The below article was published in the September, 2009 Rough Notes Magazine

NAVIGATING THE WINDS OF CHANGE

By Christel L. Sarchet, CPA & Robin C. Frost, ACA

Have you been giving some thought as of late to changing the direction of your agency? Is the driver of this line of thought expansion, perpetuation, reducing management responsibilities or some other factor? When we have posed this question to agents and brokers throughout the country, the answers generally fall into one of several categories: (1) increased capability (whether it be geographic or product driven); (2) reduction of managerial responsibilities; (3) increased market access; (4) ability to access capital to grow at a faster rate than one could on his or her own; or (5) asset allocation, which although a dangerous phrase in today's turbulent times, means in this case diversifying a large portion of one's personal wealth from the investment in their agency to alternatives vehicles.

While some of the alternatives mentioned can be accomplished without outside assistance, many of them involve some sort of partnership, merger or agreement with outside parties in order to achieve one's goals. As they say in life, your odds of being happy are not increased significantly by looking for that happiness from others, but instead by focusing on yourself first. The same can be said for strategic decisions about your company.

Increased Capacity

The desire to expand an agency's capabilities may be as simple as hiring a benefits producer in a company which currently has only property and casualty ("P&C") offerings. Many P&C firms will simply outsource this function to a "friendly" competitor in exchange for a significantly reduced commission. Others will attempt to hire producers and build the sales force. Many, however, have reached a point where they would like to capitalize on that side of the business, but have grown weary of their ability to develop producers in lines of business in which they themselves are not experts or would simply like a bigger split (or more ownership of the process) than their current commission-sharing arrangements with other firms that specialize in that line of work. This line of thought often leads one to consider a merger, especially when one is considering the benefits of cross-selling the entire account base.

Reduction of Managerial Responsibilities

Let's face it, most agency principals grew up as producers, and at some point, many of them decide they would rather get back to their roots. When the rigors and challenges of managing personnel, operating, automation and other such issues reach a boiling point, but the fire is still in the belly to sell, it is not uncommon to consider your options. Many people find themselves in this mold where they still enjoy the fight, but not so much the many administrative aspects of the job. Again, this group of people often find themselves contemplating some sort of a strategic alliance to get themselves back to their roots.

Increased Market Access

I doubt there are many agents or brokers who have not, at some point in time in their career, felt as though they missed an opportunity to write an account due to not having the proper appointment. While there are a myriad of ways to gain access to markets, those with their sights set on market access on a grand scale will often consider partnering with another firm.

Capital for Growth

Several years ago, an agency principal asked me this question, "Would you rather own 100% of $1 million in revenues or 60% of $6 million in revenues? Bringing on partners can often add stress to a business or a principal, but from the economic point of view, the answer to that question is obvious. Once you cross below the significant 51% ownership line, the answer becomes a bit murkier. But, it is an interesting question if you take it a step or two further. How about 20% of an agency with $50 million in annual revenues? Those who consider expansion at a rate faster than the cash flows of their current business will most likely, at some point, be faced with making this decision, as outside capital is the most likely means for them to achieve their goals.

Asset Allocation

Asset allocation, while a touchy word given the results of those strategies in the market over the past 12 months, in this context can be translated into diversifying the nest egg, or simply retirement. Retirement is one of the most common reasons that agency owners sell their business. In most cases, when the agency is sold by an owner who is retiring, the owner, who is commonly the best producer, will not remain involved in the ongoing operations for an extensive period of time. In this case, the seller would be looking for buyers who are interested in the already developed business but who do not require his or her continuing involvement for the long haul. Not only is this one of the most common reasons for considering a strategic partner, but in particular, the current economic and political environment has many owners considering the timing of their exit from the business carefully as the potential increase in capital gains taxes could significantly reduce the return on their investment.

Finding a Fit

Once the driver or drivers have been identified, you are in a good position to assess what type of entity may be a good fit for you. Common acquirers include other insurance agencies or wholesale operations, financial institutions (i.e. banks and credit unions), private equity groups, and non-industry sources. Insurance agencies can be further broken down into the national operators and the regional / local brokerages.

National firms

National agencies and brokerages bring a lot to the table. After all, these entities are simply a larger version of the typical agency's existing operations. And while each firm has its own nuances, they all have certain similar characteristics as a class. For example if you are seeking to increase your market access, but would still like to continue on your current path, these firms may be an option for you. For agencies located in cities where these firms have existing operations, they may also be an avenue for those who are either looking to continue down the path of selling, but without the burden of management, and also for those who are seeking to retire after a transition period. These firms also may offer the ability to write larger accounts given both their expertise in most lines of business as well as their overall name recognition.

But as with every decision in life, the seller needs to consider whether a move into the large corporate world suits the style of operation they have. Larger companies have mandated policies and procedures which may not be suited to all, and of course, each firm has its own culture or personality. A reasonable amount of seller due diligence should be considered, and ideally a meeting with other smaller agencies who have been acquired should be sought out.

Local / Regional Firms

As mentioned above, the style of the larger company is not suited to all. If the motivation for sale falls within those reasons mentioned for the national firms, another possibility may be divestiture to, or partnership with, one of the local or regional firms. A particular attraction to this sort of deal will be the opportunity for current ownership and management to continue in an executive management role moving forward, and possibly retain a significant ownership stake. However, the limitation of this option is that the scale of the expansion opportunity may be less. Similarly to considering the corporate policies concerns with a larger company, getting to know the culture of the acquirer is essential seller due diligence. Is the sales focus / compensation similar to that which exists now? How are sales leads monitored?

Also, once your operations reach a certain critical mass, the local firms may become less of an option in this class, leaving a partnership with the regional firms as one's consideration here.

Financial Institutions

In the current climate, one could argue that there are more banks who are sellers than acquirers. However, there are the national exceptions, notably Wells Fargo and BB&T, who continue to develop and grow their insurance operations, and also there are still a number of smaller, regional banks as well as credit unions who have not been hit by the financial crisis and still see the cross-selling opportunity than an agency operation affords them. Similar to the potential culture shift of sale to a large company, banks will have their own corporate procedures which will most likely be non-optional. The seller needs to discuss how the bank intends to monitor the business and ensure that the bank has a full appreciation for the particular pitfalls of the agency business.

Depending upon where a financial institution is in its insurance product offering, it may not have the ability to provide increased market access, but would certainly afford an avenue for increased sales, although history has proven that patience, persistence and constant monitoring are required to yield favorable results.

Private Equity Groups

Given the state of today's economy, one would probably come to the conclusion that private equity is not a viable option. However, while the activity may not be as robust as in previous years, there are still many private equity groups either expanding their presence in, or entering into, the insurance space. The players are generally acquisitive by nature given the financial model behind their plans, and accordingly an agency seeking capital to expand its long-term initiatives may be well-advised to consider a private equity partner. Furthermore, these groups generally do not have an extensive bench of managers waiting in the wings (of course, should they have already entered into the space, they will have the teams of the firms in which they have already invested), and thus, management will most likely retain its executive function. However, private equity partners will demand results and usually in a short time frame. For the seller who is confident the opportunity exists, this can be a great opportunity, and many times a private equity partner will offer a healthy outside view of the company in their regular periodic results reviews.

Non – Industry Sources:

Finally, there is the catch-all "other" category of acquirer to which an agency may look. This could be a company in which the product or service on offer generally requires insurance and so rather than outsource this function, the company is looking to seek an extra source of revenue from its sales efforts. Examples of companies where insurance plays a significant part in each sale are car rentals, storage, real estate, transportation, relocation, and the staffing industry, to name but a few. As in all the cases above, the key consideration is cultural fit. If the cultural issues are acceptable, there could be a significant opportunity for an agency to apply its skill set to a ready-made customer base.

So, depending on the motivation for change, an operation which has been well-run with a view to enhancing agency value should always have access to a partner who should be able to help it attain its goals. The key, however, is ensuring that your needs match those of those of your prospective partner.

The authors

Christel Sarchet and Robin Frost are Vice Presidents of Mystic Capital Advisors Group, LLC, a national mergers and acquisition advisory firm that focuses exclusively on the insurance industry.