

Burand's Insurance Agency Adviser

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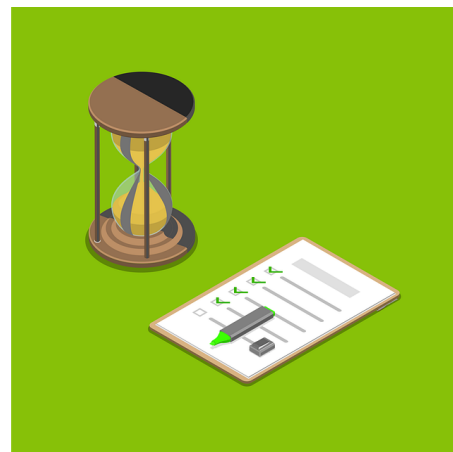
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Are you prepared?

The simple fact is: all agencies will change ownership. All agencies need a perpetuation plan, and a perpetuation plan can take up to five years to implement.

Planning for perpetuation can be one of the most difficult and emotional decisions agency owners must make. By avoiding the inevitable though, they risk losing their agency and their financial security for their family and their retirement.

Don't let your agency--or your family--get caught unprepared! We help guide agencies through the intricate details of preparing for perpetuation.



An ideal plan is flexible and can be adjusted as the needs of the owner and agency change over time. As a final step,

The process begins by learning, and sometimes defining, the owners' goals. We then complete a thorough analysis of the agency's current situation and devise a plan to help the agency reach its perpetuation goals.

we assist as the agency progresses through its plan.

A perpetuation plan is also a great way to increase the value of your agency! Contact Burand & Associates today to begin preparing for your agency's future at: chris@burand-associates.com.

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The Value of a Great Producer

Hardly a day goes by without the industry press covering an employee lawsuit, usually involving a salesperson, where a competitor has poached key people. "Poaching" typically means that the new employer enticed the employee(s) to leave in violation of the employee's contract. Sometimes the suit involves entire teams. One recent headline described how one broker poached 140 employees at one time from another broker! That would hurt!

Often, the new employer is sued along with the employees. The suits usually involve allegations of violations of confidentiality clauses and trade secrets. The real issue is the loss of revenue because clients often move with the employees, depending on the details and the consumers' attachments to the team.

There are so many of these lawsuits, and the dollars are so significant, that if the suits were all combined, we might have a micro economy. We already have a niche business development industry where specific entities have determined they can achieve a better return on investment by attracting producers and sometimes teams to come to them, hopefully with their clients and new business capacity to pay for the inevitable lawsuits, rather than developing their own production capacity. They may be especially sensitive to developing their own production capacity knowing how they poach people, which causes the current employers to lose their development investment.

The cost of developing new production ability is exceptionally high, which is also driving the high prices in agency acquisitions. It is really frustrating to pay sky high prices and

then see what you just bought get poached. But the poachers figure it is cheaper to poach than to buy or develop.

Carriers are also focused on production development. Their terminology is a little different. They call it new business acquisition cost. A few carriers focused on narrow lines have greatly decreased their new business acquisition costs, which is upsetting the market. Consider that the less money that is required to acquire new business, the less effort that is needed to maintain high retention.

Whether at the broker/agency level or carrier level then, new business development costs have become the king, queen, and bishop of success. Yet, I don't think most insurance entities even understand how these economics have entirely changed the game being played.

How much does it cost to develop a producer? The lowest starting price for a producer with true, but hidden, potential is likely \$60,000 for a 23-year-old. Finding these people takes some work, but it can happen. It's like finding a diamond in the rough when no one else is looking. This can occur for many reasons, including the educational environment, choosing the wrong major, and lacking self-awareness of one's sales potential. If they have great self-awareness of their abilities, potential employers are likely to be aware as well, and the price goes way up. Starting salaries for high-quality people in sales can be \$100,000 with no experience.

A 23-year-old, or even a 30-year-old, is unlikely to become a profitable investment in less than three years and is more likely to require at least five years. They are like de facto machines from an investment perspective. The machine cost \$X. The widget the machine makes is wobbly at first, requiring lots more tooling. After three years, the machine produces widgets that are not wobbly, and sales begin to increase. The machine costs \$70,000 times three years, plus training, benefits, and other people's time. The total cost is at least \$300,000.

But humans are not machines. The success rate, defined as a salesperson generating a positive ROI by year five without consideration of asset value, is maybe 20%. This means four \$300,000 failures for each success. If the goal is for the producer to generate a minimum of \$500,000, then roughly \$1.5 million is spent for each success, which is three times the successful producer's book value.

Therefore, maybe paying three times for an agency is a smart move. And if you are a private equity firm or publicly traded broker, accounting rules allow a buyer not to report the full cost of an acquisition on its income statement. In fact, not even 50% needs to be shown on the income statement, so a three times revenue acquisition looks like only 1.5 times. And if a buyer uses non-GAAP measures such as EBITDA, acquisitions are 100% free. From these financial engineering accounting loopholes, a firm looks far more profitable by buying business than developing producers.

Going back to the poaching suit, poachers often budget \$500,000 as a starting point for the legal bill they will incur for a lawsuit accusing them of taking employees. They are paying significant bonuses for those people to leave their employers, too, so they're spending a lot of money to poach employees. Using a \$1 million book for simplicity, and they are paying \$500,000 in legal fees and another \$1 million in damages to settle the suit and employee bonuses, the math works in their favor.

So what is an agency to do that does not want to poach producers or buy agencies at three times revenue, but still grow? The investment in new people must decrease significantly. The key is increasing the percentage of producers that succeed. Over time, I've built an infrastructure that includes all the required coaches (anyone who claims to be the only coach, even the primary coach, a new producer needs should be ignored). Within this infrastructure, the success rate is about 70% and the cost of the failures is approximately 67% less.

One other step required, which costs money, is investing in the highest quality employment contracts possible. Do not hire the local, jack-of-all-trades attorney to write these contracts. You need true experts to keep your successful producers from being poached. And if they are poached, you need a contract that keeps them from stealing your accounts and taking other employees with them. Do not pay attention to the issues around non-competes. What you need (I'm not an attorney, so don't take this as legal advice) is a very high-quality trade secret agreement.

Grow producers economically and pay whatever the price is for high-quality contracts, and you will have the foundation for beating the big guys.

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Outgunned

Around 10 years ago, I told an audience of insurance distributor associations that their lobbying efforts were poor to complete failures.

The industry had failed, completely, not partially, to prevent banks from entering the industry (which did nothing but mess up the industry further because of their incompetence in running agencies). They failed to prevent the ACA (which definitely decreased commissions and created a concentration of risk for a large proportion of agencies). Their focus on issues that were not important was only accelerating the concentration of business among a few distributors, along with a failure to develop new agencies, which would be their demise.

Today, those organizations are a shadow of what they were because around 40% of all premiums are written with admitted carriers by 20 agents/brokers. And those agents and brokers do not need most of those organizations. The remaining tiny agencies are too small to pay the bills, or they join networks that want to pay one bill.

The same events are happening again. On the lobbying front, lobbying hasn't improved, but the problem has moved to the state level, and that is more dangerous. The plaintiffs' bar is years ahead of the industry's lobbying actions. They recognized they could make a lot of money by changing courts and laws. They spent a ton of money to do so, and they are succeeding. Forget nuclear verdicts because that is a red herring argument. The issue is an increase in frequency and higher settlements that do not approach the nuclear level.

The plaintiffs' bar has invested significant sums in technology, AI in some cases, that is already having an enormous impact on the lawsuits they bring. First, they have technology that can reduce the cost of discovery by 50% and as much as 75%, according to some white papers I've read. This is just like anything else. If I can reduce my cost substantially, I can offer my services/products at much lower prices, which expands my market. In this situation, I can lower my cost so that I can afford to bring more suits targeting lower settlements. This increases the frequency of suits.

Their AI tools, which significantly decrease their cost of evaluating which cases to take, further lowers their cost. The AI tools enable them to consider combinations of variables to maximize their odds of winning while also cutting the cost of preparing their cases. Again, lower costs create expansion opportunities to lower price points. If this were the insurance world, it would be akin to previously not wanting to write an account generating less than \$50,000 but now being quite willing to write accounts at \$20,000 because now, those accounts are as profitable as the \$50,000 accounts used to be.

I don't see defense counsels investing the same amount of money in their lobbying or technology. Several surveys have noted that defense counsels feel hamstrung by the tight budgets carriers impose upon them.

Private equity has seen the combination of forces applied against a weaker defense to begin investing heavily in litigation. They've invested billions to fund trial attorneys. And the insurance industry is aiding and abetting with products like verdict preservation insurance. It's really a bit hypocritical.

In some situations, the trial attorneys seem so giddy, they are truly at risk of killing the golden goose because insurance companies will eventually pull out of states and lines after enough pain has been inflicted upon them. The plaintiffs' bar would be wise to consider a strategy where they take just enough, but not too much.

The insurance industry has a great case to make, excluding some bad actors. Yet not since around 1990 have I seen positive advertisements regarding what the industry does for society. Those advertisements should not be designed to generate business like animated advertisements do. These are image branding advertisements that carriers, agents, and vendors should all join to fund.

Why hasn't this happened? One reason might be the Achilles' heel of this industry. Everyone makes more money the higher rates go. It's one of the last remaining cost-plus

industries. The answer to losses is not better risk management and loss control, as it should be, but we'll adjust our pricing. That's sure to make the populace happy and reduce the populists' messaging of politicians and trial attorneys.

And one of the reasons, coming back to my opening, I don't believe the right messaging exists, is because the messengers don't know enough about the industry's mechanics. I have read one prominent industry expert's articles/opinions for 40 years, and he totally misses the mark as often as not in his analytics, especially with regard to the rate of return due to insurance companies. I read association executives' positions, and I sometimes, literally, not figuratively, have no clue what they're trying to say because their points are nonsensical. A funny one is that a particular company they don't like will go broke because they spend too much on advertising. But not once have they read that company's financial statements, or if they have, they don't know how to read financial statements.

Or talking about nuclear verdicts. Someone, please, share your database of true nuclear verdicts paid for by insurance companies. The NAIC does not even have a common definition of what constitutes a claim, so that kind of data does not exist, at least at that common publicly available level.

The plaintiffs' bar and lobby seem smarter, more focused, and better funded. In other words, they value winning more than this industry values losing. When I gave my presentation 10 years ago, audience members complained, "But we tried really, really, hard." Awesome. "A" for effort. But what would the outcome have been had smarter and better funded lobbyists been employed? On so many levels, this industry is staffed by people trying to make everyone happy. That's a silly goal in this environment. The goal should be to win. To make losers of the other side. This means hiring better people and letting go of others. It means investing more money.

This industry has a great story and is the least expensive form of finance, economic expansion, decreasing the cost of home ownership, and helping people climb the social ladder.

The states themselves should be careful of allowing the plaintiffs' bar too much success because insurance regulation is one of the highest profit margin parts of state budgets. The fewer insurance companies, especially admitted carriers, the less money states make.

We need better image branding and a willingness among all parties to join together to improve the industry's image. And working with the NAIC on claims ethics would benefit the best carriers, the public, and the industry overall. I don't know who will lead such an effort, but I hope someone in a powerful position will. Otherwise, ten years from now, I'll be writing about another demise and dilution of this industry because in the end, if insurance is not affordable and if carriers are unwilling to write products/areas, no one needs insurance.

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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 and 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 35 years' experience in the insurance industry. He is a featured speaker across the continent at more than 300 conventions and educational programs. He has written for numerous industry publications including the 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 NACVA, 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. Chris Burand is also a Certified Business Appraiser and certified E&O Auditor.

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