corporate boardrooms as companies strive to work smarter as the cost of operation increases. Companies often suffer from misaligned structures and bloated workforces as a result of mergers or acquisitions, or changes in the work they do. Real estate companies already function on narrow profit margins, and cost of operations must be managed very carefully. Costs that diminish bottom lines are often the very expenditures that help an organization work more efficiently and productively.

Rightsizing is the more accurate term for what companies do to realign their operations. The major part of that involves the workforce. Often, realignment (by whatever term is used) is associated with job loss. Although there may be fewer personnel positions in the short term, especially if adjustments are dictated by a downturn in the economy, the long-term result is new jobs are created with different or refined skill requirements.

Real estate companies can become more effective by downsizing the sales staff, employing a smaller number of people but ones who are highly productive. Companies that still subscribe to the practice of hiring large sales staffs (with the expectation that larger staffs will produce comparably larger revenue) are more closely scrutinizing this strategy because of the cost to attract and retain top producers while also carrying a large number of marginally productive salespeople.

Companies can also work smarter by hiring salespeople as employees rather than as independent contractors. The appeal is that companies can exercise greater control over sales activities and, ultimately, revenue production. While employee costs are higher, the expectation is that those expenditures can be offset with higher revenue. Although this strategy has not been widely embraced by residential sales companies, it is prevalent in nonresidential ones.

Certainly, the number of available licensees plays a role in staffing decisions, including the effect of portable licensing that allows practice across regulatory jurisdictions. That number tends to peak and wane as the real estate market rises and falls. The catch is that companies tend to trim staff or not replace loss by attrition when business trails off and are then caught short-handed when business flourishes again. Such is the challenge for a cyclical business like real estate, but that means anticipating shifting trends is all more important.

There is no *one* suitable model for a real estate company, only the one that supports the work the company needs to do in the contemporary environment and do it profitably. *How many people will that take? And what will they be doing?*

Who Will Be Leading the Company in the Next Ten Years?

The logical answer is the next generation, the Gen Ys. But that's not a realistic answer if the parent- and grandparent-age owners and managers don't inspire youth to enter the business and give that talent a chance to flourish.

Although there are no employment guarantees, today's workforce is more resilient, less intimidated by change than workers of decades ago. There are few 35-year-service "gold watch" retirements any longer. The Bureau of Labor Statistics indicate that 20-to-24-year-old workers change jobs every 16 months; 24-to-35-year-old workers switch every three years. The average length of time in a job is 5½ years for all workers over age 25. That mobility brings new blood with fresh perspectives into a company's workforce.

Today's workforce is a melting pot of cultures and generations, especially as people work longer. This gives a company the energy of youth, the voice of experience, and varied perspectives for competing in the global marketplace. Companies fall short, though (our nation's large corporations included), in senior management and executive positions where culturally diverse viewpoints would aid decision making in the contemporary environment.

Unless companies promote younger workers, they will move on and leave the organization with a huge void in leadership as people retire. How will the company appeal to the next generation of buyers and sellers without that next generation of business leaders? Or will those leaders shun established companies and start up their own?

What's the Next Generation's American Dream?

The real estate industry has stumped in favor of home ownership for years. Clearly, the industry has a strong business reason for its advocacy, but home ownership also supports the construct of our nation's social, political, and financial agenda.

Home ownership peaked at 69% in 2006, according to the U.S. Census bureau, but that record high was short lived and by the first quarter of 2012, reached a 15-year low as more people turned to rentals. Despite low interest rates and attractive housing prices, people sat on the sidelines, underemployed and with damaged credit, thanks to the Great Recession. The reality is that people haven't really owned, but have borrowed, the American Dream for at least the past three decades.

The rental trend isn't limited to housing. A growing segment of the population is choosing the flexibility of enjoyment for everything from cars to clothing over the permanence of ownership. This appeals to an increasingly mobile population but also serves a cost-efficient mindset—renting even high-end is cheaper than purchasing, even at the low end. And there aren't the continuing costs of maintenance and repair, either.

The rental rationale doesn't suit the mindset that values the economic accomplishment of ownership or investment with the potential for appreciation, which is the premise of home ownership. Buying a home has also been a way to pivot from one stage in life to another, especially noted by single women who were 22% of the homebuyers in 2006, as opposed to 11% in 1981. Perhaps differences in mindsets are generational ones, but no question there are financial realities that affect choices to rent instead of own.

Add the fact that college students are graduating with record student loan debt and working to pay off their past, not save for the future. And only 40% of them expect their lives to be better than their parents' lives.

One of the few bright lights in the Great Recession has been an increase in building, not single-family homes but multifamily buildings, spawned by demand for rentals. But that building boom is also a normal cycle, the hot segment being attractive until the next segment gets hot. Rental demand also attracted investors to foreclosed properties, which also absorbed overstocked single-family houses from the marketplace. *How long will it take for people to become homebuyer worthy? Or will renting be the new American Dream?*

What Will Professional Associations Be Doing?

These organizations provided a way for people with like-minded interests to learn, socialize, and affect public policy. The professional groups served purposes their members couldn't accomplish by themselves (or elsewhere) and performed self-regulating functions, particularly important when few laws guided professional activities or protected consumers. Real estate brokers, homebuilders, appraisers, virtually every business has organized a place to belong. No question that the organizations are visiting the same questions we are but the answers will come from—*Do the members need what the organizations offer? Or will a new association model emerge?*

What Will Industry Regulations Look Like?

Once was the day that the real estate industry had no oversight other than its own professional associations, especially the National Association of REALTORS® (NAR). Not until the 1920s and 1930s did the states pass licensing laws, and still many more years until the laws included education requirements. That's a long way from then to now, with real estate being one of the most highly regulated businesses.

Along the way, the business world (real estate included) encountered a variety of laws that grew out of movements to protect the consumer. And some legislation was borne out of the excesses of business. Those legislative trends continue to temper the creativity of business leaders.

We know after the headlined scandals on Wall Street that company executives are more closely scrutinized, investors are more critical, and the public is more wary of the way companies do business. Establishing credibility and trustworthiness, even for companies that aren't publicly traded (those that don't fall under Securities Exchange Commission and Sarbanes-Oxley accounting rules), is crucial to survival, let alone success. That's particularly significant for sales businesses, which have traditionally been suspect in the public's mind anyway.

The Department of Justice (DOJ), the enforcer of the antitrust laws, has been especially vigilant since the 1970s when it first cited MLSs and other professional groups (including REALTOR® boards, as they were known at the time) for setting commission rates, among other antitrust violations. The best-case outcome was allegations could be resolved by consent decree and agreements to adopt affirmative antitrust practices. In the worst case, brokers served jail time. But in all cases, the defendants incurred huge legal bills.

The DOJ continues to pursue an aggressive antitrust agenda, and the industry continues to defend. One recent case asserted that the industry's traditional policies and procedures inhibited the providers of innovative alternatives, particularly those whose business is primarily internet based. Therefore, consumers were denied access to property information and other services at a lower cost.

Another case alleged that policies of an MLS controlled the marketplace and restrained competition, affecting practices of nonmembers as well as choices for the consumer. A consent order precluded enforcing certain MLS policies, including the use of pre-printed language in listing contracts that was deemed anticompetitive.

The industry is already in transition from a singular, long-standing business model into the world of numerous creative alternatives, supported in large part by the internet. But the question remains how significantly business models will change over time. Regulatory law is typically reactive rather than proactive to foster innovation and creative free enterprise. And laws take time to change.

One last question—can you answer the other questions objectively without stumbling on the "big elephant in the room?" *The money*. We know how we make money now (usually), but it's hard to be candid if the answer would diminish or eliminate a current revenue stream. The fundamental principle of the real estate business is rooted in the long-held belief that consumers need real estate people to help navigate the complexities of a transaction. But what do consumers need in the 21st century? Is there something new a company can do that is just as good or perhaps even better?

The point is to ponder the questions to be sure that the company does make money in the future. The goal is to establish a vibrant, relevant enterprise. If it can't be vibrant or isn't relevant, then it needs to be doing something differently. This is the ultimate challenge of change. It may well be that not much needs to change. But it doesn't cost anything to ask the questions, especially if the answers prevent the company from becoming a victim of progress.

A FINAL THOUGHT

Some observers say that fundamentally nothing has changed about the real estate industry. In a sense, there's an element of truth in that—the industry is still about real estate. But *the way* the industry does business definitely has changed, and that will continue in the future. In the triteness of "the future is closer than you think," there's another element of truth. The future any real estate company has to prepare for is not decades from now, but next year and the next.

All business organizations face similar challenges for similar reasons. Bottom-line pressures, economic downturns, abundant regulations, and aggressive competition are but a few of the realities of life. The latest challenge is the competitive forces brought about by the internet. The real estate business isn't any different in these respects.

Many valuable lessons can be learned from the corporate world. But this means stepping outside the real estate industry and learning how business organizations, in general, function. The processes that are explored in later chapters are similar to those that any business organization goes through. That is, business management.

CONCLUSION

The fitting conclusion to this chapter is really a beginning. Having opened some lines of thinking from a global perspective, now you can take the next step. Look at your local business environment and your own organization. Some situations may be similar or you may identify other forces that impact your business. The point is that change is inescapable. Astute businesspeople see change as an opportunity. Be open-minded and innovative, especially when you look into the future. No old way is so good that it can't be improved on. Keep this in mind as you work through the management functions explored in this book.

DISCUSSION EXERCISES

What is your candid assessment of the current housing market in your area? The current economic climate? What do you expect to be different during the next few years?

What has changed about the demographic profile of your consumers and your company's workforce in recent years? What do you expect in the future?

What effect has recent litigation or regulatory changes had on real estate practices in your area? What issues are pending that could affect future practices?

Considering the financial pressures on today's organizations and the consumers' attitudes about the cost of real estate services, how do you think fees for real estate services and costs for transactions should be structured?