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In This Issue...

Chris Burand,
Certified Business Appraiser

Burand & Associates, LLC
215 S. Victoria Ave., Suite E
Pueblo, CO 81003
719/485-3868
chris@burand-associates.com

Visit us at:
burand-associates.com

In Memory of Jack Burke

Jack Burke, the voice of the industry's long running Audio Outlook, passed away in September. Jack was a good friend to many in the industry including myself and many consultants, agencies, and insurance companies for whom he provided marketing consulting. While most would not know it, Jack's marketing expertise was behind the successful campaigns of many insurance related entities. He was also the author of three excellent books on effective marketing.

Jack was important to my career. He

I read an article the other day where Gene Simmons of the rock group KISS proclaimed that rock music is dead. It is dead, to paraphrase him, because consumers do not and need not pay for the music. So if rockers are not paid for rocking, why would they write rock music? Hence: Rock is dead.

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was the first person to ever interview me and that was my good luck. About two minutes into the audio interview, Jack stopped me and told me I was doing everything completely wrong. He coached me how to answer interview questions. Over the years and many interviews with Jack that followed, I never forgot how important his coaching was. For those that knew Jack and wish to share, here are a couple links:

www.hometowndailynews.com/2015/09/28/john-frederick-jack-burke-jr/

www.hometowndailynews.com/2015/09/28/jack-burke-dies-at-cox-branson/

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Do You Love Your Agency Enough to Change It?

I am often asked to advise an agency owner on how to improve his/her company and yet, they already know what needs to be changed. Sometimes they just need an independent confirmation. Sometimes they need a third party to break a tie vote between partners. Sometimes they know the answer and they are hoping I can provide an easier solution. In these cases my job becomes one of creating enough urgency for the owner to execute the difficult solution on their own.

In this last scenario, the question often becomes, do you love your agency enough to force change? This question is more complicated than it first appears. Agency owners generally can be divided into two categories: The first group has personalities that cope better with painful, emotional discussions. They are more fortunate and more rare.

The second group is much more common. These agency owners' personalities are such that any type of difficult progress is nearly impossible for them to address. Unless pushed to the brink, they may not be capable of leading change if pain is involved. This is because change usually involves conflict from their perspective and they avoid conflict at all cost. The situation is so common I'm willing to bet everyone reading this knows someone running an agency who is a conflict avoider. These owners see conflict even when conflict really does not exist. Any kind of conversation in which they think the other party may be unhappy creates significant stress, anxiety, and often paralysis.

For these folks, love of their agency is not enough per se. I feel for these people because their lives are tough. Their situation is often debilitating. While I am obviously not a doctor, I have read many researchers' opinions that this is a true disorder. The question then becomes similar to a treatment program. Do the owners want to decrease their anxiety and increase their success enough, in many areas of life, to get coaching (deep coaching--not the vanilla kind advertised and sold all over)? Then they can answer the question of whether they love their agency enough to lead change and to truly thrive.

Why is loving your agency required to lead change? Because in many agencies, the current model is playing to not lose. The model is not designed to win. I see this reality played out over and over when I visit agencies, even agencies that on the surface (or covers of magazines) appear to be playing to win. Models designed to not lose have specific cultures and that culture must be broken and a new culture built. The willingness to break a culture requires guts, a willingness to inflect pain, a willingness to fire, a willingness to be cruel in order to be kind. Shakespeare said it best in Hamlet, "I must be cruel only to be kind. Thus bad begins and worse remains behind."

Only psychos are completely without stress when inflicting pain so it is normal to be stressed out when leading change. This is why tremendous love is required. Thinking as a parent when, sometimes their child must learn on their own, even if the lesson is painful, only a parent's love for their child can exceed the regret of knowing the child will feel pain.

Do you love your agency enough to get the coaching you need so you can lead change? If so, I have the resources required to help.

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Equity & Retained Earnings

Equity value is found on balance sheets. It is the difference between the assets listed on the balance sheet and the liabilities listed. Retained earnings are part of the Equity value. These are earnings not distributed to partners/shareholders and otherwise retained as earnings. Typically retained earnings and paid-in capital are combined for the majority of the total Equity value. Agency owners sometimes look at this equity number, or especially the retained earnings number, and think this is money sitting in a bank account ready for a withdrawal. It is not sitting there ready for a withdrawal. It may not even exist. Do not withdraw money based on this number!

To understand why NO ONE should make withdrawals or tax decisions based on this number one must first understand how the Equity number is calculated. It is a plug number. Call it what you want, make all the carefully itemized accounting entries you want, at the end of the day, equity MUST equal the difference between assets and liabilities. It is a plug number.

Second, understand the agency's biggest asset likely is not shown on the balance sheet, at least not in full. The agency's biggest asset is most likely its book of business. If the biggest asset, often the biggest asset by ten or a hundred times, is not shown on the balance sheet, then the equity portion of the balance sheet cannot be correct other than for accounting entries.

Third, many agencies have off balance sheet liabilities. Off balance sheet liabilities may be items like deferred compensation, vesting, phantom stock, loans not shown and employee liabilities. A shortage of working capital is also an off balance sheet liability. If all liabilities are not shown, how can the equity portion be correct?

Fourth, of an agency's hard tangible assets (versus a book of business which is an intangible asset) and liabilities, often the largest items are cash, premiums payable and premiums receivable. Typically, much of these three items are fiduciary trust monies. These items appear to belong to the agency and to a large extent the agency owns the receivables and the payables, but often it does not own the cash. The cash is being held in trust, in a fiduciary position. Legally, the agency likely cannot touch these items (although unfortunately and not correctly, many agency owners do spend these trust monies sometimes intentionally and sometimes naively thinking that because their state permits commingling of trust monies they do not have a fiduciary responsibility to hold the monies in trust whether commingled or not). If a shortage exists, as roughly determined by the trust ratio, the equity portion will be totally wrong.

Fifth, paid in capital does not really count. That money was spent and it is usually gone.

Sixth, sometimes when agencies do an agency management conversion, these lines are carried over incorrectly. The agency's internal bookkeeper rarely has any checks and balances on these items (partially because these are plug numbers and partially because these items do not involve monthly general ledger entries bookkeepers check). The basis going forward then is totally erroneous.

Seventh, many agency owners think of retained earnings as unencumbered cash. That is not what retained earnings is. To know what your unencumbered cash is, an agency can run a cash flow statement or manually calculate its monthly unencumbered cash. Most agencies likely have to choose the latter because at least one major agency management system does not seem to offer a capable cash flow statement.

Furthermore, many agencies do not have adequately accurate accounting for their cash flow statements to be correct (which leads to an entirely different set of problems).

I have seen far too many agencies damaged and even ruined because agency owners did not adequately understand what the equity and retained earnings lines on their balance sheets meant. Sometimes their accountants and CPA's did not understand either resulting in these professionals giving bad advice. Insurance agency accounting is extremely unique which is why it is more important for agency owners to understand agency accounting than it is for business owners in other industries to have the same level of knowledge.

If you are going to use the equity of your balance sheet, make sure you have a full understanding of its calculation, make sure the numbers are correct and make sure your balance sheet fully represents all liabilities to the extent possible. Additionally, be sure this is what you really need. More than likely what most owners really need is to know what their unencumbered cash is.

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Success Due to Economic Backwaters?

My observation is that many of the most profitable agencies, on a percentage basis, are in economic backwaters. At first this conclusion may not seem plausible. After all, if economic backwaters were so great, why don't all businesses seek growing their sales in the boonies?

Walmart actually used this strategy by initially focusing on small rural towns and then worked their way up to more urban areas. I think history shows this strategy worked. However, most businesses do not use this strategy for a simple reason: Growth is sexier than profits. Growth is easier than profits to sell to investors and Wall Street. Growth stories sell insurance magazines faster. Growth sells agencies to companies for appointments.

Profits in economically flat to dismal areas can be higher because usually less competition exists. Where is the competition in the county with 15% unemployment, low wages, 0% economic growth and maybe even a declining economy? Where is the competition for these counties especially if the counties have little population? Consumers have fewer agents and companies chasing them so retention is higher, regardless of rates. The agency can employ people for 20%-40% lower wages. With less competition, rates can be higher. With higher rates, loss ratios should be lower so contingencies should be higher (and my observation is that unless the agency is incompetent or corrupt, contingencies are often highest in these scenarios).

The catch, and the catch is omnipotent, is agency owners making lots of profit in these backwaters are apt to completely believe their high margins are due to their brilliance. Their mistaken belief has nothing to do with their location and if you are thinking they are simply egotistical hillbillies, the reader is mistaken. Humans have a huge bias for taking credit for results that are pure good luck. Consider gambling, a game of pure chance, as an example. If the player wins, odds are extremely high they will attribute their increased wealth to skill. In other words, almost any random person put into a highly profitable backwater agency will attribute their success to skill rather than the true driving force – little competition for clients or employees. This is quite an amazing and consistent phenomenon, but dangerous.

The price for taking credit for luck is a person <u>always</u> overplays their hand. Again, overplaying a hand when success is mostly a factor of luck is a characteristic of human nature. Overplaying a hand is not specific to the person's personality in these situations except when they try to grow by acquiring other agencies located in economic dead zones. Then typically the buyer over pays but does not understand, realize, nor grasp the house of cards they are building. They see their house as made of brick and steel placed on a strong concrete foundation when in reality the foundation is sand and the structure is straw. (This scenario does not, by any means, only apply to insurance agencies. It also applies, with a different basis being coastal property and long tail casualty, to more than a few insurance company executives.) The result is a bad business model built on weak human psychologies that compound one another.

For those who own an agency located in an economically struggling county, the key to developing a strategy is appreciating your luck. Appreciating luck rather than taking credit for luck can lead to the greatest of successes. For the first time, consumers in these areas have access to the same choices their urban and more economically vibrant peers possess due to direct writers and particularly, the internet. As the older customers die or move away, the incumbent local agent will have to compete more and more for younger customers. The agency owner who takes credit for their current success will be blindsided as retention begins declining more quickly. The person who appreciates their current luck can build a strategy for this inevitable day. Maybe the strategy is to build a quality marketing program for younger people. Maybe the strategy is to branch out geographically. Maybe the strategy is to build a niche program. The key is using the profits that exist today for growing tomorrow. I have worked with enlightened agency owners to implement each of these strategies and they work.

If you want to enter this lucrative market, keep in mind the only aspect where competition seems high is the rush to buy these wasting assets. I have seen too many of these acquisitions to believe the buyers have great M&A strategies. At best, the buyer understands they are buying wasting assets and strips all the unnecessary costs driving up profits while accelerating the retention loss. At worst, most of these acquisitions are egotistically driven by buyers with access to too much money.

The profits, the EBITDA's, are legitimately high even before stripping nonessential costs. The relative pricing then may be high but beware of using EBITDA. Non expert use of EBITDA multiples in this scenario is unwise because the EBITDA multiples readers see, hear and discuss typically assume some growth. Growth of any nature cost money. Agencies in economic backwaters are often lucky to maintain top line commissions year-to-year. Therefore, the EBITDA multiples applied to agencies in backwaters should be less, all else being equal. An interesting fact is that quite often if the buyer is in the economic doldrums themselves, they do not know this and over pay which is one reason their M&A strategy is a house of cards.

So to buy into this market, finding the right seller is vital. Making the terms dependent on results other than a wasting asset is vital. Building a strategy that exceeds personal relationships is crucial. Building a culture of true business accountability rather than liking everyone and everyone liking you is absolutely necessary but in these counties, this requires delicately not upsetting the wrong people. In other words, it does not pay to be a bull in a china shop but the culture still has to be improved so that results and accountability are primary. Then, sales can actually grow even if the economy is flat. This is so much easier said than done, which may be why so many agency owners do not even bother trying. In and of itself, this is a key opportunity for the person able to execute this key turn.

For all readers not interested in these economically downtrodden areas, my suggestion is to try to keep the normal human bias of taking credit for good fortune at bay. Spend your good fortune to protect your tomorrows.

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Rock is Dead

I read an article the other day where Gene Simmons of the rock group KISS proclaimed that rock music is dead. It is dead, to paraphrase him, because consumers do not and need not pay for the music. So if rockers are not paid for rocking, why would they write rock music? Hence: Rock is dead.

That got me thinking about the music industry. The industry generated a large proportion of its revenues from record sales for 40 years. Now consumers do not think they should have to pay for music. They seem to think all music is public property. No industry, no company, no person changes cultures and business models easily but the music industry clearly has no choice but to find a new model.

I recently visited a classic rock band's website that was methodically, carefully, and creatively designed with considerable precision and ingenuity to create sales of merchandise and experiences that cannot be transmitted electronically. This rock band clearly had partnered with or developed internal abilities recognizing the new reality, they had accepted new reality, and they have invested financially to reap the greatest awards from this new reality. I was inspired looking at their site and seeing how powerful their new model is. Instead of fighting reality, they embraced it and in doing so, they discovered many new opportunities.

What does this all have to do with insurance agencies? Insurance agency owners and many a rocker have at least one characteristic in common. They both like to live by their own rules, which often mean no rules, which means flying by the seat of their pants, which means not planning. The rockers have an advantage here. They figured out that because rock was dead, playing cowboy with a business is also dead. A thorough business model, complete with strategy, tactical planning, and thorough execution is required in today's electronic age. Many agency owners have yet to learn this lesson. If aging rockers after drinking too much and doing way too many drugs (I have no idea if this particular band these things or not, just making an accepted generalization) can figure out the new reality, what is taking agency owners so long to figure it out?

The answer is their pain is not as much as the rockers' pain--yet. The reality is simple, the train has left the station, and just because it hasn't arrived at your station does not mean it is not going to arrive. In this electronic age combined with an age of the greatest advertising expenditures ever known by factors of tens, continuing to do business without a plan is a slow suicide. Continuing to survive on contingencies, continuing to not hold producers strictly accountable, continuing to not follow procedures, and so on is all just a slow suicide.

My clients that have accepted reality, built strong and methodical plans complete with accountability top to bottom are all excelling in both growth and profits. Agency owners that have yet to accept reality almost always conclude their peers' success is because of some special company, having more companies, having some special program, cheating, having been born with a silver spoon, or whatever other rational. Sometimes they are correct, but my clients are not succeeding because of these factors and often they are not succeeding because they are even smarter. They are succeeding for the exact same reason these classic rockers are succeeding. They accepted reality. They embraced reality. They changed their business culture to take advantage of the new reality. They changed their business culture to take advantage of agency owners who refuse to accept reality. Getting to see the difference up front and personal like I do when I analyze agency after agency day in and day out, their success is stark compared to their competitors' losses.

The question then is this: Are you ready to embrace the new reality that agency success going forward requires a professional, methodical approach and investing in the required managerial and leadership strengths? In other words, are you ready to restrict yourself, as the agency owner, to a set of rules and procedures while sharing management and leadership responsibilities? The choice is yours. Slow suicide or thriving success. To use a famous classic rock song lyric, "What will it be, boy?"

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One Glorious Day

In a future approximately 476 days from today, today being the day you read this because the clock begins ticking upon you reading the article title, producers will become obsolete. Agency owners will rejoice not having to have producers and not having to manage producers ever more.

Producers will become obsolete because three progressions will occur simultaneously. These progressions are tied together in a mind meld, irrevocably linked but invisible to humans. The first progression will be that both consumers and businesses will call your agency on their own, with no effort on your part. You will no longer have to actually ask for the sale. Be careful to go outside that day because gusty winds are expected. Meteorologists will be perplexed by the wind because high pressure will not be forecast. The high pressure will be created by the combined sighs of relief of agency owners and producers who never wanted to make sales knowing they never more have to stress about making sales.

The second progression will be that consumers and businesses will become insurance experts. They will know exactly what coverage they need. They will know all the forms too. They will give you an exact order. They will just need you to place the business. The transformation will be similar to "name your price" insurance but the buyers will actually know what they are doing.

The third progression will be divine because the agency will have a 100% hit ratio. Unlike the currently low hit ratio and current low quality of most agency related internet quotes, each consumer and business will only call the agency with which it is divinely meant to be matched. Call it divine intervention if you will.

On the 523rd day after you read the title of this article, agencies will become obsolete. You see, a computer program can be written easily enough that places insurance automatically for any kind of insurance if the customer will simply provide the parameters. In between the 477th day and the 522nd day though, those 50 days will be one great party for agency owners!

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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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