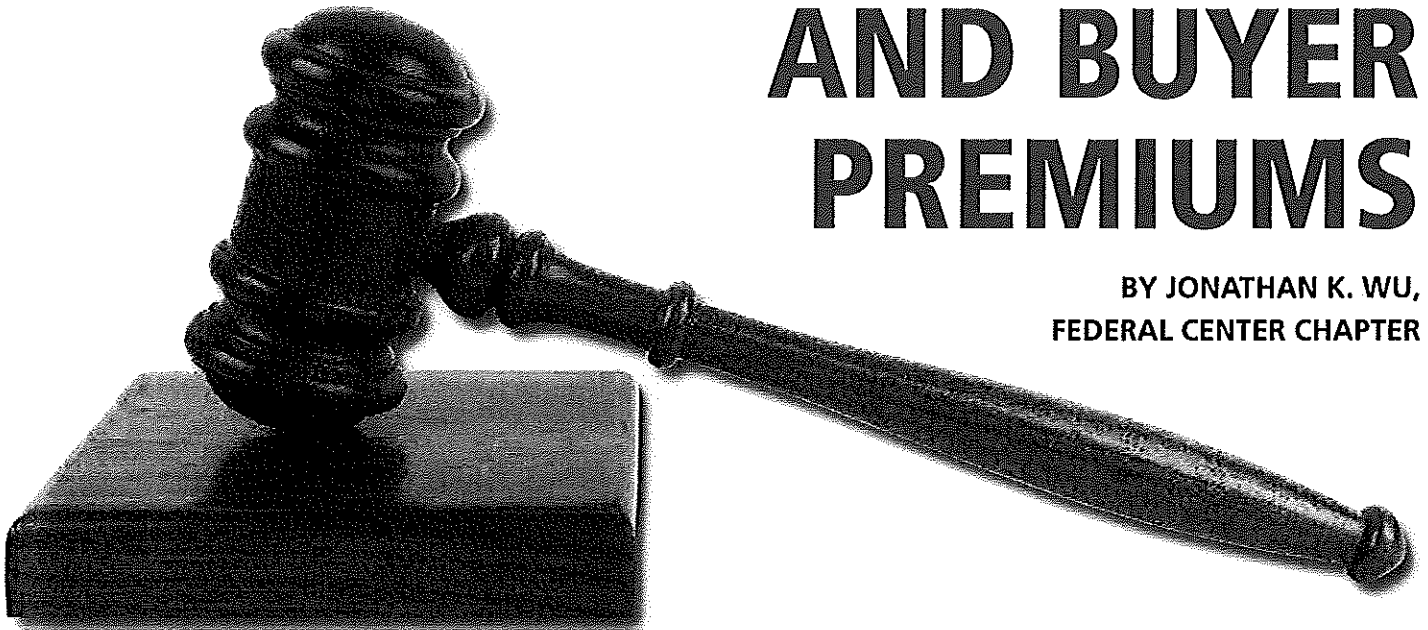


SALES COMMISSIONS AND BUYER PREMIUMS

BY JONATHAN K. WU,
FEDERAL CENTER CHAPTER



INTRODUCTION

If you're a property manager selling your surplus assets, you may have come across some auctioneers charging sales commissions while others charge a buyer premium. This article will explain exactly what a buyer premium is. In addition, many people think that a 10% buyer premium has the same effect on your net proceeds as a 10% sales commission. But this is actually wrong! We'll discuss how these two pricing methods differ in affecting your bottom line as a property manager.

BACKGROUND ON BUYER PREMIUMS

Auctioneers have at their disposal two pricing mechanisms to generate revenues: sales commissions and buyer premiums. Though auctions can be traced all the way back to 500 B.C., it was Christie's, the famed art auction house, that introduced buyer premiums more than 32 years ago in 1975. Buyer premiums are fees paid by the buyer that are typically expressed as a percentage of the "hammer price" at which an item is sold. Both Sotheby's and Christie's use both buyer premiums and sales commissions in all their auctions. Today, buyer premiums are a widely-accepted pricing mechanism in the auctioneering industry for real estate, industrial equipment, vehicles, collectibles and scrap.

QUESTION

Let's say a property manager (the seller) meets with 3 auctioneers:

- Auctioneer A proposes a 10% sales commission and a 10% buyer premium.
- Auctioneer B proposes a 20% sales commission.
- Auctioneer C proposes a 20% buyer premium.

Assuming the same quality of services for all 3 auctioneers (i.e. buyer base size, marketing approach, reporting capabilities, etc.), which auctioneer maximizes the seller's revenue? If you think they're all the same, you're wrong.

MYTH

A sales commission of 1% has the same impact on the seller's revenue as a 1% buyer premium.

REALITY

A sales commission of 1% reduces the seller's revenue more than a 1% buyer premium. In fact, as the sales commission increases, its negative impact on the seller's revenue accelerates when compared to the buyer premium.

ANSWER

Use the following Equivalency Formula to convert buyer premiums into their "sales commission equivalents" (defined as the sales commissions that have the equivalent effect on the seller's revenue):

Sales Commission Equivalent = [Buyer Premium / (1 + Buyer Premium)]		
Auctioneer	Proposed Pricing	Sales Commission Equivalents
A. 1	0% sales commission and 10% buyer premium	0% sales commission + 9.09% sales commission = 9.09% sales commission.
B.	20% sales commission	20% sales commission.
C.	20% buyer premium	16.67% sales commission.

The seller should choose Auctioneer C with the 20% buyer premium in order to maximize revenue. Even though all the auctioneers might have appeared to be exactly the same, the reality is that the seller could have mistakenly given up 3.3% in revenue with the wrong choice (the difference in seller revenue generated by Auctioneer B at 20% versus Auctioneer C at 16.67%). For example, with auctions worth \$1,000,000, Auctioneer C will provide the seller \$24,000 in more revenue than Auctioneer A and \$33,000 in more revenue than Auctioneer B.

IMPLICATION

Sellers should normalize sales commissions and buyer premiums using the Equivalency Formula when evaluating auctioneers based on price. □

APPENDIX

Two formulas have been derived that can convert the buyer premium into its sales commission equivalent (and vice versa) in terms of its effect on the seller's revenue. We call these the Equivalency Formulas.

Sales Commission Equivalent = [Buyer Premium / (1 + Buyer Premium)]
Buyer Premium Equivalent = [Sales Commission / (1 - Sales Commission)]

Conversion Table: The tables on the right convert between buyer premiums and sales commissions while keeping the seller's revenue constant.

Algebraic Proof

The following is the algebraic proof for the Equivalency Formulas.

Definitions

Let V = \$ value of the asset to the buyer (final auction price plus buyer premium)

Let P = \$ final auction sale price of the asset (excluding the buyer premium)

Let s = % sales commission

Let b = % buyer premium

Let RS = \$ revenue to the seller

Relationship A: Value of Asset to the Buyer vs. Final Auction Sale Price

The value of the asset to the buyer (V) is equal to the final auction sale price of the asset (P) plus the buyer premium paid by the buyer (b x P). But how do we express the final auction sale price (P) as a function of the value of the asset to the buyer (V) and the buyer premium (b)?

Relationship B: Seller's Revenue vs. Value of Asset to the Buyer

The seller's revenue from the auction (RS) is equal to the final auction sale price (P) minus the sales commission paid by the seller (s x P). How do we express the seller's revenue (RS) as a function of the buyer premium (b), sales commission (s) and value of the asset to the buyer (V)?

Relationship C: Sales Commission vs. Buyer Premium

How do we express the sales commission (s) as a function of the buyer premium (b), or vice versa, if we set the seller's revenue (RS) to be equivalent in either case?

Jonathan Wu is the Director of Liquidity Services, Inc.
 Jonathan.Wu@Liquidation.com

BUYER PREMIUM → Sales Commission			Sales Commission → BUYER PREMIUM		
BUYER PREMIUM	Sales Commission	QTY	Sales Commission	BUYER PREMIUM	QTY
1.00%	3.29%	2.29%	1.00%	3.01%	3.01%
2.00%	6.58%	4.58%	2.00%	6.02%	6.02%
3.00%	9.87%	6.87%	3.00%	9.03%	9.03%
4.00%	13.16%	9.16%	4.00%	12.04%	12.04%
5.00%	16.45%	11.45%	5.00%	15.05%	15.05%
6.00%	19.74%	13.74%	6.00%	18.06%	18.06%
7.00%	23.03%	16.03%	7.00%	21.07%	21.07%
8.00%	26.32%	18.32%	8.00%	24.08%	24.08%
9.00%	29.61%	20.61%	9.00%	27.09%	27.09%
10.00%	32.90%	22.90%	10.00%	30.10%	30.10%
11.00%	36.19%	25.19%	11.00%	33.11%	33.11%
12.00%	39.48%	27.48%	12.00%	36.12%	36.12%
13.00%	42.77%	29.77%	13.00%	39.13%	39.13%
14.00%	46.06%	32.06%	14.00%	42.14%	42.14%
15.00%	49.35%	34.35%	15.00%	45.15%	45.15%
16.00%	52.64%	36.64%	16.00%	48.16%	48.16%
17.00%	55.93%	38.93%	17.00%	51.17%	51.17%
18.00%	59.22%	41.22%	18.00%	54.18%	54.18%
19.00%	62.51%	43.51%	19.00%	57.19%	57.19%
20.00%	65.80%	45.80%	20.00%	60.20%	60.20%
21.00%	69.09%	48.09%	21.00%	63.21%	63.21%
22.00%	72.38%	50.38%	22.00%	66.22%	66.22%
23.00%	75.67%	52.67%	23.00%	69.23%	69.23%
24.00%	78.96%	54.96%	24.00%	72.24%	72.24%
25.00%	82.25%	57.25%	25.00%	75.25%	75.25%

$$R_s = P - sP$$

$$R_s = (1 - s)P$$

$$R_s = \frac{1 - s}{1 + b}V$$

Relationship A: $V = P(1 + b)$

$$R_s = R_v$$

$$\frac{1 - s}{1 + b}V = \frac{1 - s}{1 + b}V$$

$$\frac{1}{1 + b} = 1 - s$$

$$s = 1 - \frac{1}{1 + b}$$

$$s = \frac{1 + b - 1}{1 + b}$$

$$s = \frac{b}{1 + b}$$

$$1 = (1 - s)(1 + b)$$

$$1 = 1 + b - s - sb$$

$$0 = b - s - sb$$

$$s = b(1 - s)$$

$$s = \frac{b}{1 - s}$$

NPMA FOUNDATION

Giving back to the Profession

Ways to Give

- Give Online (<https://www.npma.org/donate/>)
- With your NPMA membership renewal
- By Mail

28100 US Highway 19 North, Suite 400
 Clearwater, FL 33761

NATIONAL PROPERTY MANAGEMENT ASSOCIATION is committed to advancing the profession of personal property and fixed-asset management. Since 1997, hundreds of leaders in the property profession have pledged their support and commitment through the NPMA Foundation. The NPMA Foundation provides grant funds to property professionals who would otherwise not be able to fulfill their career goals.

The commitment to the property management profession can be measured in many ways through donations to the NPMA Foundation:

- More than 70 NPMA members have received grant funds to attend courses, workshops and seminars at the chapter, regional or national levels of NPMA.
- Nearly \$70,000 in grant funds from the Foundation have been disbursed to members seeking to advance in their careers, gain new knowledge or enhance their skills.
- More than \$10,000 was made available to NPMA members who were directly affected by Hurricane Katrina and in need of money for food, clothing and clean-up.