The Effect of Agents and Mediators on Negotiation Outcomes

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The field of negotiation research has been a major area of growth in recent years. Most of this research has focused on two-party negotiation, often within a mixed-motive context (Walton & McKersie, 1965), which emphasizes the integrative potential that exists (Fisher & Ury, 1981; Raiffa, 1982; Bazerman, Lewicki, & Sheppard, 1991; Neale & Bazerman, 1991). Some extensions of this perspective have focused on multiparty negotiations (Mannix, Thompson, & Bazerman, 1989; Brett & Rognes, 1986). While this research has moved beyond dyadic negotiation, it typically studies actors negotiating their own outcomes. Participants are led to believe that their objective is to maximize their individual benefit. In contrast, many negotiations occur through third parties such as agents or mediators, where these additional parties may operate under competing motives: to optimize the outcome in favor of the principals; to maximize their own personal gain; or to simply gain an agreement.

While the theoretical and empirical literature on principal–agent relationships has also grown dramatically in recent years (Eisenhardt, 1989; Jensen & Meckling, 1976; Ross, 1973; Zajac, 1990), there is virtually no empirical research on the impact of self-interested agents on the negotiation process. A considerable amount of research within the industrial relations literature examines the impact of institutional third parties (mediators, arbitrators, etc.). As a result of its industrial relations heritage, the empirical literature on intermediaries has focused on the impact of formally assigned third-party neutrals on negotiator behavior (Johnson & Pruitt, 1972; Neale & Bazerman, 1983). For example, research has focused on the impact of mediation versus arbitration, and the differential effects of alternate forms of arbitration (McGillicuddy, Welton & Pruitt, 1987). With some notable exceptions (Bartunek, Benton, & Keys, 1975, for example), past research has often focused on the impact of the threat of third-party intervention and its effect on
negotiator behavior prior to using the third party, rather than on the direct impact of using third-party procedures per se (Grigsby & Bigoness, 1982; Neale & Bazerman, 1983; Notz & Starke, 1978). This industrial relations perspective does not capture the essence of the third-party roles negotiators face. They may often use third parties who have an incentive to get an agreement and/or have their own incentive structure separate from that of the disputing parties.

A special case of the agency problem (Arrow, 1985; Ross, 1973) involves the use of agents as third parties who act for, on behalf of, or as the representatives of the principals. Agents are called for in many situations because of their specialized knowledge and their skill at matching buyers and sellers. The agents may transmit information for the principals or act as deal makers if the principals delegate such responsibility to them. While we acknowledge their benefits, using agents incurs costs. One obvious cost is that whatever compensation an agent receives from the transaction must come from one or both of the parties. The principal may assume that the agent will negotiate a settlement that covers the additional costs incurred. However, a critical issue in the agency literature is that the agent’s incentive structure may not match the incentive structure of the buyer or the seller, despite the implicit representation in the process (Rubin & Sander, 1988). Common organizational examples of this mixed-incentive structure include union negotiators in a contract dispute, who may have political concerns, or leasing agents, who have personal profit concerns.

This chapter examines how agent and mediator interventions affect the behavior of negotiators. The first study explores the impact of alternative third-party roles (agents and mediators) on the outcomes of negotiation. Specifically, we examine the impact of these forms of third-party intervention on the likelihood of impasse and the negotiated price if an agreement is obtained. In the second study, we explore the nature of the negotiated relationship between principals and an agent.

**Study 1**

Study 1 examines how informal third-party roles affect the outcomes of negotiation through the direct use of the third-party structure. Thus, this study focuses on the impact of negotiating with neutral third parties (mediators) and nonneutral third parties (agents) in comparison to negotiating without the use of third parties. We outline the roles of agent and mediator, create a set of predictions concerning how these roles are expected to affect negotiation outcomes, and provide an empirical test of these predictions in real estate negotiation simulations.

In the real estate setting, the potential buyer and seller often depend on the real estate agent(s). In a typical sale, the agent is legally working for the seller, and the seller formally pays the commission – normally 6%. Since
the agent receives a commission based on the selling price, the agent has some incentive to be biased toward the interests of the seller. The incentive structure of this self-interested agent may affect the information transmitted in the negotiation process.

In contrast to an agent’s incentive, the mediator’s role is to help disputing parties reach agreement (Kolb & Rubin, 1991; Sheppard, 1983, 1984). Typically, any fee the mediator receives is independent of the nature of the negotiation outcome. When the parties are unable to reach a settlement, the mediator can take an active role of applying pressure, channeling communications, allowing the parties to save face, persuading and leading the group in its task accomplishment and social relationship (Kolb, 1983). A mediator can also try to help the parties to see the negotiation from a more rational perspective (Neale & Bazerman, 1991). That is, the mediator can help the parties to make decisions that maximize their own utility. However, a mediator, by definition, cannot impose a settlement. Mediators have an incentive to help the parties reach an agreement — their reputations depend on their success at reaching agreements (Goldberg, Green, & Sander, 1985). Whether mediators should be concerned with the specific nature of the agreement is an ongoing dispute in the mediation literature (Susskind & Cruikshank, 1987; Goldberg et al., 1985; Kolb & Rubin, 1991).

On the basis of this preliminary overview of the roles of agents and mediators, one finds that while both types of third parties try to achieve the goal of encouraging agreement, the means they use to achieve this objective can have an important influence on the negotiated outcomes. Two critical questions arise. What impact do these third-party roles have on the likelihood of agreement? What will be the nature of the resulting agreements?

The way in which a third party influences the likelihood of agreement differs with the type of third party used. The use of an agent is likely to make it more difficult to reach agreement for at least two reasons. First, the more nodes in a communication channel, the greater is the probability of omissions or distortions in the message after it leaves its source (Hopper, 1976). Negotiating through an agent may be less efficient than direct bargaining because of the increased noise in the communication channel. In addition, the commission an agent receives must come out of the surplus otherwise available to the parties. The difference between the amount the buyer is willing to pay for a given property and the amount the seller is willing to accept determines the bargaining zone for the negotiation. An agent’s commission is paid out of the seller’s surplus, effectively reducing the size of the bargaining zone. Although a skilled agent may provide many of the benefits that have been associated with mediators in the literature, we argue that the communication complexity and the reduced bargaining zone will overwhelm any problem-solving skills the agent brings to the negotiation. Thus, the presence of an agent in a negotiation is expected to decrease the likelihood of settlement.
In contrast to the use of an agent, using a mediator may increase the likelihood of an agreement. The mediator’s role is to provide unbiased conciliatory efforts toward resolving a dispute. In essence, the mediator provides the negotiation with an extra mind to help the parties think through the problem in a less partisan manner. The mediation process puts a great deal of pressure on the parties to appear reasonable. As a result, we predict that mediation will increase the likelihood of agreement in comparison to negotiating without a third party or negotiating through an agent.

Similar to the impact on settlement rates, the effect a third party has on the nature of the agreement will differ between agents and mediators. The use of an agent is expected to increase the sales price of the housing unit, since the seller will have to pay the agent’s fee out of his/her surplus. However, the amount of the increase is unclear. One extreme prediction is that the sales price will increase by the amount of the agent’s fee, for it is the seller who formally pays the commission. In addition, the agent has the incentive to increase the sales price, which pushes the price toward the point where the seller gets the additional amount in the sales price to cover the commission. This is a typical argument provided by realtors for why the seller should hire an agent rather than selling a house without an agent. In contrast, when individuals or professional appraisers evaluate the market value of a home, they do not provide one figure with an agent and one without. Rather, market value implies a set figure specifying the value of the home regardless of whether an agent is involved. This suggests that the price of the house will not change as a result of agent intervention. Note the initial logic implies that the buyer implicitly pays the agent fee, while the latter logic implies that the seller pays the agent fee. In one study of actual real estate negotiations (in which comparability was controlled for based on characteristics of transferred property), Jud and Frew (1986) found sellers and buyers roughly shared the cost of the realtor commission. While we clearly expect a result between the two, resulting in an increase in the sales price, we offer no clear prediction concerning the degree to which the buyer versus the seller can be expected to pay for the agent.

The mediator, in contrast to the agent, is unlikely to have the incentive to increase the negotiated price. The mediator is in a position of trying to resolve the conflict between buyer and seller impartially. The mediation process has been criticized for coopting the less powerful parties in negotiations, because of the implicit value mediation places on getting an agreement (Roehl & Cook, 1989). Alternatively, mediators have been accused of putting pressure on both sides, even when one side’s position may be justified based on market forces, etc. (Carnevale & Conlon, 1987). This behavior increases the likelihood that the mediator will obtain bilateral concessions. In the study presented in this chapter, information on market values of comparable properties was provided for principals and agents. The market value of a property is expected to form an anchor from which the buyer and seller will adjust
their offers. As a result of the anchoring and adjustment bias (Bazerman, 1990; Slovic & Lichtenstein, 1971; Tversky & Kahneman, 1974), parties are expected to keep their offers centered around the market anchors, unless some external pressure is exerted to move them away from this point. We predict that mediators will push the parties toward an agreement in the middle of the bargaining zone, regardless of whether the anchor provided favors the buyer or the seller.

The arguments provided above lead to the following formal hypotheses to be tested in Study 1:

H1: The use of an agent will increase the selling price of a house in comparison to negotiating with no intermediary.

H2: The use of a mediator will lead parties to reach agreements closer to the midpoint of the bargaining zone than if they negotiated with no intermediary.

H3: The use of an agent will increase the impasse rate in comparison to negotiating with no intermediary.

H4: The use of a mediator will decrease the impasse rate in comparison to negotiating with no intermediary.

Methods

Subjects. All 294 subjects were MBA students at a large midwestern university. Their average age was 26 and they averaged 3.6 years of work experience. Subjects participated in the experiment as part of course activities.

Design. The design simulated three different property transactions (house, townhouse, and condo) across three third-party conditions (no-agent, agent, mediator), crossed with two sets of market anchors (high or low market anchors) describing the value of the properties. These factors were fully crossed in a $3 \times 3 \times 2$ design, creating 18 different negotiation contexts. Property and third-party condition were varied within subject, while the market anchor was varied between subject.

Description of Negotiation Simulations. Three different simulations were used, to allow for multiple use of the same subjects in a within-subjects design. All three were structurally similar, but varied on surface characteristics. One case, "house," had an asking price of $235,900, with the buyer’s reservation price set at $230,000, and the seller’s reservation price set at $210,000. The second case, "townhouse," had an asking price of $195,000, with the buyer’s reservation price set at $190,000, and the seller’s reservation price set at $175,000. The third case, "condo," had an asking price of $139,500, with the buyer’s reservation price set at $138,000, and the seller’s reservation price set at $128,000. For each property, a brief description of the real estate was given, and several features of the property such as inside and outside amenities
were depicted in the description. In addition, comparison data on similar properties recently sold in the neighborhood were given as a reference.

To test the impact of the tendency of mediators to push the agreement toward the middle of the bargaining zone, we created two versions of each of the three housing simulations. In one form, the comparison data implied that a figure around the seller’s reservation price was the fair market price on the unit (low anchor). In the other form, the comparison data implied that a figure around the buyer’s reservation price was the fair market price on the unit (high anchor). All members of the same class participated under three “high” anchor simulations or under three “low” anchor simulations, making “anchor” a between-subjects variable.

Assignment of Participants to Roles. Each subject participated in each of the three simulations of the experiment in a different role – buyer, seller, or third party. Since the third-party role is one of the manipulations, they were assigned to one of three possible third-party conditions. They were involved in simulations under the other two third-party roles in their other two simulations. Thus, all subjects participated in each of the three different housing simulations, and under each of the three third-party roles.

To create the three third-party conditions (no-agent, agent, mediator), three intermediary roles were created. In the “no-agent” condition there was an “observer,” who was simply required to verify the agreement with the buyer and the seller after the close of the agreement and return the signed agreement to the instructor. The “agent” was assigned the role of helping the parties reach agreement. In this condition, the buyer and seller could communicate to one another only through the agent. Participants were told the buyer and the seller were not to meet directly with one another at any point in the negotiation – they were allowed to meet only with the agent. The agent version informed all parties that it is normal for the seller to pay the agent a commission of 6% of the transaction price upon sale of the property. However, the subjects were also told that the rate of 6% was not legally binding and was negotiable. If no sale was consummated, the agent received no commission. In the “mediator” condition, the mediator was told (consistent with the understanding of the other parties) that “Buyers and sellers pay a flat fee to your organization to obtain access to your services. However, you are paid your service fee only if you get an agreement between a buyer and a seller. Thus, your pay is dependent on getting buyers and sellers to agree to sign a final agreement.” The parties were able to use the mediator in any way that they chose. However, the parties were required to include the mediator in any face-to-face meeting.

Participants were told how each party would be evaluated. In the “no-agent” version, net surplus to the buyer (seller) was the amount under (over) the reservation price. In the “agent” version, the buyer’s net surplus was again the amount under his/her reservation price. The seller’s net surplus
was the amount over the reservation price minus the realtor commission. As such, the agent’s commission reduces the size of the effective bargaining zone. Obviously, the agent’s net surplus was the commission received. Buyer and seller surplus was calculated exactly the same in the mediator condition as in the no-agent condition. The mediator was told that “You will be evaluated on whether or not you get the two parties to agree to a settlement. If they agree, you are a success. If they do not agree, you have failed in this exercise.”

**Procedure.** Explanation of the simulation to each class of 27, 30, or 33 subjects took about 15 min. No participants interacted with the same party more than once in their three simulations. Since all subjects participated in all three cases, there were three unique negotiating groups to which each subject belonged. Subjects were allowed to negotiate the three cases in any order and were not required to conclude one negotiation before initiating others. Participants were told they had 6 days outside of class to conduct the three negotiations. Failure to reach agreement within the designated time period was defined as an impasse. Subjects were required to submit the results of their negotiations 1 day prior to the next class meeting. Subjects informally reported spending between 4 and 10 h to conduct the three negotiations.

Each participant received three packets of materials which included: (1) instructions for each role; (2) description of the real estate; (3) information about sales prices of real properties recently sold in the neighborhood; (4) payoff table of the costs or savings surrounding the extra two issues besides price; (5) note on how each party would be evaluated; and (6) agreement form to be signed by all concerned parties in the negotiation. (A complete set of materials is available from the authors.)

An Agreement Form, to be signed by all concerned parties in the negotiation, was used to record the contract to which a buyer, seller, and third party agreed. The third party was responsible for returning the form by the deadline. Instructions indicated that each party should maximize his/her profit in the negotiation. Results would be posted in the next class period. Use of the telephone was allowed, but any agreement had to be confirmed in writing on the Agreement Form.

**Results**

The data tend to support the hypothesis that the use of an agent will increase the selling price in comparison to negotiating with no intermediary. The means for each condition are presented in Table 26.1. For all properties, the selling price of the property was higher when an agent was used than when no intermediary was involved in the negotiation \( p < .05 \). In addition, in a full regression that includes controls for the type of property sold, the
Table 26.1. *Mean Sales Price by Condition*

<table>
<thead>
<tr>
<th></th>
<th>No Intermediary</th>
<th>Agent</th>
<th>Mediator</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>House (BZ: $210,000–230,000)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High anchor</td>
<td>$221,862</td>
<td>$224,484</td>
<td>$222,167</td>
</tr>
<tr>
<td>Low anchor</td>
<td>219,132</td>
<td>221,621</td>
<td>219,339</td>
</tr>
<tr>
<td><strong>Townhouse (BZ: $175,000–190,000)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High anchor</td>
<td>$183,383</td>
<td>$186,500</td>
<td>$184,800</td>
</tr>
<tr>
<td>Low anchor</td>
<td>180,448</td>
<td>182,610</td>
<td>181,153</td>
</tr>
<tr>
<td><strong>Condo (BZ: $128,000–138,000)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High anchor</td>
<td>$133,478</td>
<td>$132,012</td>
<td>$133,745</td>
</tr>
<tr>
<td>Low anchor</td>
<td>132,492</td>
<td>133,373</td>
<td>132,403</td>
</tr>
</tbody>
</table>

Selling price is significantly higher when an agent is used than under either of the other two conditions ($p < .05$). Two dummy variables were used to represent the properties.

Given that price increases when an agent is used, a question arises whether the increase covers the commission the seller pays the agent. To what extent is the agent commission being paid by the seller versus the buyer? One way to gain insight into this question is to determine the percentage of the commission coming out of seller surplus versus buyer surplus. If we define $P_a$ to be the average selling price with an agent, $P_{na}$ to be the average selling price with no intermediary, and $P_{a-c}$ to be the average selling price with an agent less the commission, then $[(P_a - P_{na})/(P_a - P_{a-c})]$ is equal to the percentage of the commission coming from the buyer's surplus. $\{1 - [(P_a - P_{na})/(P_a - P_{a-c})]\}$ is equal to the percentage of the commission coming from the seller's surplus. Using this equation, we find that the buyer pays 28.1% of the commission in the house case, 39.4% of the commission in the townhouse case, and 23.1% of the commission in the condo case.

The second hypothesis, that when using a mediator the selling price will be closer to the midpoint of the bargaining zone than when no intermediary was used, was not supported. Our design assumed that large differences would exist between high and low anchor conditions for each of the three properties, and that this hypothesis would be tested by looking for movement toward the middle of the range, away from the high and low anchors, when mediation was used. Surprisingly, the differences between high and low anchor conditions were quite small, eliminating the potential of providing evidence for Hypothesis 2.

The incidence of impasse relative to settlement is shown in Table 26.2. The data show support for Hypothesis 3, that the use of an agent would increase the impasse rate in comparison to negotiating with no intermediary (11 impasses of 99 negotiations with an agent; 5 impasses of 98 negotiations
Table 26.2. Impasses/Settlements by Property and Third-Party Role

<table>
<thead>
<tr>
<th></th>
<th>No Intermediary</th>
<th>Agent</th>
<th>Mediator</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>House</td>
<td>1/31</td>
<td>5/29</td>
<td>0/32</td>
<td>6/92</td>
</tr>
<tr>
<td>Townhouse</td>
<td>2/31</td>
<td>3/30</td>
<td>1/31</td>
<td>6/92</td>
</tr>
<tr>
<td>Condo</td>
<td>2/31</td>
<td>3/29</td>
<td>1/32</td>
<td>6/92</td>
</tr>
<tr>
<td>Column total</td>
<td>5/93</td>
<td>11/88</td>
<td>2/95</td>
<td>18/276</td>
</tr>
</tbody>
</table>

Note: $\chi^2$ significant at .05.

with no intermediary, $p < .05$). The data do not support Hypothesis 4, that
the mediator would decrease the impasse rate in comparison to negotiat-
ing with no intermediary (2 impasses of 97 negotiations with a mediator; 5 impasses of 98 negotiations with no intermediary, $p = \text{ns}$). Obviously,
the limited number of impasses make the testing of impasse predictions
more difficult. It is interesting to note, however, that the direction of im-
passe results (agent > no intermediary > mediator) held up under each of
the three property simulations.

Discussion

The results generally support our predictions concerning the impact of
mediators and agents on impasse rates: agents hurt and mediators help.
Buyers and sellers acting solely through an agent cannot speak directly to
one another. The information they pass to one another through the agent
may be insufficient, misunderstood, or simply misrepresented. There were
several incidents where the participants playing the role of agent in this
study clearly misrepresented one or both of the parties, by withholding in-
formation or providing false information. In debriefing, the agents claimed
to be trying to ensure that the sales price was as high as possible, but the
potential result was impasse where settlement was clearly in all three parties’
interests.

Unfortunately, the small number of impasses in this study hinders our
ability to reach conclusions concerning the impact of mediators on impasse
rates. While the predicted pattern was observed across all three property
simulations, the statistical test comparing impasse rates of mediation to the
no-intermediary condition was not significant. Another explanation of why
the effect for mediation was not significant is that the participants in this
study were not trained in mediation techniques. Their marginal effectiveness
at bringing about settlement may reflect the benefits of the mediation process,
mitigated by the inexperience of the mediators. A third explanation is that
while mediators may facilitate settlement, the presence of an extra party
in the communication network makes interaction more complicated. Thus, some of the positive effects of the mediator are counteracted.

This study highlights a more general problem with using laboratory studies to understand negotiation. The negotiation literature is lacking in controlled studies that look at settlement as the dependent variable. Why? It may be that the demands for agreement in a laboratory are so high that subjects will go to extremes to reach agreement. This raises an important question concerning how we can study this important dependent variable in controlled contexts.

The results also show that agents raise the sales price of the property, and both the buyer and seller contribute to the payment that the agent receives. While the seller pays a greater proportion of the commission, the amount paid by the buyer is still quite significant. This is consistent with field data by Jud and Frew (1986). This counteracts the impression many people have, based on the fact that the seller formally pays the commission. Thus, a "for-sale-by-owner" situation does imply savings to both parties in the negotiation.

While this study provides evidence for the self-serving behavior of agents, it raises many questions regarding how this affects the principals in a negotiation. To what extent do negotiators realize that the agent is a self-interested, not a neutral, third party? Do negotiators adjust their behavior toward the agent to take this into account? These are questions addressed in the second study.

Study 2

An often overlooked issue existing in negotiations through agents is the implicit or explicit negotiation between the principals and the agent(s). The terms we use to describe a negotiation process often lead us to conceptualize the negotiation in a way that includes putting buyer and seller on different sides and viewing the agent as a neutral or as a representative of one side. In contrast, an economic analysis would suggest that if the buyer has a reservation price, and the seller has a reservation price (net of paying the agent), then payment to the agent must come out of the surplus. Thus, the parties are in a negotiation not only with each other, but also with the agent. This study initiates the empirical examination of the negotiated relationship between the principals and their agent.

To start the investigation of the negotiation relationship between the principal and the agent, it is necessary to confront the counterrational fact that realtors most commonly receive 6% of the sales price of residential real estate. In the large majority of residential transactions, the real estate commission is not negotiated (Jud & Frew, 1986). This outcome is very different from what would be expected given an economic analysis of a three-party negotiation game in which a fixed amount of surplus is available to be divided. While
such an analysis yields no equilibrium solution, Nash (1950) would predict that the settlement would maximize the product of the surpluses of the three parties. This occurs when the total surplus is equally divided among the parties. Thus, holding sales price constant, it is reasonable to expect agent commission rate to decrease with a decrease in the size of the bargaining zone. Why is actual behavior so different from this expectation?

One powerful explanation of the stability of the 6% commission is the institutionalized nature of this commission rate. Institutionalization theory (DiMaggio & Powell, 1983; Zucker, 1977) argues that action can be perpetuated because acts take on a “taken-for-granted” nature. According to Meyer and Rowan (1977), institutionalization involves the processes by which social roles, obligations, or actualities come to take on a rule-like status in social thought and action. For highly institutionalized acts, it is sufficient for one person simply to tell another this is the way things are done (Zucker, 1977). The institutionalized nature of the 6% fee or “the standard 6,” as it is referred to by real estate agents, is a carryover from the days when fees were set by local real estate boards (Allen, 1990). It is now illegal for these fees to be fixed, but the norm continues to guide agent behavior. “While boards no longer published a fee schedule that could be enforced, members [of real estate boards] continued to act as if a schedule were fixed” (Allen, 1990). Economic theory argues that behavior will only continue to the extent it is in the interest of the parties involved. Agents are expected to provide specific facts and advice to the buyers and sellers to aid them in their decision making. How much is this assistance worth? The only parties with a continuing interest in answering this question are the agents, and it is in their interest to keep the answer at 6%.

Another possible explanation for the rigidity of the 6% commission comes from the psychological literature on anchoring and adjustment (Slovic & Lichtenstein, 1971; Tversky & Kahneman, 1974). Given that the 6% fee has been at least partially institutionalized, an interesting question becomes what adjustment would be made if the parties recognized the 6% as a high figure in a specific transaction and negotiated an adjustment to the commission rate. Slovic and Lichtenstein (1971) have shown that if people use an anchor (e.g., 6%), and make an adjustment from that anchor, the adjustment will be insufficient in comparison to the decision that would have been made without the anchor, even if the party(s) knows the anchor was (completely) irrelevant (Bazerman, 1990). Thus, to the extent the parties anchor on 6% they will end up closer to that figure than they would have had they started with a blank slate.

Finally, Staw, Sandelands, and Dutton (1981) argue that under scarcity (e.g., insufficient joint surplus for the deal to be completed), individuals within a system are likely to become more rigid in their behavior, and less open to novel alternatives. To the extent that reducing the agent’s commission is thought of as something out of the ordinary, Staw et al. (1981) would
suggest that scarcity provides a barrier to creativity that may prevent the flexibility of adjusting the commission.

Despite the relevance of these behavioral explanations for the rigidity of the 6% commission, there are stories of real estate agents cutting their commissions. The most common reason given for this behavior is to "close the deal" – the buyer and seller are a couple thousand off, and the agent feels that if he/she does not yield on commission, the deal will fall through. Thus, the pressure of a reduced bargaining zone may lead one of the three parties involved – the buyer whose budget is restricted, the seller whose alternative is slightly less desirable, or the agent who is paid only if a sale is made – to initiate discussion of a reduced commission. This argues that the 6% commission rate is most likely to be adjusted when it is economically necessary in order for an agreement to be reached. Yet, even under these conditions, we expect the adjustment will be less than suggested by a Nash (1950) solution. Thus, as the size of the bargaining zone decreases, the size of the commission is expected to decrease, but not to the same degree as the surplus of the parties decreases.

Based upon the arguments provided above, the following hypotheses are proposed:

H1: The percentage of the sales price that the agent receives will be lower when the bargaining zone is smaller.

H2: The percentage of the total surplus that the agent receives will be higher when the bargaining zone is smaller.

Methods

Subjects. All 93 subjects were MBA students at a large midwestern university. Their average age was 26. The subjects had an average of 3.6 years of work experience. The exercise was part of the course requirements.

Design. The design simulated three different property transactions (house, townhouse, and condo) crossed with two different size bargaining zones ($20,000 or $10,000). These two factors were fully crossed in a $3 \times 2$ design, creating six different negotiation contexts.

Description of Negotiation Simulations. Three different simulations were used, to allow for multiple use of the same subjects. The three were similar to the cases used in Study 1, with the modifications listed below. While the anchor was a manipulation in Study 1, in this study the anchor was a constant and always set equal to the middle of the bargaining zone. One case, "house," had an asking price of $235,900, with the midpoint of the bargaining zone equal to $220,000 (also the imputed value of the comparison houses). In the $20,000 zone condition, the buyer's reservation price was set at $230,000, and the seller's reservation price set at $210,000. In the $10,000 zone condition,
the buyer’s reservation price was set at $225,000, and the seller’s reservation price set at $215,000.

The second case, “townhouse,” had an asking price of $195,000, with the midpoint of the bargaining zone equal to $180,000 (also the imputed value of the comparison houses). In the $20,000 zone condition, the buyer’s reservation price was set at $190,000, and the seller’s reservation price set at $170,000. In the $10,000 zone condition, the buyer’s reservation price was set at $185,000, and the seller’s reservation price set at $175,000. The third case, “condo,” had an asking price of $139,500, with the midpoint of the bargaining zone equal to $128,000 (also the imputed value of the comparison houses). In the $20,000 zone condition, the buyer’s reservation price was set at $138,000, and the seller’s reservation price set at $118,000. In the $10,000 zone condition, the buyer’s reservation price was set at $133,000, and the seller’s reservation price set at $123,000.

Assignment of Participants to Roles. Assignment was made in the same manner as in Study 1, except that Agent was the only third-party role assigned. The “agent” was assigned the role of helping the parties reach agreement, and was the only means by which the buyer and seller could communicate. Participants were told that the buyer and the seller were not to meet directly with each other at any point in the negotiation—they were allowed to meet only with the agent. All parties were told that when a sale is made, it is normal for the seller to pay the agent 6% of the transaction price of the property as commission. However, the subjects were also told the rate of 6% was not legally binding and was negotiable. If no sale were consummated, the agents received no commission.

The participants were told how each party would be evaluated. The buyer’s net surplus was the amount of the purchase price under his/her reservation price. The seller’s net surplus was the amount over his/her reservation price, minus the realtor commission. The agent’s commission thus reduces the size of the bargaining zone. The agent’s net surplus was the commission received.

Procedure. Explanation of the simulation to each class of 30 or 33 subjects took about 15 min. Participants were told they had 7 days outside of class to conduct their three negotiations. Failure to reach agreement within the designated time period was defined as an impasse. All other procedures were the same as in Study 1. (A complete set of materials is available from the authors.)

Results

The means for the commission rate and the percentage of the surplus received by the agent in each of the six conditions are shown in Table 26.3. The hypotheses were analyzed formally using two regression equations (n = 93)
Table 26.3. Mean Commission Percentages (Standard Deviations) by Condition

<table>
<thead>
<tr>
<th>Agent Commission as Percentage of Sales Price</th>
<th>House*</th>
<th>Townhouse*</th>
<th>Condo*</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10,000 bargaining zone</td>
<td>1.8838 (.929)</td>
<td>2.2947 (.589)</td>
<td>3.1650 (1.255)</td>
</tr>
<tr>
<td>$20,000 bargaining zone</td>
<td>3.7279 (1.604)</td>
<td>4.3000 (1.198)</td>
<td>4.6980 (1.719)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Agent Commission as Percentage of Total Surplus</th>
<th>House</th>
<th>Townhouse</th>
<th>Condo</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10,000 bargaining zone</td>
<td>.4017 (.180)</td>
<td>.4175 (.109)</td>
<td>.4092 (.164)</td>
</tr>
<tr>
<td>$20,000 bargaining zone</td>
<td>.3938 (.169)</td>
<td>.3950 (.112)</td>
<td>.3191 (.104)</td>
</tr>
</tbody>
</table>

* \( p < .01 \).

which tested for the impact of bargaining zone, while controlling for type of property sold. Two dummy variables were used to represent the three different properties. The results of this regression equation support the hypothesis that agent commission, when measured as a percentage of the sales price of the property, will be lower when the bargaining zone is smaller \((t = 6.797, p < .001)\). This effect was also significant for each of the three properties when analyzed separately (see Table 26.3).

The second hypothesis, that agent commission, when expressed as a percentage of total surplus available to the three parties, will be higher when the bargaining zone is smaller, was not supported. While effects were in the predicted direction, they were not significant.

Discussion

Our second study examined the nature of the negotiated relationship between an agent and the parties. We found reducing the size of the bargaining zone led to a reduced commission, when commission was expressed as percentage of transaction price. But, as the bargaining zone shrinks, agent commission is not reduced proportionately. Thus, commission expressed as percentage of total surplus actually increased as the zone decreased, though not significantly.

The effects of institutionalization may not have been strong enough to keep the agent’s commission as high as possible. As the zone shrinks, agents are forced to reduce their commissions, but strong norms pulling agent fees to 6% serve as an anchor when the agent is forced to negotiate his/her commission. These norms operate in the real estate market, but are not so influential in a simulated setting.
Another explanation of why the agents were willing to negotiate away more of their commission than we expected may result from the lack of extra information brought to the negotiation solely by the agent. In a real estate transaction, the agent often has access to information that is difficult for the buyer or seller to obtain. While in many markets this information is available to the public, buyers and sellers may not be aware of this or may be unwilling to invest the time required to collect it. Thus, agents provide a resource, information, for which buyers and sellers are willing to pay. In this study, all information was provided to all parties. The differential knowledge of the agent was taken out of the negotiation and the justification for retaining a 6% commission was reduced.

General Discussion

This study has several objectives: to open up a new agenda for empirical research in negotiation; to begin to understand the unique nature of the negotiated relationship between third parties and their respective principals; to assess one form of agency costs in buyer–seller relationships; and to consider the impact of third parties, such as agents and mediators, on the outcomes of negotiation. While these initial studies are far from conclusive, they do offer a number of suggestions for future research attention. First, it is important to realize that any surplus received by an agent must come from somewhere, i.e., from the parties. The specific structure of a third party’s incentive contract can make it more, rather than less, difficult for buyers and sellers to reach an agreement. Second, the results suggest that the payment to a third party is made by all the parties in the negotiation (i.e., the buyer and the seller), not just by the party making the formal payment (the seller). Third, there is some indication that mediators do reduce the likelihood of impasse, although this result was not significant. Finally, the results from the second study support the notion that the agent should be thought of as a negotiator with his/her own self-interest. While these results support the view of the principal–agent relationship as discussed in the agency theory literature (Ross, 1973), we believe they are contrary to conventional wisdom concerning the role of the agent, where he/she is perceived as a member of one negotiation side.

This line of research also has theoretical and empirical implications for both the agency and transaction cost literatures (Williamson, 1975), which are part of what is increasingly referred to as the field of “organizational economics” (Barney & Ouchi, 1986). Theoretically, the agency literature typically studies the divergence of interests between principals and agents, but not the role of agents as third parties in buyer–seller relationships. Transaction cost theory, on the other hand, is centrally concerned with the structure of buyer–seller relationships, but not with the possibility that the third parties entrusted to govern such relationships may themselves be self-interested. This
study examines buyer–seller relationships with self-interested third parties, a “hybrid” situation relevant to agency and transaction cost theory.

Empirically, the agency and transaction cost literatures are heavily reliant on the notion of agency and transaction costs, respectively, but these costs have typically been difficult to measure directly using field and archival data. This study shows how an experimental design enables the direct observation and measurement of one type of agency or transaction costs in buyer–seller relationships.

Future research should also examine the impact of agents in a world where the commission rate has a higher level of institutionalized acceptance. Other important questions to be addressed include the impact of third parties on the integrativeness of agreements, and the impact of giving information to a third party on the nature of the resulting agreement. We also need to examine contexts in which more than one agent is involved. Finally, we need to learn more about the process involved in negotiations through agents.

This chapter fits into a more general research theme of extending the boundaries of the nature of negotiation research. The vast majority of existing negotiation research focuses on two-party negotiation. Only recently have groups been conceptualized as negotiations (Brett & Rognes, 1986; Bazerman, Mannix, & Thompson, 1988). We believe a negotiation perspective is likely to have a significantly greater impact if we expand our focus to include group behavior, third parties, negotiation in markets, and a variety of other more complex social contexts.

References

Allen, J. L. (1990). “There was some carryover” of a set fee schedule. Chicago Tribune. March 18, 1990, Section 16, 2H.


