BUSINESS SUCCESS THROUGH THE FAIRNESS DOCTRINE

Stephen Covey wrote a seminal book on how to optimize your life and your business, *The Seven Habits of Highly Effective People*. If you haven't read it, it’s a must read to fully understand the concepts of this article. If you have read it, read it again – at least once every quarter – until you have absorbed these ideas into your psyche and are living those seven habits. One of the formative habits is “Begin with The End in Mind.” It is at the core of Strategic Planning. But an even more important principal of life and business is ALWAYS DO WHAT’S RIGHT FOR THE END USER.

The basis of this principal is ‘Treat Others as You Would Have Others Treat You.’ Sound familiar? If we live our lives in that way, we don’t become extremists (in any direction); we become proponents of the Fairness Doctrine. Another way of stating the same principal is, “Be Fair to Everyone – Always.”

The 10 Commandments is a pretty good set of codes for living. Even if it wasn’t sourced in the Judaic/Christian religion, it would still be a good set of codes for everyone on earth, regardless of what form of higher source they believed (or whether they believed in one at all). But no one should have a problem with the second five of the Commandments that suggest how we can live a Principal-Based Life;

1. Honor Your Parents – if they deserve to be honored. They, hopefully, raised you as best as they could. But it is extreme to presume that all parents deserve to be honored. Treat them as you would have your children treat you someday – and treat your children in a way that will cause them to “honor” you someday, firm, but fair = The Fairness Doctrine.

2. Don’t Murder -- It is extreme to either permit indiscriminate killing (cold-blooded murder, genocide, simple retribution, etc) but it is just as extreme to refuse to end someone who would continue to hurt others if left unpunished. The “eye for an eye” doctrine is not meant to be literal. It is meant to subscribe to the Fairness Doctrine.

3. Never cheat – yourself or anyone else. You don’t want anyone to cheat you. This covers a number of the 10 Commandments (adultery, lying, stealing). This, again, describes the Fairness Doctrine.

4. Don’t Covet – It’s not bad to want “things”. It motivates us to be successful. But don’t drive yourself to ‘keep up with the neighbors’ or to be like anyone else just because of what they have. That’s extreme! We have built our country and our culture on a healthy dose of “wanting” a better life for ourselves and our families. “Wanting” with our primary concern being the “end user” (the well-being of ourselves and our families), is good. “Wanting” with our primary reason being coveting someone else’s possessions is extreme. Again, the Fairness Doctrine rules.

Applying the Fairness Doctrine to our business lives will fulfill both our own best interest and, simultaneously, the best interest of our clients and our employees (the most important ‘end users’ in our businesses).
When we do our Strategic Planning, we “plan” for business success, growth and profit. Why? We should want success in order to give ourselves and our families a good and secure future. There is nothing wrong with that. But if we are concentrated on doing what’s best for the end user, you won’t grow and/or profit by taking away from our employees best interests or those of our customers.

The concept of “being fair to everyone – always” is simple. But simplicity doesn’t imply that it is easy to accomplish. We see frequent examples of rationalization for actions that are obviously ‘unfair’ in order to accomplish end results that may be commendable. The false principal of ‘The End Justifies the Means’ has sounded good and rationale to extremists all over the world to justify what they consider ‘right and just’ causes. Similarly, raising taxes is an example of negatively impacting one group of people (taxpayers) in order to accomplish (hopefully) noble goals, serving all people. The interesting reality that is facing most Americans today is that we may not be able to afford to provide the wonderful things we would like for everyone when most taxpayers are backed against the ‘wall’ economically. Localities and States are all feeling the impact of taxpayers acting in their own self-interest, rejecting new initiatives and taxes, both questionable and commendable, simply because it would hurt their ‘end users’, their families, to an extreme.

Now let's translate these concepts to our own lives, both personal and business. Good things happen when people do the right things consistently over time. But bad things sometimes still happen to good people in the short term. If we stop doing the right things consistently because we face a personal or business downturn, our only option is doing things that we know will harm someone in order to gain an advantage in our own goals. For instance, if we face a downturn in profit it is perfectly reasonable to take less income in a year as an owner. The ramifications of business ownership is that we enjoy the rewards of our business when we are successful and bear the burden of taking less profit (or none) if business is not successful. The Fairness Doctrine certainly justifies lowering raises for our employees coincidental with our own reductions in compensation. This is not easy to explain to employees, but it is JUST. We cross the line when we lower or eliminate raises to employees IN ORDER TO maintain our business profits at artificially high levels.

Many agencies experience losses in a soft market. There is no question about profits above your expenses. You actually lose money and must suffer deficits or take less income personally – and that affects you and your families’ well-being. Many agency owners, in the spirit of paternal feelings for their employees, try to continue to give raises to employees when they, themselves, are taking less income in a given year. This is an EXTREME in the other direction. It is absurd to pay someone a 5% or 10% raise when the owners (who are often the hardest working employees of their businesses) are taking a pay cut. They do so in the misdirected feelings that they are responsible for their employees’ well-being. They are, but only insofar as their own wellbeing is not negatively affected.

Of course, the preceding paragraphs imply that the agency owners are paying themselves a ‘fair’ compensation for the work that they are doing in the agency (“fair” = the same amount that they would pay someone else to perform the same functions at similar levels of performance). This means that they benefit annually from business success or suffer from business decline through the profits of the agency and they benefit in the long term by the increased value of the business that will eventually be transferred to the next generation (or to someone else) when the business is perpetuated.

The Fairness Doctrine for agency clients and prospects pertain to how you treat your customers. Do you concentrate of what products are best for your clients, or do you concentrate on the commission rates offered or the pressures from the carriers to bolster volumes? Do you find that most of your accounts are ‘Renewed, As Is’ without analysis or do you analyze their accounts each year to determine which products are best for them for the next term? Which of these preceding statements properly defines the Fairness Doctrine? Are you being ‘fair to
everyone – always’? Are you treating your client the same way YOU would want to be treated in similar circumstances?

If you ask yourself these questions every time you make a decision with respect to your employees or your customers you will find that the ‘right’ choice is relatively clear -- CLEAR, not necessarily easy. Just remember, PEOPLE are always more important than entities. ‘Fairness’ applies to yourself and your family as much as it does to your employees and your clients. If you don’t cheat, yourself or anyone else, you will feel better about yourself in the long run. Your business success should be defined by how hard you work and how smart you are about growing and creating more profits, not by whether you are cheating yourself or anyone else to get the results you desire.

THE DIFFERENCE BETWEEN A STRATEGIC PLAN AND A CRISIS PLAN

For decades we have helped growth-oriented agency owners develop and implement plans that guarantee the continued growth, productivity and profitability of their businesses. Integrated into those Strategic Plans have been Succession/Perpetuation Planning and Disaster Recovery Plans. But, of course, Succession/Perpetuation Plans and Disaster Recovery Plans require and deserve evolution and development of their own as subsets of the overall Strategic Development Plans of the agency.

A Strategic Plan lays out the future development of the agency over a foreseeable period of time, usually five years. Looking out more than five years becomes “fuzzy” and problematic. Too many things can happen in the short term that affects the overall organization that far out. But if you have at least five or ten years of history, you can already project what will happen in one, three or even five years, whether you continue the same path you’ve tread historically – or plan to implement changes that are expected to influence the growth pattern of the agency in the short term. The longer your history, the more accurate your Strategic Plan especially if you plan few or no substantial changes in your operation. And, a long history allows you to estimate and project the effects of any single changes made to alter your results. YOUR PAST HISTORICAL TRENDS PORTENDS YOUR FUTURE UNLESS SPECIFIC CHANGES ARE MADE.

On the other hand, a Disaster Recovery Plan (DRP), including a Crisis Plan for things like the Chinese Virus now circulating around the world, works as a short term plan in three sections: 1. What to do immediately, 2. What to do in the short term 30-90 days, and 3. What to do to get back to normal for you and for your clients beyond the medium term.

Historically, Crisis Plans have been created and implemented primarily in the event of a weather emergency

Right now, every agent should have or should be drafting a Crisis Plan for how to recover from whatever ramifications you have suffered as the result of the physical, emotional and economic “hit” caused by the Wuhan Virus in your area.

Steps in Crisis Planning:

1. Evaluate Immediate Needs to satisfy clients and employees. Whether a physical crisis (fire, flood, wind, etc.) or a health crisis (stay-in-place orders due to a medical crisis) specific logistics must be in place with an implementable document that can result in staff and management moving from the normal to a crisis mode that fits the cause of the crisis.
2. Identify what we must have in place to continue to provide critical services tomorrow and over the next week.

3. Create the management reporting mechanism to assure all critical items are accomplished during the next 30 days.

4. Plan a transition to normality from the time the crisis has peaked until normality is logically achieved.

Committing a Disaster Recovery or Crisis Plan to paper is ESSENTIAL. The reason it is so important is that while everyone will consider the big things after a disaster, what will be missing and likely will severely harm you are the minor details that will be much easier to identify when listing all that needs to be done.

Start with the big things. Work your way down to the details of facilities, equipment, personnel, locations, etc.

Understand that you will likely NOT have all the resources at hand. That’s O.K. But now is the time to begin a structured acquisition program that will set aside Crisis Packs that will permit you to seamlessly flow from normal operations to Crisis Operations when the need arises. At the same time, you create your Plan for what you will need that you don’t already have you must also designate staff members to tasks that they will need to accomplish if the need arises for disaster recovery or crisis management. That, too, must be written and rehearsed sufficiently for the staff involved to be acquainted with their responsibilities in the event of imminent need. Then once each quarter review the plan with the staff members letting them touch and feel the Crisis Packs as you acquire them.

I know we are not first responders in a crisis as insurance agents. If you are a first responder, I give you all of my respect and well wishes. But once the need for extraordinary measures are past, the first thing that your clients will think about is recovering their insurable belongings and property. In order to show them the value of using an independent agent we must BE THERE when they need us. Even if our facilities were harmed, we must stand ready to help our clients and gain and reinforce the reputation that we have as the unheralded heroes who help put our clients back into normal operation after a crisis.

If you need help creating a Disaster Recovery Program, call us at 856 779 2430. We will come to you and set up a tailored program with and for your specific conditions and potential for disaster.

WHAT IS THE CURRENT MULTIPLE VALUE OF AGENCIES IN THE U.S?

Two agencies (Agencies A and B) live a few blocks apart in a medium sized city in the Midwest. Both of them generate $1.75 Million in gross commissions (including contingency income) 50% PL/CL and both of them generate about 20% profit. The owners of each are in their mid-sixties. ARE THEY BOTH WORTH THE SAME AMOUNT?

Agency A:

125-year-old agency with the same family owning it for the last three generations. The owner has no family interested in assuming ownership and has no active producers (Active = growing the agency’s book of business annually). Revenue has struggled to remain at $1.75 MM commissions with sufficient referrals generating revenue to offset retention losses as the client base dies, retires or sells their businesses and properties.

Agency B:
20-year-old agency started by two producers who left a large agency to start their own business. Each has a child in the agency, one in a producer role and the other in a service and management role. They bought a small ($125k) competitor five years ago. Revenues have grown from zero 20 years ago to $1.75 MM and they continue to grow at around $125,000/yr.

Are both agencies worth the same amount/multiple? Will both agencies attract the same buyers? Should they? Are the succession/perpetuation/financial goals of the owners of both agencies the same?

WHAT MAKES YOU THINK THAT ONE FORMULA OR MULTIPLE (OF ANY AGENCY MEASUREMENT OR COMPONENT) COULD DEFINE THE SAME VALUE FOR SELLING OWNERS WITH DIFFERENT NEEDS OR FOR BUYERS WITH DIFFERENT MOTIVATION FOR THE POTENTIAL ACQUISITION OF EACH AGENCY SIMPLY BASED ON THEIR REVENUE OR PROFIT AT A SPECIFIC POINT IN TIME?

First of all, NO – WE HAVE NOT LOST OUR MINDS AND CHANGED OUR PHILOSOPHY -- we will neither calculate nor share the results of the thousands of valuations we have done in general multiple terms (Multiple of Revenues, Multiple of Commissions, Multiple of Profits, Multiple of EBITDA, etc.). We know from bitter experience that if we create those “average” benchmarks, agents will try to use them in defiance of the common sense that dictates that no “average” is possible based on the differences in tangible and intangible asset values of any agency in the U.S. Using any multiple, regardless of how they are created will end up cheating either the buyer or the seller as is reflected by the obvious difference in value of the two agencies displayed above even though they are the same size and same profitability at the point of review.

Our goal has always been to calculate the appropriate value of an insurance agency asset based on the conditions and needs of the seller and the potential earnings from that property for the specific buyer that is considering the transaction.

THE “SPOILER” – THE BIG REVEAL!

THE VALUE OF AN AGENCY IS ITS FUTURE EARNINGS POTENTIAL FOR THE SPECIFIC BUYER BASED ON THE HISTORIC PERFORMANCE OF THE SELLER OVER AN ACCEPTABLE PERIOD OF TIME TO BOTH BUYER AND SELLER. IF A COMPANY IS TRANSACTED RATHER THAN JUST THE BOOK OF BUSINESS, THE TANGIBLE NET WORTH OF THE COMPANY’S BALANCE SHEET IS ADDED TO THE INTANGIBLE ASSET VALUE OF THE BUSINESS AND GOODWILL.

THE TERMS OF THE TRANSACTION DEPENDS ON THE CASHFLOW ANALYSIS OF THE TRANSACTION OVER TIME. If the agency can’t afford the cash to support the buyout, the transaction can’t be successfully accomplished without cash infusion over time – something that most buyers can’t or won’t permit.

What Agency Consulting Group, Inc. does when valuing agencies for internal or external succession or perpetuation is to calculate the historical trends of revenues, expenses and profitability and project those trends with appropriate elimination of a) expenses specific to the retiring owners, and b) known changes that will take place with the new ownership. The end result is a statement of future earnings potential against which we apply several hundred risk factors specific to insurance agency operations (tangible and intangible) to determine the discount rate to the future earnings potential that could likely affect the agency’s future earnings potential. The total of the discounted future earnings potential over a period of time acceptable to the buyer and seller determines the likely value of the asset to the specific buyer.
If the specific seller’s situation (economic, age, health, reason for the transaction, etc) allows for the price and terms offered for the asset the transaction will be deemed fair and will conclude. If not, the transaction will not be concluded and another buyer must be found whose purchase potential will better meet the needs of the seller. UNLESS THE SALE IS BEING MADE UNDER DURESS, THE NEEDS OF THE SELLER, NOT THE NEEDS OF THE BUYER, WILL DETERMINE WHETHER A TRANSACTION WILL BE MADE.

For instance, in Agency 2 it is likely that the buyers will be the children of the current owners and, unless debts, health, financial condition require high value or immediate cash price, the sale can be made on a longer term basis benefitting the sellers over the long term and on very “friendly” terms for the buyers who will sponsor the purchase using agency cashflow.

However, Agency 1’s eventual sale depends on unknown conditions of the seller. Are he and his spouse healthy or do they need time and cash to address health concerns? Have they set aside funds for retirement or do they need the proceeds of the agency sale to support their lifestyle? Is the owner trusting of a potential buyer or does he require financing cash up front to assure his value actually comes to him?

A similar set of circumstances must be derived from the potential buyers in order to create and value of the asset to the particular potential buyers.

If you’re considering buying, selling or merging, we suggest that you have a proper valuation done for your agency. Call us at 856 779 2430 and we’ll be happy to discuss it with you.

**WHEN Mergers AND Acquisitions DESTROY VALUE**

Not every merger or acquisition will work. Most agents are so hot to grow through mergers and acquisitions that they do whatever is necessary to make them work. Sometimes we’re lucky and organizations mesh well. Other times, not so much.

Every large agency we know is involved in acquisitions or wants to be. Most medium size agencies are seeking acquisitions or mergers to strengthen themselves. Many smaller agents find themselves continuous targets of other agencies acquisition marketing, getting some welcomed and other unsolicited offers that sometimes sound too good to be true.

What we don’t hear is that 50% to 65% of all mergers and acquisitions actually result in decreased values of the remaining or combined entities. How can that happen? Here’s a recent example in which we were called upon to value a combined operation after an acquisition:

A $3 Million (value, not income) agency purchases a $1 Million (value) agency. One year later the combined business is valued (the same way each was valued previously, based on the entities future earnings potential). It is valued at $3.5 Million, a $500,000 loss of value in one year.

**WHY?**

To find out why these happen, we collected what some of our clients told us when they invited us to help them re-connect with growth, profit and value AFTER each implemented a business combination (merger or acquisition).

1. So much time was taken by management in the consolidation that we forgot to sell some insurance.
2. In the attempt to “integrate” one organization into a larger organization we destroyed the creativity and chased way the innovators that attracted us to the acquisition in the first place.

3. We never communicated properly with our employees and with our customers. We knew what we wanted to do in the merger, but we never shared our goals and strategies with the folks who we count on most to make us successful.

4. We consistently searched for and found weaker or failing companies that we could get at a bargain. They imbued us with their negativity. It turns out that it wasn’t such a bargain after all.

5. We were two companies, both facing their own institutional problems, that merged creating a single, larger troubled company.

How do you avoid this scenario and still grow through mergers and acquisitions?

1. Plan your organizational growth STRATEGICALLY. Don’t even consider merging or acquiring unless you have determined that it fits your long-term goals as an organization. What’s “long term”? At least five years and often 10 years. Does it make any sense to take on the responsibility for a merger or acquisition if you have just a few years before you want to retire? It may sound great to retire with a larger book of business under you, but are you ready for the work of integration at your stage in your career? Do you have the staff to handle a transaction now and again when you retire? Do you have your own perpetuation plan in place?

However, if you have a cogent Strategic Plan that identifies the market trends that you are pursuing (product, carrier, lines of business, geography) and expansion through merger and/or acquisition will help you reach those goals, then go for it!

2. The only agencies who should be considering mergers or acquisitions are ones who already understand their customers’ needs are meeting them. Don’t lead with your weaknesses, lead with your strengths. An agency ready to acquire or merge has customer retention rates consistently above 90% (better at 95%). This means that you have strong customer loyalty and they “want” to stay with you. You lose them when they retire, die or sell their businesses. An agency ready to buy and merge experiences growth through referrals and wants to multiply their referral strategy by forming similar relationships with a whole new set of customers for whom they can offer similar services.

3. Benchmark yourself. Do you know how you stack up against similar sized agencies (overall, or in your State)? Do you keep records of your own productivity growth historically? If you don’t know yourself, how will you know if an association with another firm improves or decreases your metrics? We’ve known for years that we pay attention to what we measure. So, if all we look at is commission dollars, we might beat ourselves unmercifully when our revenues decline in a period of soft insurance economy during which the market depresses by 10% or more in a given year. Agencies that pay attention to their own metrics understand and react to market fluctuations but measure the real signs of growth or shrinkage, customer counts.

4. Are you like the Buggy Whip manufacturer who bought up other failing buggy whip manufacturers as the automobile gained leverage on the personal transportation industry or could you expand into other categories of your industry? Most of our readers are insurance agencies. Have you looked to your merger or acquisition appetite for other dimensions in our industry beyond personal and small commercial lines property/casualty insurance? If not, consider Dimension Extension within your strategy for growth.

5. Don’t acquire or merge beyond your physical (or staff) capabilities to manage that growth. We encounter agencies every year that acquired or merged with the “hope” that they would gain the
skills and talent to manage the resultant organization because they knew their own weaknesses. If you don't have the strength to integrate and manage the combined operation, do your Due Diligence (including long term employment commitments) for the management and other talents needed to bolster your organization.

6. Define your technical competence before you venture into acquisition. We recently encountered a young Personal Lines agent who had the means and desire to acquire. But he wasn't computer literate enough to understand his own basic agency management system. Nor did he have (or understand) the need for Internet presence for agencies expecting to remain in the personal lines business for more than one more generation. The more technically competent you are and the more you understand the relationship between internet technology and the customer in a service industry like ours, the more likely you are to make and implement successful acquisitions. The world is changing – quickly. You needn’t change to continue your career. But you can’t grow by acquisition or merger without a deep understanding of technological strategies around customer portals and remote access service.

There is a subset of large, medium and smaller agencies whose owners and drivers are prepared to plan for growth instead of following every scent toward potential acquisition or merger “prey”. The untrained ‘nose’ may find the scent may turn into a vicious odor once they pounce on their target. But if you take the time (before you acquire or merge) to strategically plan for your growth; if you understand and please your current customers; if you know your own metrics and benchmark yourself to assure that you are efficient and effective enough to enjoy value growth in a merger or acquisition; if you have examined your products and what will be the successful insurance products (or financial security products) of the future; if you have strong management and staff and if you are technically savvy, you are well prepared to enter the fray. Seek a merger or acquisition and gauge your success in the baseline terms of value to you over time. Otherwise, gain knowledge and get assistance BEFORE the acquisition or merger to keep from following a proverbial “skunk” down a hole (your worst-case scenario occurs if you actually catch it).

Need help growing through strategic acquisitions and mergers? Call Agency Consulting Group, Inc. at 856 779 2430.

LEST WE FORGET!

*I believe there are more instances of the abridgment of the freedom of the people by gradual and silent encroachments of those in power than by violent and sudden usurpations.* -James Madison

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