Agency Consulting Group

PIPELINE

For Independent Agents

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Welcome to The PIPELINE, the premier newsletter for agency owners and principals published by Agency Consulting Group, Inc.

"Your Road to Success Begins With Agency Consulting Group!"

INSURSTORE

Agency Consulting Group, Inc.'s commitment to its clients and readers of the PIPELINE is to bring the 'cutting edge' of insurance technology and management to them whenever we encounter them. To that end we would like to introduce you to InsurStore. This concept is not unique in e-commerce but is 'slick' and workable.

WHEN DOES IT MAKE SENSE TO SELL AN AGENCY INSTEAD OF INTERNALLY PERPETUATE?

We won't bother to discuss the obvious situation in which a retiring agency owner has no internal perpetuator available to whom to sell the agency. Those circumstances require an outside transaction at Fair Market Value to provide the asset value of the agency to a retiring owner.

Valuing an Agency vs. Valuing a Book of Business

Many agencies have producers who own some or part of their books of business with agreements to sell their books of business to the host agency upon their death, disability or retirement from the business of insurance.

THE ACCIDENTAL OWNER

Why some agency owners thrive and grow their agencies while others never seem to 'get the hang of it.'

INSURSTORE

An E-Commerce Site That Brands Products to Each Agency and Permits On Line Sales to Flourish

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The *InsurStore®* is a multi-carrier, multi-product, e-commerce solution developed with GBO's *InsurIQ®* technology for the purchase of individual insurance and personal protection products. The *InsurStore®* has been designed to provide a new source of commission income for agents and distributors to supplement revenues from traditional insurance sales and distribution methods.

High Tech - Low Touch: Provide your clients with a complete digital experience!
Core to the *InsurStore®* is a simplified, uniform and consistent, end-to-end, web-based, buying experience for consumers, including the ability to research and explore multiple product types and categories, obtain product pricing, apply for products, pay for those products, get immediate access to instantly issued

policies, customer service and claim contacts and other fulfillment materials through a secure on-line account.

The purchase process
can be consumer-driven or deployed to support an agent-assisted process - either for face-to-face sales or for an agent call center.

Each InsurStore includes multiple products from multiple carriers in a single "storefront". Life, A&H and P&C products may be offered side-by-side with non-insurance products creating a broad portfolio on the virtual product shelves. Currently, dozens of products are available from a growing number of name-brand manufacturers. Products include insurance for dental, vision, pet, accident, life, hospitalization, critical illness and more. The *InsurStore* also includes a variety of non-insurance products like products like medical discounts, pharmacy and pet savings plans and identity theft protection.

InsurIQ works with each distribution partner to customize their product portfolio and add the distributor's branding. Once established, the distributor links to their *InsurStore* from their own website, and embeds the *InsurStore* links into email marketing campaigns or other customer communications.

The **InsurStore** includes an agent portal providing access to marketing, sales and servicing tools.

Expand the product portfolio you offer to your clients and prospects.

Products offered can include life, accident & health and property & casualty products along with non-insurance products. Insurance products include term life, AD&D, dental, vision, legal, pet, wedding, unemployment protection, critical illness and cancer insurance. Non-insurance products include travel assistance, discount programs, telemedicine, auto clubs, and more.

Rather than directing consumers to many, single product insurance websites, agents and other distributors can deliver a consistent, familiar, web-based, multi-product "shopping cart" experience under their own brand. Returning customers can easily add to their product portfolio with a "one-click" buying solution for follow-on purchases.
Distributors are notified by email of all transactions completed in the *InsurStore*®. A distributor portal is populated with all relevant customer information including: customer name, products purchased by carrier/vendor, effective date, premium/fees paid and commission due.

The *InsurStore* is not for every agent. But if you have been entertaining e-commerce as a venue and avenue of agency growth, this is a good way to gain entry quickly, painlessly and at modest cost. For more information about the *InsurStore*, please visit www.insuriq.com or call either Carole Hans (203-446-8053) or Lee Walters (203-446-8066).

WHEN DOES IT MAKE SENSE TO SELL AN AGENCY INSTEAD OF INTERNALLY PERPETUATE?

THE DIFFERENCE BETWEEN GOING CONCERN VALUES AND FAIR MARKET VALUES

We won't bother to discuss the obvious situation in which a retiring agency owner has no internal perpetuator available to whom to sell the agency. Those circumstances require an outside transaction at Fair Market Value to provide the asset value of the agency to a retiring owner.

But what happens when an agency with children or qualified staff successors begins getting offers (that are usually quite lucrative)? In order to evaluate the offers vs. selling down to internal successors, the agency owner must understand the difference between the Going Concern Value and the Fair Market Value of his business. The more the departing owner understands these two critically important valuations, the more intelligent he can be about the disposition of the business.

The first certainty that all business owners must understand is that (with a few exceptions) a business must pay for itself with its own earnings and cash flow over a period of time. For all practical purposes a buyer whether from inside the agency or outside, understands that he is giving up future earnings of the agency for some period of time to allow principal and interest payments to be made up to the value he agreed to for the agency.

Going Concern Value
The GOING CONCERN VALUE of an agency is its future earnings capacity over a reasonable period of time ***as the agency has been operated historically.*** The best way of looking at this definition is for a continuing agency owner's purpose of purchasing key man insurance on the agency owner to allow for replacement of the agency's potential earnings to him if something unforeseen was to happen. It is the estate planning value of a continuing business. It also describes the potential value of the agency book of business if the successor is from inside the agency and the agency is not expected to change appreciably in the transition of ownership.
In practical terms this value defines how long it will take the new owners to pay for the value of the agency that they are purchasing. During this time all or most of the agency's free cash flow will be devoted to principal and interest (if a note is required from the seller or from a financer). So if an agency has $50,000 of cash flow (after tax earnings and other free cash available) and the agency is priced at $250,000, the new owners will not be able to take any earnings from the agency for over five years (considering interest) as the benefit of their purchase. That's

fine if the new owners are 40 years old but not so much if the new owners are 65 years old and expect to retire before they are 70.

So the consideration of passing an agency down to the next generation is keyed to the value of the agency, its cash flow and the timing tolerance of the new owners.

Fair Market Value

The FAIR MARKET VALUE of an agency still defines its future earnings capacity over a reasonable period of time. The government's definition is "the price that property would sell for on the open **market**. It is the price that would be agreed on between a willing buyer and a willing seller, with both being required to act, and both having reasonable knowledge of the relevant facts." (Pub 561 (4/2007) When an outside agency considers buying another agency they calculate the future earnings capacity including two very important ingredients, the savings generated from the loss of the current owners and the economies of scale that they can generate by spending less money on redundant or undesirable costs.
If old owners remain with the agency they may be paid at a lower scale to help retain the business. The economies of scale depend on the intention of the buyer to keep the purchased agency open or to consolidate it into other offices. The buyer may also need less staff and other operating expenses that are redundant. The end result is very specific to the buyer's ability to generate more profits, earnings and cash with which to pay the seller for the agency. This results in different buyers having different models and different values for the same agency - and all of them are correct. This is especially true for the "reasonable period of time" each buyer selects for the maximum payout period.

Reasonable Period of Time

What is a REASONABLE PERIOD OF TIME? This is a subjective measurement from the perspective of the person financially responsible for the valuation. For instance if you are planning for life insurance and you are 60 years old, five years may be a viable "reasonable" period of time to project earnings potential. If, under normal circumstances, you expect to still be in the business at the end of the period it is reasonable to project that need in life insurance to protect your family in the event of your death. If you are younger and conservative, you may wish to provide ten or fifteen years' worth of earnings to your family in the event of your death. But if you are 70 years old, the projection of ten or more years of continued earnings may be a stretch.
On the other hand, if you are buying an agency, the "reasonable" period of time is defined by the maximum duration of the payments you will make to purchase an agency. Do you want to take ten years to pay for the agency, during which you will take no (or less) profits from the agency than it earns in order to devote the bulk of the agency's profit and cash flow to paying the former owners? If you determine that you must fully pay off the agency within five years, then the earnings value of the agency over that period of time becomes your outside limit for your valuation. That's one of the reasons that multiple suitors may well propose multiple values, each quite different from the others - with all of them

being reasonable to the potential buyers because of their specific needs and conditions.

Considerations of whether to sell to internal perpetuators or to outside buyers

1. If the owner is primarily concerned with maximizing value, the outside sale will normally generate a higher price. However, we have seen agencies in which an inside buyer matches an outside offer using a longer payout period to allow the agency cash flow to still be manageable.
2. If the owner is concerned for the successors (i.e. children and loyal employees), concerned about long term employees well-being and concerned about the consistent treatment of clients who were (or have become) friends more than just customers, perpetuating the agency internally makes a lot of sense with terms long enough to satisfy the seller within the scope of a buyer's ability to pay. For instance, an agent's child may have no problem with a long term payout to manage a higher price.
3. Financing is NOT a problem in either Succession or Perpetuation as long as the price and terms make financial sense to a lender (cash flow).
4. Whether internal or external sales, Agency Consulting Group, Inc.'s Liquidity Audit can assure a seller of the buyer's ability to continue to make payments throughout the payout period. (link Liquidity Audit).
5. Most internal sales involve the buyer acquiring the company including its stock, assets and liabilities. The internal successor has been involved in the agency for years and is well aware of the strengths, weaknesses, and procedures of the agency already. They buy the cash of the agency through the calculation of Tangible Net Worth as a component of the price (dollar for dollar value). This way they simply continue the bank accounts, receivables collections, payments, etc. of the agency.
6. External sales are most often asset purchases to allow the buyer to take advantage of the 15 year amortization rules applying to agencies. Assets can be the book of business alone, but often includes both tangible and intangible assets. Buying assets does not involve the buyer in the prior acts of the previous agency owner nor does it assume any previous liabilities.

The key to deciding whether to sell internally or externally is more in the mindset of the owner than in the mechanics of the transaction. Finances (or lack thereof) should never be a deciding factor since any "good" deal (in which the value can be substantiated over a reasonable period by agency cash flow) can be financed, if needed. Most deals are determined by whether the agency owner trusts the buyer to be able to meet the total financial obligation. Call Agency Consulting Group, Inc. for assistance on either (or both) sides of potential transactions to get an impartial view of the deal and to create Win/Win situations.

Valuing an Agency vs. Valuing a Book of Business

Scenarios:

1. Agency A wants to sell itself to Agency B. Each has infrastructure - building, contents, carrier relationships, staff, equipment, software as well as the book of business that would be melded together under single agency ownership.
2. Agency C wants to purchase the book of business of Producer 1 who owns his book of business and has placed it with Agency C.
3. Agency C wants to purchase the book of business of Producer 1 who owns his book of business and has historically placed it all with Agency D.
4. Agency E wants to purchase the book of business of Producer 2 who also owns his own book of business and places his accounts through a variety of agencies with commission splitting arrangements.

These are just four citations that we encounter every day of the transfer of ownership that occurs in our industry. Each one of them could be for the same volume of commission and the value of each one of them will be defined completely differently. It is important to note the difference in the handling of an AGENCY ownership transfer and a book of business transfer considering the variations available in each.

Buying an Agency:

Internal acquisitions are often stock sales in which the entire corporation's stock is purchased. The value is comprised of the future earnings potential of the book of business, most often the most valuable part of the sale, over a specified period of time (determined by the buyer) PLUS the Tangible Net Worth of the Seller (Owners' Equity less Intangible Assets like Goodwill). Stock is transferred which means there is no change in basis value. No opportunity exists to amortize the purchase price and the acquisition is for the agency's liabilities as well as its assets.

External acquisitions are most often Asset Purchases in which the buyer purchases specific assets (like the book of business) but not the stock of the pre-existing Company. 15 Year amortization is allowed and only specific assets and liabilities are purchased with the rest staying with the denuded company's prior owners.

Buying a Book of Business - Scenario 1

This is pretty straight forward. The Present Value of the Future Earnings potential of the book of business is calculated based on assumptions that are created by the buyer about the retention rate of the business being purchased. No provision is made for growth since all growth is generated by and is claimed by the buyer. A "floor" and "ceiling" is constructed on the potential net income stream of book of business over a pre-selected period of time and the total value of the book of business within that 'floor and ceiling' becomes the value of the book of business for which an agency is willing to take the financial risk of buying the book of business.

Scenarios 2, 3, and 4 describe a few of the many variations possible that raise or lower the risk of achieving the expected retention levels that will affect the value of the book of business in question.

Internal Book Purchases - Scenario 2

Many agencies have producers who own some or part of their books of business with agreements to sell their books of business to the host agency upon their death, disability or retirement from the business of insurance. This is a best case scenario for agencies since the book is already in house and would suffer less trauma from the acquisition which is seamless and transparent to most clients. Retention is typically very high in this scenario unless the producer has close relationships with his clients and the agency does not. In this case the risk for lower retention becomes relatively high causing a lowered price. But in normal conditions the client relationship is already invested in the agency and retention of business would be high. The agency also has a vested interest in maintaining the book of business with agency carriers for relationship, loss ratio and contingency purposes.

External Book Purchases - Scenario 2

When a producer who owns his book of business leaves an agency and sells his book of business to another agency the effect of transferring carriers as well as transferring client relationships must be considered both an asset and a liability in the sale. As an asset, the new agency can bolster its premium volumes with its carriers to benefit its relationship, loss ratio, and contingency potential. As a liability new service relationships may occur that will be different than typical for clients whose choice to move to a new agency was not considered in most such transfers. Retention may suffer and the risk is higher to the buying agency, often softening the price offered.

Brokered Book of Business - Scenario 3

Business placed by licensed agents among many agencies is more frequent in the urban areas of the country than in its rural areas. The customers are more related to the producer than to the servicing agency or entity. The transfer of ownership of these books of business is really a transfer of each client one-at-a-time and retention is often questionable if the original producer is not a part of the transition.

Projecting Earning Stream Potential

When considering buying a producer's book of business the exercise we use at Agency Consulting Group, Inc. is the project the future earnings potential of that book of business in the hands of the specific buyer. We calculate the historical customer retention and then we project the revenue stream using the historical perspective as the basis and change it based on the dynamics of the new organization that would own the business after the sale.

We then consider the economies of scale as well as any extra costs associated with the purchase to the specific buyer. The resultant profit stream is subjected to the buyer's (not the seller's) tax rate to determine the future earnings stream that defines the benefit to the buyer from purchasing the seller's book of business. We then calculate the cashflow projected for the buyer over a period of time acceptable to the buyer for the transaction. This forms the raw value of the book of business to the buyer agency.

We suggest if you choose NOT to use the services of a professional appraiser of insurance agencies that you follow the same track as we do in our professional valuation service. If you would like to use Agency Consulting Group, Inc. for your valuation needs, please contact info@agencyconsulting.com or call 800 779 2430 for more information and our Valuation Questionnaire.

THE ACCIDENTAL OWNER

Why some agency owners thrive and grow their agencies while others never seem to 'get the hang of it.'

"It isn't a career when you hate what you're doing --- it's a Life Sentence."
Al Diamond

Common Situation One

A young man, or woman breaks away from an agency or company, desiring to be his own boss. He or she is a good salesperson, relatively knowledgeable in the insurance business and personable. With no large pre-existing book of business, they throw themselves into the selling process through enthusiasm or desperation for income sources, and they start selling insurance. As their book of business grows, so do the pressures exerted on them by their existing clients for service and administration. Eventually, they find that they are better salespeople than processors and they hire an assistant. That assistant is clerical and simply does what she is told. As time passes and the book of business continues to grow, so does the staff. The staff starts taking on a life of their own and one or more become the 'Alpha' employees and assume some supervisory or management roles. Suddenly, it seems sudden to the producer, that he or she is surrounded by a large number of employees, has a payroll larger than his personal compensation and he again finds himself being called upon to do management, personnel, carrier and administrative tasks rather than processing policies and endorsements, and he can't do what he does best, sell and maintain customer relationships.

Common Situation Two

Dad gives 'Junior' (son or daughter) work to do in the agency to earn some money in high school. 'Junior' goes off to college never intending to return to the family agency. When schooling is complete and Junior finds life on the outside more challenging and less rewarding than expected, he also finds himself drawn to the agency into which he can easily fit, pleasing Mom and Dad immensely and making an adequate compensation level without the strain of competing against others for the job. The offspring either starts at the bottom and works their way into a more competent role in the agency. By the time they have been in the agency five or ten years, they absolutely know that they could run the agency better than their parents. A few years after that, after having earned their wings by selling, servicing and/or administering the agency, or just by spending enough time in the agency, parents decide to pull back and let 'junior' take the reins. Junior eventually takes control and either buys out the parents or manages as defacto owner until the time comes that he inherits the agency.

In each case, above, the agent in question never intended to become a business owner responsive to personnel disputes, argumentative clients, pushy suppliers and unappreciative family and employees. He has become the ACCIDENTAL OWNER. If the agent was a good salesman once, he misses the simplicity of visiting prospects, selling them on using his services and getting paid for the successes. If he was never a salesperson, the agent wonders for the rest of his career whether he made the right decision and why he is burdened with all of the worries and responsibilities of ownership and management.

The agents in these two examples are not lazy. They are not stupid. They have simply evolved into agency owners without, necessarily, desiring or expecting that end result.

Unfortunately, the ramifications of the 'Accidental Owner' is discomfort with the job, dissatisfaction and, often, disillusion and depression. We have encountered Accidental Owners during our 42 years working with agents who were making $500,000 /year and hating every minute of their careers. We knew more than one that evolved alcohol, drug and other personal problems that in a few cases resulted in total personal and business collapse and even in death.

The common trait of the Accidental Owner is a relatively low self-esteem that reflects itself by 'acting out.' This could be demonstrated by repulsive or abusive management techniques, overly-gregarious natures that are more shallow than sincere, or changeable management philosophies (the members of the Idea-of-the-Month Club).

Like a teenager forced to go to school in the Fall, the Accidental Owner doesn't enjoy the ownership role, even though he understands it and knows it has to be done. He doesn't like, and sometimes can't tolerate, the record-keeping that is a keystone of good manager in any business. He firmly believes that no one can "Plan" or budget a business because it is easier to credit luck when business is good and blame fate and everyone else when business is poor.

If the agency is large enough to support the role, the Accidental Owner hires an operations manager. If it's not large enough, he seeks merger with another agent who is more amenable to management tasks. If he isn't large enough or motivated enough to do either, he simply becomes embittered over the tasks he is forced to do and performs them when he has to in order to keep the agency operating.

If you came into agency ownership in one of the ways above, or if you actually wanted to be an owner/manager and found that the role was not suited to your personality, there are solutions that will permit you to maintain the pleasant parts of your career without requiring you to perform tasks for which you are not suited. We mentioned two, above.

One of the motivators of growth for the Accidental Owner is the desire to generate sufficient revenue to sponsor a competent manager to oversee the administration of the agency while the agent performs the sales and relationship tasks that should be in the owner's domain. There is no magic revenue mark that signifies sufficient revenue to hire a manager. That mark is unique to each agency and is found when the owner can continue to support himself and still have sufficient profits to devote a full time manager to the necessary tasks.

Agents who are not large enough to sponsor a manager or who desire greater profits more than a pleasant career might find the same result from a constructive merger with another agent who is more attuned to management while our Accidental Owner can direct his attention to sales and relationships. In this way the agency grows by merger, enjoys the profits generated from the economies of scale and, most importantly, it finds a matching manager to the agency's needs.

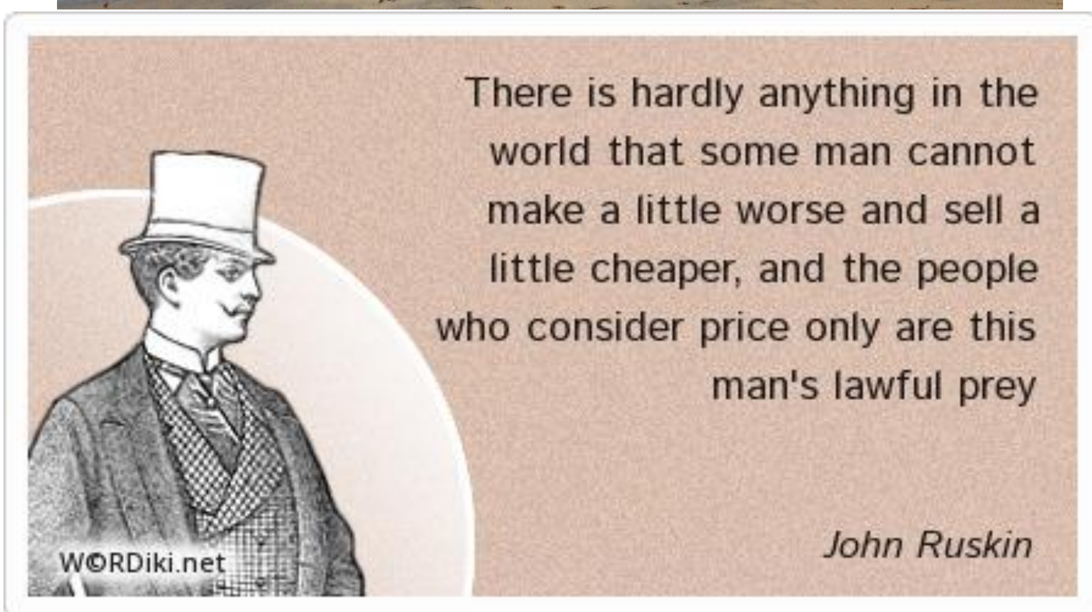
Unfortunately, we still encounter the worst of cases, the agent who doesn't want to part with enough revenue to hire a manager or doesn't trust anyone else to manage and doesn't want to share ownership, even though it means that the agency becomes a larger fish in a much larger pond. Ego sometimes rules, and the Accidental Owner is sometimes fearful of sharing ownership. These agents are miserable until they can't stand it any longer and they sell out. Sometimes they wait until retirement is an appropriate alternative. But each year we see agents who still have many more productive years in their careers selling down, selling out or merging simply because they don't enjoy their jobs.

A key to converting from Accidental Ownership to the happy, satisfied, professional insurance agency owners is to find the role in the agency that makes you happiest and is most productive to you and to your business and concentrate on that role. Hire, merge, or promote from within the people who can better accomplish those tasks that fall to agency management, but are not either your strengths or pleasing to you. You can still be productive and will probably be much more successful in business by doing what you enjoy, rather than what is forced upon you.

A final caution - every agency employee, including the owners, must have a productive role in the agency. You are LOST if you feel you have "paid your dues" and can now coast while others produce, service, manage and administer the agency. We have all seen agency owners who no longer manage a book of business, have managers to run the operation and/or partners to take care of the agency growth, carrier and client relationships. This is not a healthy situation for an agency. It is like milking cows without feeding them or maintaining the equipment that keeps the cattle productive, assuming that they will get all they need from grazing in the pasture. You may maximize profits for a short while. But eventually, the milk will diminish, the cows will dry up and the farm will become worthless. It is better to sell the agency and get its full value while it is in a growth mode than to reign over a 'maintenance agency' and watch its value erode each year.

"A shepherd who loves his job will lead a happier and more fulfilled life than a king who hates his role."

Al Diamond



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USA INSURANCE NETWORK

Do you want exclusive access to 200,000 prospects who need all types of insurance? Take advantage of the free adoption of USA Insurance Network, the newest vehicle for agency differentiation and access to over 700 specialty programs.

USA INSURANCE NETWORK

In mid-2016 George Nordhaus and I began a new company, Monday Morning Markets. He's the Chairman and I'm the President. That means he was smart enough to think up this concept and I was asked to help make it happen. In August, 2017 we expanded the scope of the company and renamed it USA Insurance Network.

What is it?

USA Insurance Network gives you exclusive rights to put over 700 specialty markets on your website for as many as 200,000 people who live around you. It also give you referrals of Personal and Commercial customers in your area who desire insurance products of any kind.

If prospects need a specialty program, your agency will be the only one that is permitted to have these programs available in the USA Insurance Network concept. The concept includes featured programs for which the program manager and George develop video content explaining their program and access to the 700+ markets available on Rough Notes Marketplace.

Once at territory is granted to an agency, no other agency will be given USA Insurance Network (as long as the USA Insurance Network agency posts USA Insurance Network on their website - we'll give you all the directions you need to get that done). Please act NOW!! Link here to access USA Insurance Network and register for the program.
We at Agency Consulting Group, Inc. have been encouraging independent agencies to show their prospects and clients points of differentiation that adds value to an association with the agency. Here is one such point of differentiation.

Remember, every one of the 200,000 residents you will reach needs almost every line of insurance that you have available.

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