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In This Issue...

Leadership: It Isn't Just One Thang!

I've read innumerable articles and books, taken classes, and listened to speaker after speaker talk about what it takes to be a leader. You know what? Every single one of these so-called leadership experts is freakin' wrong!

They are absolutely, undeniably, WRONG! If they were right, we wouldn't have so many organizations suffering a lack of quality leadership! Businesses, governments, athletic teams, and armies would not be experiencing leadership crises and even leadership vacuums!

Read More...

Vesting Agreements: Beware of Hidden Tax Traps! by Linda Wilkins

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How to Treat Top Producers

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Announcing... The Certified Business Appraiser!

Chris Burand has earned the Certified Business Appraiser (CBA) designation from the Institute of Business Appraisers. The CBA designation is only earned by those who prove they know how to: value businesses using all major valuation methods, convert values from C-corp's to S-corp's and vice versa using at least four different methods, calculate the value and cost of replacing staff, calculate discounts and premiums for minority and majority positions, calculate the differences between asset values and stock values, and calculate the lack of marketability discounts. A CBA is also required to demonstrate extensive knowledge of valuation case law and the

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ability to write high quality valuation reports that meet stringent requirements. Most valuation designations do not require proof the appraiser can put their knowledge to constructive use in valuation reports, which is obviously important and a tremendous benefit to the client.

Love wintertime in the Rocky Mountains?
Interested in Networking with Other Agency Leaders?

Then I'd like to invite you to attend the **2016 Keystone Agency Management Meeting**, March 3-4, 2016 in Keystone, CO!

This opportunity consists of a small group of agency professionals who meet only during the morning. The group discusses critical agency management topics, as well as attendees' ideas, roundtable topics, successes, questions and concerns.

The schedule leaves the afternoons free for skiing and enjoying the breathtaking Colorado Rockies. The registration fee for this two day meeting is $549 per person. Please contact me at chris@burand-associates.com to learn more.

We have very limited space available so if you're interested, don't wait!

"Most organizations are pessimistic about their ability to change and use cosmetic changes to defend against change."

-Peter Block

Leadership: It Isn't Just One Thang!

I've read innumerable articles and books, taken classes, and listened to speaker after speaker talk about what it takes to be a leader. You know what? Every single one of these so-called leadership experts is freakin' wrong!

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Now, who am I, a small consultant, to conclude the Ivy League professors, *Harvard Business Review*, and $100,000 per speech consultants are so incredibly wrong? All I have to go on is 25 years' experience, decades of detailed financial analysis that effectively compares leaders' results, and quite a library of history books. This is a combination these folks do not have because they're flying too high.

I get to see the results of companies led by people the experts have concluded, in articles I've read, are true leaders. They may be leading their firms somewhere, but they are not all leading them to success. Being a great leader is not just about leading. It is also about leading in the right direction. The distinction is important.

That is just the first problem these experts typically miss. One reason they miss and are so wrong is that they base their conclusions on anecdotes and they sell books with anecdotes. Anecdotes are absolutely and completely inadequate for measuring positive leadership success. Yet audiences fall for it over and over because the human brain desires to believe stories rather than hard facts. Humans, in other words, are suckers for leadership guru storytelling.

A second problem, among many, is the premise and usually the conclusion that leadership is one point, the tip of a hierarchical structure. Leadership correctly structured and hired is not completely hierarchical. There is not ultimately one leader at the top. Thinking so and structuring so is a systematic failure. It is a design flaw.

Adam Smith, one of the world's greatest philosophers and economists, wrote an economic proof in *The Wealth of Nations* (1776) that to maximize wealth, a country (then) should focus on manufacturing what it manufactures best among nations. If that manufacture is wheat, then it should focus its resources on wheat rather than diversifying. The risk is greater but wealth is ultimately maximized. He went on to show that even if a nation manufactured two items better than any other nation, say wheat and textiles, it should focus on the item it manufactures best. In other words, specialize.

Leadership is similar when done well. Any given person with leadership qualities will have stronger leadership qualities <u>in a particular area</u>. Personally, I like George Barna's distinctions of a visionary leader, a strategic leader, an operational leader, and a team leader. Few leaders I've ever met have true leadership ability in all four areas. A huge mistake organizations make is they look for visionary leaders and treat all the other roles as management positions rather than leadership positions. These are not management positions. These are leadership positions. They are equally important to the visionary leader.

Different people have different leadership skills and organizations need to emphasize different skills at different times. For example, I cannot imagine most people questioning Churchill's leadership of Great Britain during WWII and yet the people fired him almost immediately upon WWII ending. I've always thought that was a horrible and unfair send-off, but the populace understood they needed a different kind of leader then and they needed a different kind of leader immediately. I'm not sure whether Churchill was a visionary or strategic leader but his country after WWII needed a team leader foremost after the war and Churchill was divisive.

It has been written that General Eisenhower was not the best American general in WWII but he was the best political general. That is a difference between strategic and team leadership. Roosevelt was smart recognizing the difference when he chose Eisenhower for the job.

These two examples (I know they're anecdotes) of how visionary leadership was not right for the situation show that leadership is not one thing. These examples show that visionary leadership is often the least needed type of leadership and visionary leadership can even get in the way. One reason that organizations continue to choose one kind of leadership is they don't like the idea of firing a leader when their particular leadership strength is no longer the most important. It's the same reason organizations put up with mediocre to poor employees. It's easier.

Leadership does not have to be a pinnacle though. I am encouraging my clients to engage in a more stable leadership structure based on George Barna's structure. Even small organizations can afford this more stable structure and often have people with adequate leadership ability in their particular area. For example, quite often a staff person will have considerable leadership skill in either operations or team building. To emphasize again, these are not management positions. These are leadership positions. Leadership requires championing, owning, and having passion about what you are building including building the organization and people around you.

At times, the visionary leader is most important but other times the operational leader is most important. None of the four really are ever useless. Working together while simultaneously building the vision, the strategy for achieving the vision, the operations to support the strategy and the team to support the operations are all necessary.

This also brings to the forefront another issue so incredibly often missed by leadership gurus and that is cooperation. Within this model, all four leaders have to work as cooperative team. Tyrants and dictators have no place and yet, this does not mean stasis either because another absolutely key aspect of leadership, for all four kinds of leadership, is the ability to have crucial conversations. So many visionary leaders are truly salespeople at heart. Whether they're making sales to clients or selling Wall Street, they are salespeople and sales people generally do not like confrontation. I cannot count the number of visionary leaders I've met that do more damage to their organizations than their "vision" ever can overcome simply because they cannot deal with confrontation, even constructive criticism. They see all criticism as bad. A new book about Richard Nixon identifies that if Nixon had not been so adverse to confrontation (a man that ran a war nonetheless) on a personal level, he would have avoided Watergate. But he couldn't confront his key aides. I can believe this because I've seen it repeatedly. Each of these four leaders then, to qualify as leaders, must be able to constructively and proactively deal with conflict. If all four leaders have this ability, which is a completely intelligent requirement when seeking a leader, stasis is nearly impossible.

Leadership then is not about one person or one thing. That is asking too much of a single person and risks gaining the kind of person for the job that thinks he or she can be THE person for all times, situations, people, etc. The opportunity then is to build upon four corners of strength, rather than trying to balance on a single pinnacle.

To help agencies identify and build stable leadership, I have partnered with Jay Brenneman, Principle of SageQuest Consulting. With our combined expertise, we help agencies navigate the complexities of their current leadership, identify areas of weakness, and develop strategies for building a solid leadership structure. When we help agencies find their balance on the four pillars of leadership, the result is a stronger more prosperous work environment.

[Back to Top]

Vesting Agreements:

Beware of Hidden Tax Traps!
by Linda Wilkins

Burand & Associates estimates that at least 20% of its clients have vesting agreements, deferred compensation plans, phantom stock, and other such agreements with their producers (or former owners) - often called "vesting agreements." These agreements provide for payments of deferred compensation to producers upon retirement and other events. Many of these agreements have been around for decades and may only rise to your attention when (i) your producer retires, or (ii) you are selling your business.

Does your agency have any such agreements? If so, it's time to dust them off and hire a trusted tax advisor to review them for compliance with current laws.

Even if these agreements are fully vested now, it is important that you review all of your agreements to see if they comply with "Section 409A" of the Internal Revenue Code.

FAQ's:

1. What types of agreements does Section 409A apply to?

Section 409A applies to any agreement that provides for a payment of deferred compensation, that becomes vested based on employment, and then is subsequently paid following retirement, if the agreement was not fully vested at December 31, 2004. It also applies to agreements vested on December 31, 2004 if they are "materially modified" after that date.

2. What are the "traps" in complying with Section 409A?

The written agreement must contain certain provisions, such as specifying the payment dates and what events trigger payments. Funding is another potential trap. This is a complex law (more than 400 pages) - it is easy to fall into "traps" that create significant tax liabilities for you and your producers.

3. What taxes are applied if an agreement violates Section 409A?

The producer (not your company) owes an additional 20% income tax on the deferred amounts, and this tax is owed immediately upon vesting of the agreement. Obviously because the tax falls on the producer, you <u>do not</u> want to have that conversation.

The complexity of this law is just one more reason to avoid vesting plans. However, complexity is not a reason to avoid using well-written deferred compensation plans. Well-written deferred compensation plans create a significant competitive advantage to attracting and keeping high quality producers. Your opportunity to perpetuate internally can be significantly improved with high quality, 409A-compliant plans. Don't be put off by the complexity, because it really creates the opportunity, provided the plan is properly designed.

Please contact us if we can assist you in reviewing your vesting agreements and assuring that they meet the Section 409A requirements.

[Back to Top]

How to Treat Top Producers

This article is written at the suggestion of a producer who thinks I've written enough articles regarding how to manage poor producers. His point is valid. Moreover, an agency's best interest is served by treating its best producers differently.

Competition is good and competition intensity can be created by treating winners better than mediocre/poor producers. Start by not treating poor producers as if they were good. This is business. This is sales. This is not a business where every kid should get a medal for trying hard. This simple point is at the core of many producer management issues because most producer contracts do not acknowledge success. Yet most poor producers are paid a higher commission percentage than good producers. I know that all producer contracts in an agency pay the same percentage. That is good on paper but that is not how it works in reality. The National Alliance Research Academy shows poor producers are paid approximately 60%-70% higher commission rates than the best producers. Based on the analyses I conduct every year of dozens of agencies, the trend is to pay poor producers more than the agency's standard commission split. Whether by accident or intentional, it happens. And this fact sucks motivation out of good producers like a vampire sucking blood.

Create competition by recognition. Simply recognize top producers. Use a rolling twelve month annual measure. Reward the best producers with a different title. Use perks such as bonuses, trips, gifts. Most perks are small items that are more about recognition such as a free weekly car wash, a better phone, etc. A more substantial perk is special staffing in recognition of great sales thereby giving the producer more capacity and confidence to sell even more.

DO NOT change commission schedules. Agencies cannot afford to change commission schedules enough to effect a change in behavior. A producer with $1,000,000 in commissions is not likely going to sell more just because the commission rate changes from 35% to 37%. An exception exists where in some situations mediocre producers are paid 25% and the agency has an excellent cost structure so that it can afford more for $1,000,000 producers. If an agency is this well managed, then pay the best producers more straight commission. This brings to question how much does a high quality producer produce? $500,000 - $1,000,000 and up.

I'd be amiss though if I did not mention the common expense many top producers cost agencies. Many top producers create enough drama agency owners sometimes must feel they are financing a Broadway show. The idea of fueling more drama by building and enhancing the large but delicate egos of their top producers is anathema to some.

So what is the solution? My favorite solution is a tiered compensation plan. For a producer to earn recognition and perks requires $X if they operate without creating drama. If they only sell by creating drama, they have to sell 50% more to earn the same opportunities. The choice is theirs and the agency benefits with either choice.

By drama, I mean do they or do they not follow the agencies rules and procedures? The good producer that only brings an incomplete application to the account executive at the last minute has considerably less value to an agency than a slightly less good producer that follows procedures. The profit margin on the latter is far higher and the E&O exposure on the latter is far less.

Good producers should be recognized, feted, and paid more, but they should not be given carte blanche to do as they please.

[Back to Top]

The Disconnect

Historically, independent agencies were very small. They were run by founders who were often entrepreneurs and their insurance agency was just one of their businesses. Every sale they made was profitable because their overhead was already paid and they did not have to pay a producer for the sale. This worked very well for insurance companies because the company could direct their agents to sell whatever the flavor of the month was and their agents still made money.

This system is a version of what is known as cost plus pricing. Cost plus pricing works, generically, by a contractor or provider estimating their cost of performing some action and then charging a profit on top. For example, if a project will cost $100,000, the provider will charge $100,000 plus 15% but if the project costs increase, they will charge 15% on top of the increase too. This system guarantees the provider a profit. The way agents used to work, every sale was profitable, just like a cost plus contract.

Every sale is no longer profitable to agencies. The potential loss and actual loss is significant. The reason every sale is no longer profitable is a result of many factors. A key factor is that insurance companies do not pay as much as they used to pay. Other factors include agencies are generally larger and carrying more overheard; the complexity of business today; carriers do not provide as much support as they used to provide; agencies must be more diligent protecting themselves from E&O claims; and policy forms are more complex.

Two factors, however, trump all the others. First, agencies have to pay people to make sales and second, every sale requires considerable staff hours. When a person has to be paid to make sales versus the owner making those sales, then right off the top the producer's commission must be subtracted. Many agency owners and carriers think that still leaves 60% profit (if the producer is paid 40%), but that conclusion is naïve. It is naïve because of scale. Staff has to spend x hours on every account every year (if they do not, the agency's E&O risk escalates, its retention declines, it likely will suffer from adverse selection, and its reputation is damaged). The two most recent agencies I've studied had the following results: the first agency's staff spent an average of five hours per account, regardless of size (hence the "average hours per account"). The second agency spent eight hours per account. Adjusting for size, maybe 20% was saved on the smallest accounts. So let's use the best case scenario of four hours per account.

Using 1,900 working hours, average retention and average new business hit ratios a CSR can service 475 accounts, at most. If the agency is writing 500 small accounts, it has to employ another CSR. If these accounts are only generating $200 commission, this is only $95,000. If a producer is paid 30%, that only leaves $66,500. A good commercial CSR is going to make $45,000 leaving only $20,000. After adding benefits, no money is left even excluding sales, marketing, and administrative expenses. And keep in mind, this is a best case scenario.

Unfortunately, carriers have identified small commercial accounts as being highly profitable. So companies are pushing agents to write more small commercial and yet it is not in the agent's best interest to spend money writing and emphasizing small commercial. Without an excellent business model for writing small commercial, an agency can literally go broke. So when carriers push agencies to write small accounts, many an agency owner is hearing a company that is pushing a very selfish agenda. On the other side, pushing small sales is a short term solution to the company's needs because if its agencies are not adequately profitable, they will cease to exist. They will sell out. No perpetuation will occur.

Companies that keep pushing an agenda that damages agencies' futures will lose credibility and respect. Agencies will conclude that if companies are that naïve as to how agencies work or simply that selfish, the agency needs to find smarter carriers with which to do business. The pressure agency owners feel today to fulfill carrier needs without going broke is immense. This pressure is one of many reasons agency owners sell out.

On the other hand, companies that deliver win-win solutions can have the best of all worlds. Solutions exist for informed carriers and agencies. I have developed many solutions for agencies alone. The starting place is whether the agency and the carrier are both coachable. Then if they are coachable, are they both willing to take a more methodical approach to sales. If so, the growth and profit opportunities are fantastic because models exist to literally make every sale profitable.

[Back to Top]

What's Right about Consolidators/Aggregators

I hear many companies and agents talking about how different consolidators and aggregators are ruining the industry and/or their models are sure to fall apart. They may have a lot of issues, and some certainly have significant issues, but many have four key advantages few independently owned agencies possess:

1. Management is not personal. While some people look at that as a disadvantage, impersonal management is a strength. The right decisions can be made and executed rather than worrying about hurting an under-performing employee's feelings.
2. Better data. The good ones have better data because someone's employee review will depend on whether they have been managing data correctly. Quality data in turn provides the basis required to make the best decisions.
3. Operations are segmented. Each division has quality data and the data doesn't spill over. For example, personal lines revenues and specific expenses are segmented to personal lines. The same goes for benefits, life, risk management, and any other division. When agencies do not segregate their revenues especially, and their expenses too, the profitability and efficiency of a department even down to the individual cannot easily and correctly be assessed. This leads to more non-management, non-leadership.
4. The result is that if they choose, these organizations have more accountability. Accountability is a huge competitive strength.

The disparaging remarks often make it sound as though a large organization is required for accountability and then it most often takes accountability too far. A business does not have to have more than one person to establish an accountability culture.

The real difference that size makes is that because management is less personal, it is easier to create accountability because people become numbers. The best scenario is to have accountability but where employees are still treated as humans. Without a doubt, putting the two points together is difficult but the rewards are worth it. To have accountability in a more family atmosphere, the first step is to think of accountability as a positive rather than a negative. Come up with a different word if you want but make it a positive because accountability is a positive.

Next, coaching or some assistance may be required to achieve the separation between the sense of responsibility to make all decisions and the reality of one's ability to make certain emotional decisions, much less execute actions. For example, every agency owner knows employee reviews should be done but emotionally, many owners cannot actually execute on them. Coaching may be necessary to teach how they're done or how to make them more constructive or simply to overcome the emotional barrier that stops the owner from conducting them. Or maybe the solution is to have someone else do them. You know they need to be done and feel it's your responsibility, so you always do them even if you are a year or five behind. Sometimes it's okay to assign someone these kinds of responsibilities. They need to be qualified but if someone else can do the job almost as well or even better, even if they don't have the right title, let them do it.

Other examples are managing producers, especially the hiring of producers, and managing IT systems. Sometimes too just making a decision, even the wrong decision, is better than no decision. The impersonal nature of some of these larger firms makes making decisions easier. That is a huge competitive advantage if utilized well. Everyone else though has an even better advantage if they will create accountability for executing the job while remaining a very personal firm. Accountability and a good work environment are not mutually exclusive. In fact, where accountability is well executed in the hundreds of agencies I've visited, the environment and results are always the best!

Take advantage of these lessons but apply your personal touch. A former client of mine, who did not make these improvements, sold to a firm that had instituted this accountability culture. My client recently told me their sales growth has skyrocketed with the same resources. He had to sell first though. Wouldn't you prefer to keep the financial gains and feeling of success for yourself?

[Back to Top]

Chris Burand is president and owner of Burand & Associates, LLC, a management consulting firm that has been specializing in the property/casualty insurance industry since 1992. Burand is recognized as a leading consultant for agency valuations, helping agents increase profits and reduce the cost of sales. His services include: agency valuations/due diligence, producer compensation plans, expert witness services, E&O carrier approved E&O procedure reviews, and agency operation enhancement reviews. He also provides the acclaimed Contingency Contract Analysis® Service and has the largest database and knowledge of contingency contracts in the insurance industry.

Burand has more than 20 years' experience. He is a featured speaker across the continent at more than 180 conventions and educational programs. He has written for numerous industry publications including *Insurance Journal*, *American Agent & Broker*, and *National Underwriter*. He also publishes *Burand's Insurance Agency Adviser* for independent insurance agents.

Burand is a member of the Institute of Business Appraisers, a department head for the Independent Insurance Agents and Brokers of America's Virtual University, an instructor for Insurance Journal's Academy of Insurance, and a volunteer counselor for the Small Business Administration's SCORE program.

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