The True Cost of a Sale
By Chris Burand

Are your losing money on every sale? Most agencies are. The average agency with revenues of $750,000-$1.2 million *spends $1.03* (based on 1996 APRS data) *on every commission dollar made.* This is the overall cost – not just the cost of new sales which most people already agree are money losers. This means *agencies are losing money on each and every sale.*

Is your agency in this situation? The only way to know is to examine the agency's expenses in detail and determine your true cost of sales. Every agency is unique, so the sources of an agency's expenses are also unique. However, there are several common areas where expenses are often too high.

The most common reason agencies spend more than they make on sales is that most agencies' producers are overpaid. According the Academy of Producer Studies (*Resources*, Spring 1995), "... producer compensation should reflect roughly 30% of the producer's production." However, the latest edition of *Producer Compensation* states the average commercial lines producer's compensation equals 35% to 42% of production. This can be devastating because when producers are overpaid, the agency loses money on every sale! Simultaneously though, agencies must pay enough to keep their good producers loyal and motivated. The trick then is to balance profitability with enough compensation to motivate the sales force.

The problem does not end simply with overpaid producers. More important is the fact that most agencies pay producers to make sales rather than profits. This problem is not just limited to the insurance industry. For instance, the *Wall Street Journal* recently reported the results of a study showing that 60% of all sales people would rather make a sale at any cost, rather than make a profit. It is critical that a compensation system pay for profits rather than sales.

Another example occurred recently when I suggested an agency cut their number of companies. The agent responded by saying that such action would decrease the number of potential sales their producers could make. He was exactly right. However, sales with marginal companies are not profitable. Based on *Rough Notes'* studies year after year, the more companies an agency represents, the less money the agency makes. The agency would be more profitable if it did not make the sales in the first place.

Low hit ratios also consume profits. Experienced producers with hit ratios in the 20's and 30's are not efficient or effective and cost the agency tons of money. The CSR, and many producers, still get paid whether or not the sale is made. Marketing money and staff time are depleted even if the deal is not closed. So if it cost $1,000 to make a sale and producer has a 25% hit ratio, the real cost is $4,000!

Do any of these problems plague your agency? Examine the source of your costs to find out. Solutions to every one of these problems exist, but the first step is to determine the true cost of your sales.

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