



# How Important Is Culture?: An Inside Look at Keller Williams Realty

By David F. Larcker and Brian Tayan

April 16, 2015

*“When we talk with top agents and ask them what attracted them to Keller Williams, they mention our models and systems, they mention our training, they mention our technology, and they absolutely mention our culture.”*

— Chris Heller, CEO

## INTRODUCTION

Corporate leaders pay considerable attention to the strategy and finances of their organization but often less attention to organizational features that impact whether their strategy is successful, including the decision-making structure and the incentives, values, and culture that motivate individual employees to act in the interest of the firm.<sup>1</sup> While a sound strategy and business model are fundamental to financial results, these elements must be implemented by *people*, and people have their own set of motivations, interests, and aspirations. The responsibility of the leader is to devise organizational systems that encourage individuals to pursue corporate goals, when the goals of the firm are not necessarily paramount in their minds.<sup>2</sup>

One commonly employed model is the “command-and-control” system. In a command-and-control system, leaders retain considerable power, decision making is centralized, and a series of rewards and punishment mechanisms ensure compliance. Many corporations rely on some variation of this approach.

An alternative to the command-and-control system is decentralization. In a decentralized system, the people closest to the market are responsible for decision making, and cultural mechanisms and financial incentives are put in place to encourage

the sharing of information and best practices to improve the quality of decisions, benefiting both the organization and individual employees.

Keller Williams Realty is an example of a company that takes a blended approach. While its franchising process is centrally controlled, the company willingly cedes significant decision-making authority to its associates and relies on culture to ensure that its operating model and people are successful.

## KELLER WILLIAMS

Keller Williams is the largest real estate franchise in the world with over 115,000 agents.<sup>3</sup> Founded in a single office in Austin, Texas, in 1983, the company has grown to the top of its industry, surpassing well-known rivals including Century 21, Coldwell Banker, and RE/MAX. The company began expansion outside North America in 2012, and by early 2015 had offices in 10 regions around the world. By several relevant economic metrics—sales volume per office, sides per office, agents per office—the company’s performance exceeds that of every other major brokerage in the United States (see Exhibit 1).

Keller Williams has achieved these results by leveraging an economic model that delivers profits through economies of scale and a cultural model that relies on profit sharing, interdependence, and success through the efforts of others.

## ECONOMIC MODEL

The company’s economic model relies on low fixed costs and high commission volume to generate profitability at the market center (local office) level.<sup>4</sup> A typical Keller Williams market center employs over 150 agents (compared to between 30 and 40 at key

competitors) and generates more than twice the sales volume. The franchise headquarters is careful to approve franchises with large territories to maximize profitability for the office and its agents. With fewer offices in a market, commission revenue is divided across a lower fixed-cost base, thereby increasing profitability. In 2014, 98 percent of Keller Williams market centers open at least a year were profitable.

The commission split is a hybrid of that offered by various competitors and is designed to share the benefits of production equitably between the market center and agents.<sup>5</sup> A Keller Williams agent generally receives a 70/30 commission split from the first dollar of gross commission income (GCI) generated from the sale of a home. The agent splits commissions with the market center at this rate until reaching an annual cap. The cap is determined by the owner of the market center at the time the center is opened and typically ranges between \$20,000 and \$60,000, depending on the market. The agent retains all GCI in excess of the cap. The agent is also responsible for paying a small franchise fee to the international office each year.

Keller Williams is unique among real estate franchise companies in that it offers a second source of income—profit sharing—to its agents. The formula for distributing profits is based on the productivity of other agents that the agent recruits to the company and the cash profits generated by their market center. It takes into account not only agents directly recruited (so-called “level one” profit sharing) but also agents that those agents recruit, extending up to seven degrees of separation, and is designed to reward the recruitment of highly productive agents. The international office calculates each agent’s profit share based on financial reports transmitted monthly by the market centers.<sup>6</sup> In 2014, Keller Williams shared \$98 million in profits with its agents (see Exhibit 2).

The combination of the Keller Williams economic model and profit sharing system results in an economic profile that is very different from competitive firms (see Exhibit 3). Agents retain a higher percentage of GCI (approximately 82 percent versus 66 percent). Market centers have a lower operating margin (5 percent versus 8 percent), and the

international office receives a lower effective royalty rate (3 percent versus 6 percent). However, because each market center tends to be much larger than those of competitors, the dollar amounts flowing to the owners of market centers and to the international office are higher. Less money is spent on expenses (7 percent versus 20 percent). The economic system is designed to be consistent with the company’s “win-win” philosophy.

### CULTURAL MODEL

To the leaders of the company, Keller Williams’ culture is equal in importance to the economic model in accounting for the company’s success. According to former president and current board member Mary Tennant, “We know for a fact that our systems don’t work without our culture. We need our culture to reach our full potential.” According to Vice Chairman Mo Anderson, the culture is “the glue that holds it all together.” In the words of a former executive, “It’s very difficult to separate the culture and the systems, because the systems are written for the culture and the culture exists for the systems.”<sup>7</sup>

The company’s culture encourages interdependent relationships and achieving success through the efforts of others.<sup>8</sup> It is encapsulated in the company’s belief system: WI4C2TS (pronounced “why four see two tees”):

- Win-win – or no deal
- Integrity – do the right thing
- Customers – always come first
- Commitment – in all things
- Communication – seek first to understand
- Creativity – ideas before results
- Teamwork – together everyone achieves more
- Trust – starts with honesty
- Success – results through people

The company maintains four cultural practices to ensure that agents, market center owners, and team leaders operate like real stakeholders in the company. First, the company shares its profits, as discussed above. Second, the company involves agents, owners, and team leaders in decision making. Third, the company maintains open financial books. Fourth, the company offers extensive training to agents and leaders.

*Decision making.* The organizational structure of each market center encourages shared decision making among owners, leaders, and agents. The Keller Williams franchise agreement requires a separation between the ownership of a market center and its leadership. Market centers are owned by an operating principal (OP) but managed by a team leader whom the OP recruits. This structure gives the team leader accountability. It also means the OP and team leader have aligned incentives; whereas the OP is principally concerned with maximizing owner profits, the team leader makes money primarily through an operating profit bonus that depends on profitability. The OP recruits a core of top-performing agents to launch the office. These agents become the bedrock of the market center and help the team leader attract additional agents. The team leader's responsibility is to grow agent count, and the profit sharing system gives an additional incentive to do so.

The management of the market center is not the sole responsibility of the team leader, nor is it the joint responsibility of the OP and the team leader. Keller Williams believes that agents are stakeholders in the success of the market center and therefore should share in decision making. As a result, the OP, team leader, and select agents (chosen among the top 20 percent measured by GCI) jointly serve on what is called the Agent Leadership Council (ALC). Together, they jointly make office decisions relating to financial planning, recruiting and retention, marketing and advertising, training, technology, social events, and philanthropic giving. The ALC structure has the following benefits: those with local knowledge and the greatest financial stake in the market center help make decisions; agents learn a business mentality with special attention to cost control; shared authority leads to better retention; and policies have greater validity throughout the market center because they have been set by peers. According to former CEO and current board member Mark Willis, "We empower our people to make decisions that they literally own and are accountable for, because they have been given a voice. They've been treated like partners and they've been respected."<sup>9</sup> In the words of a team leader, "We have a saying, 'As the ALC goes, so goes

the market center.' We're an agent-driven company. Any time we've gotten in trouble it is because we didn't slow down, help to explain [our choices], and get everybody's buy-in."<sup>10</sup>

Bottom-up decision making extends to the executive leadership of the company. CEO Chris Heller and President John Davis both were successful agents, owners, and regional leaders for the company before assuming their current roles.

*Open books.* In order for the profit share and ALC decision-making systems to maintain their integrity, Keller Williams operates an open books policy. All agents in the market center have access to view detailed revenue and expense information for the entire market center to help increase the market center's profit and profit share. Because the profit share formula does not change, agents can run calculations to make sure they are receiving the correct amount. Minutes of ALC meetings are also available for review. The open book system means that there are no secrets between the leaders of the market center and individual agents regarding financial or managerial decisions.<sup>11</sup>

*Training.* Finally, the leaders of Keller Williams believe that if individuals are expected to play a role in the management and success of the company, the company has an obligation to provide education and training to help them reach their full potential. Keller Williams offers extensive training to agents, team leaders, and OPs through courses that document best practices for business building, leadership, and personal development. These include instructor-led classroom courses, instructor-led virtual sessions, and online self-paced modules. In 2014, 100,000 associates and affiliates completed classroom-based sessions, and 26,000 associates completed online self-paced study programs. *Training* magazine ranked Keller Williams number one on its 2015 list of the top 125 companies providing learning and development for employees, across all industries.<sup>12</sup>

The Keller Williams operating model results in an organization that is essentially agent led. All major initiatives are originated in the field, and agent initiatives are implemented in a market center only

with the buy-in of associates. For example, recent initiatives to boost market center profitability and agent count, charitable activities, the company's expansion into specialty lines, and the adoption of new technology were all initially devised by individual associates before adoption by other market centers.

Furthermore, all Keller Williams' training courses are created by and modeled on the successful activities of individual agents, team leaders, and owners. For example, BOLD, an agent coaching class designed to improve sales productivity, is based on the systems and business practices that KW MAPS Coaching CEO Dianna Kokoszka developed when she was an agent. Kokoszka now leads the course company-wide, and agents enrolled in BOLD average more transactions during the seven-week course (13) than a typical agent in the industry averages during a year (9).

Similarly, the Growth Initiative, a training and accountability program for local and regional leaders, was developed by John Davis when he was a regional director to improve the profitability of market centers in his area. The Growth Initiative was presented as an opt-in program and has now been embraced companywide. The company's leadership attributes much of Keller Williams' growth over the last four years to adoption of tools developed and refined through the Growth Initiative.

According to Bryon Ellington, chief learning officer of Keller Williams, "There is a level of cooperation between agents and offices that doesn't exist at other companies. Our training, our systems, the profit share: it creates a virtuous cycle. And it all ties back to this culture of giving back, of sharing knowledge."<sup>13</sup>

#### WHY THIS MATTERS

1. Corporate leaders pay considerable attention to their strategy and business model but somewhat less attention to the culture of the organization. How important is culture as a determinant of economic outcomes? Are there industries or settings where culture is more important and others where it is less important?
2. The leaders of Keller Williams believe that the company's economic model would not succeed

without its culture and that its culture could not exist without its economic systems. Is this true? Could a new culture be introduced without compromising economic results?

3. The Keller Williams operating model has several unique features, including scale economies, profit sharing, shared leadership, open financial books, and training. How important are each of these to the company's success? Are some "more important" than others?
4. The Keller Williams belief system places considerable emphasis on specific values and individual behaviors. What impact do values and behaviors have on economic outcomes? How are values and behaviors within an organization influenced by "tone at the top"?
5. Some economists believe that culture is simply a reflection of the incentives (financial and nonfinancial) in place in an organization. Is this true? Are culture and incentives the same, or is culture something more than "incentives"? ■

<sup>1</sup> To this end, a 2013 survey found that boards of directors do not pay close attention to personnel-related issues such as mentoring and developing talent, listening skills, and conflict management when evaluating the performance of CEOs. See: The Miles Group and the Rock Center for Corporate Governance at Stanford University, "2013 CEO Performance Evaluation Survey," (2013).

<sup>2</sup> Economists refer to this problem as the "agency problem."

<sup>3</sup> For more on this topic, see: James N. Baron and Brian Tayan, "Keller Williams Realty (A)," Stanford GSB Case No. HR-29A (April 12, 2007); and James N. Baron, David F. Larcker, and Brian Tayan, "Keller Williams Realty (B)," Stanford GSB Case No. HR-29B (February 15, 2011).

<sup>4</sup> The company refers to local offices or brokerages as "market centers," the owners of market centers as "operating principals," and the individuals who lead the market centers as "team leaders."

<sup>5</sup> Traditional brokers offer a 60/40 split. "Rent-a-desk" firms offer a 100 percent commission split and charge a fixed monthly expense.

<sup>6</sup> Detailed monthly reporting also gives the international office access to better information about productivity and local market conditions than competitors have access to. Most real estate offices do not share detailed monthly profit and loss statements with their franchisor.

<sup>7</sup> This line of thinking has roots in academic theory. According to Kreps (1990), an organization's reputation is formed on the basis of how it responds to unforeseen contingencies. If an organization responds positively, it will improve its reputation in the eyes of employees (and potential employees); if it responds in a negative manner, it will detract from its reputation. Each positive action increases the amount of faith that an employee has in the organization and encourages performance that might not otherwise take place. An organization that wishes to protect a positive reputation will apply its principles "even when its application might not be optimal in the short run" and "even in areas where it serves no direct organizational objective if doing so helps preserve or clarify" its principles. See: David M. Kreps, "Corporate Culture and Economic Theory,"

Chapter 4 in James E. Alt and Kenneth A. Shepsle (Editors), *Perspectives on Positive Political Economy* (Cambridge University Press, 1990). Quotes from: Keller Williams Realty (A), *loc. cit.*

<sup>8</sup> Keller Williams' culture is also reflected in the charitable activity of its associates. The company's charitable 501(c)(3) organization—KW Cares—helps associates and their family members enduring unexpected hardships including medical emergencies and natural disasters. For example, after Hurricane Katrina, KW Cares raised \$5.3 million from Keller Williams offices nationwide to support more than 700 associates who were displaced by the catastrophe; by comparison, the National Association of REALTORS with more than 1.2 million members raised \$5.8 million. KW Cares originated at the market center level before being adopted company-wide. The company also maintains a global day of service—RED Day (“Renew, Energize, and Donate”)—on which associates close their offices to volunteer in their local communities. In 2014, Keller Williams associates donated hundreds of thousands of hours of service.

<sup>9</sup> Keller Williams Realty (A), *loc. cit.*

<sup>10</sup> Interview with the authors.

<sup>11</sup> For more on the organizational benefits of the open books system, see: Anne Claire Broughton and Jessica Thomas, “Embracing Open-Book Management to Fuel Employee Engagement and Corporate Sustainability,” UNC Kenan-Flagler Business School (2012).

<sup>12</sup> Lorri Freifeld, “Keller Williams Is at Home at No. 1,” 2015 Training Top 125, *Training* (January/February 2015).

<sup>13</sup> Interview with the authors.

David Larcker is Director of the Corporate Governance Research Initiative at the Stanford Graduate School of Business and senior faculty member at the Rock Center for Corporate Governance at Stanford University. Brian Tayan is a researcher with Stanford's Corporate Governance Research Initiative. They are coauthors of the books *A Real Look at Real World Corporate Governance* and *Corporate Governance Matters*. The authors would like to thank Michelle E. Gutman for research assistance in the preparation of these materials.

The Stanford Closer Look Series is a collection of short case studies that explore topics, issues, and controversies in corporate governance and leadership. The Closer Look Series is published by the Corporate Governance Research Initiative at the Stanford Graduate School of Business and the Rock Center for Corporate Governance at Stanford University. For more information, visit: <http://www.gsb.stanford.edu/cgri-research>.

Copyright © 2015 by the Board of Trustees of the Leland Stanford Junior University. All rights reserved.

**EXHIBIT 1 — REAL ESTATE BROKERAGE PRODUCTIVITY METRICS (U.S.)**

	Agents per office				Volume per office (\$ in millions)			
	2010	2011	2012	2013	2010	2011	2012	2013
<b>Keller Williams</b>	<b>117</b>	<b>125</b>	<b>140</b>	<b>165</b>	<b>144.4</b>	<b>172.3</b>	<b>228.0</b>	<b>299.8</b>
Sotheby's	31	32	37	37	93.0	90.4	132.4	161.4
RE/MAX	34	32	29	32	106.9	96.7	107.3	136.8
Prudential	46	44	38	33	85.2	80.6	74.9	73.0
Coldwell Banker	33	28	31	33	62.4	52.6	70.4	84.1
Century 21	37	30	34	37	56.2	42.7	60.9	73.4
ERA	38	32	36	45	48.8	44.4	54.7	76.2

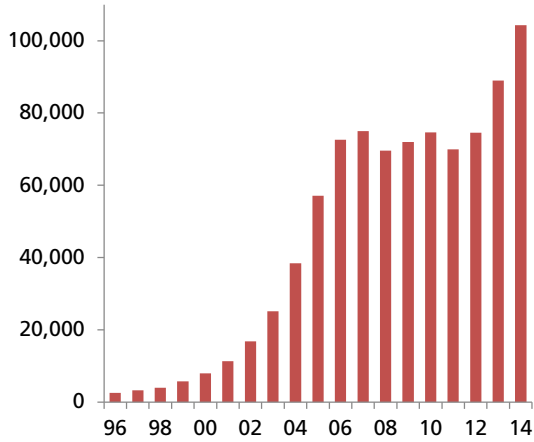
	Sides per office				Sides per agent			
	2010	2011	2012	2013	2010	2011	2012	2013
<b>Keller Williams</b>	<b>689</b>	<b>859</b>	<b>1068</b>	<b>1245</b>	<b>5.9</b>	<b>6.9</b>	<b>7.7</b>	<b>7.5</b>
RE/MAX	500	475	492	555	14.7	15.1	16.8	17.5
Coldwell Banker	332	291	369	414	10.1	10.3	11.8	12.6
ERA	300	260	311	368	7.9	8.2	8.6	8.3
Prudential	284	274	314	314	6.2	6.2	8.2	9.6
Century 21	272	209	290	302	7.3	6.9	8.5	8.1
Sotheby's	121	158	211	243	3.9	4.9	5.8	6.5

Note: Sample includes select companies among the top 500 brokerage offices in the United States, based on number of sides. The term "sides" refers to transactions done by either the selling or buying agent. Because there are usually two agents on each real estate transaction, the industry reports approximately twice as many sides as home sales each year.

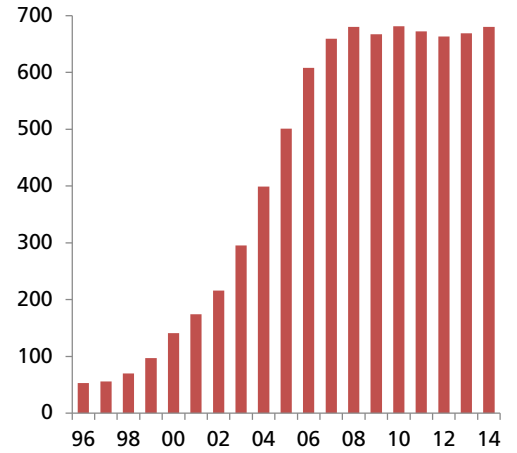
Source: REAL Trends 500 Survey

**EXHIBIT 2 — KELLER WILLIAMS PERFORMANCE METRICS**

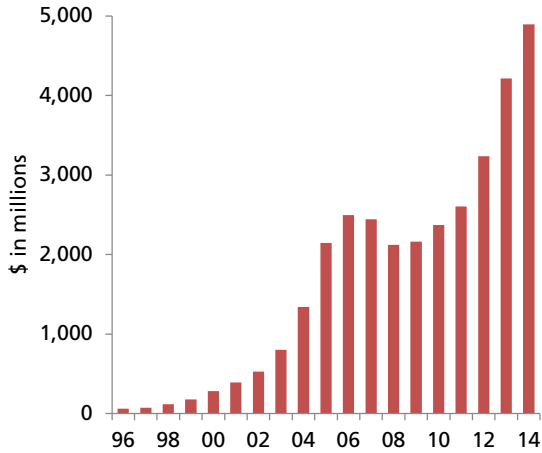
AGENT COUNT



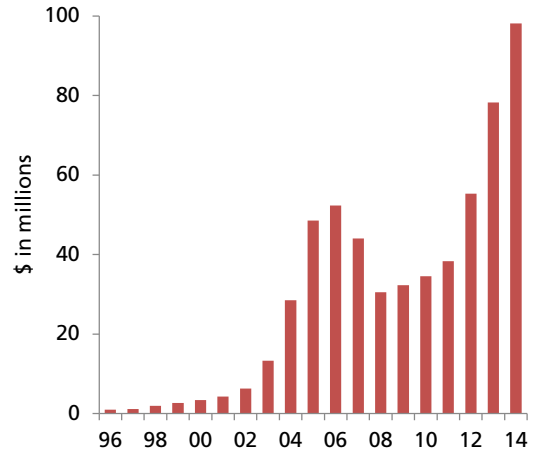
MARKET CENTER COUNT



AGENT GROSS COMMISSION



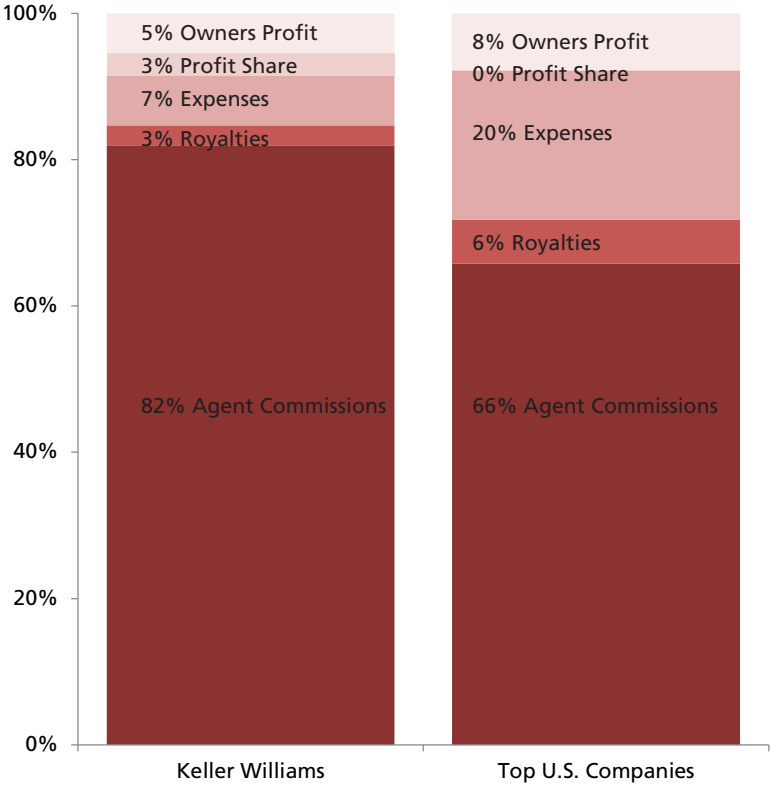
PROFIT SHARE



Source: Keller Williams Realty

**EXHIBIT 3 — KELLER WILLIAMS MARKET CENTER ECONOMIC MODEL**

DISTRIBUTION OF GROSS COMMISSION INCOME



Note: Based on performance of top 25 percent of Keller Williams market centers versus top 500 real estate companies as reported by REAL Trends. Estimate royalties for top 500 real estate companies for those national companies that charge 6 percent on all GCI (may vary from office to office and company to company). Percentages reflect effective rates based on actual dollar amounts distributed.

Source: Keller Williams Realty