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Multiple business strategies help you plan for the future

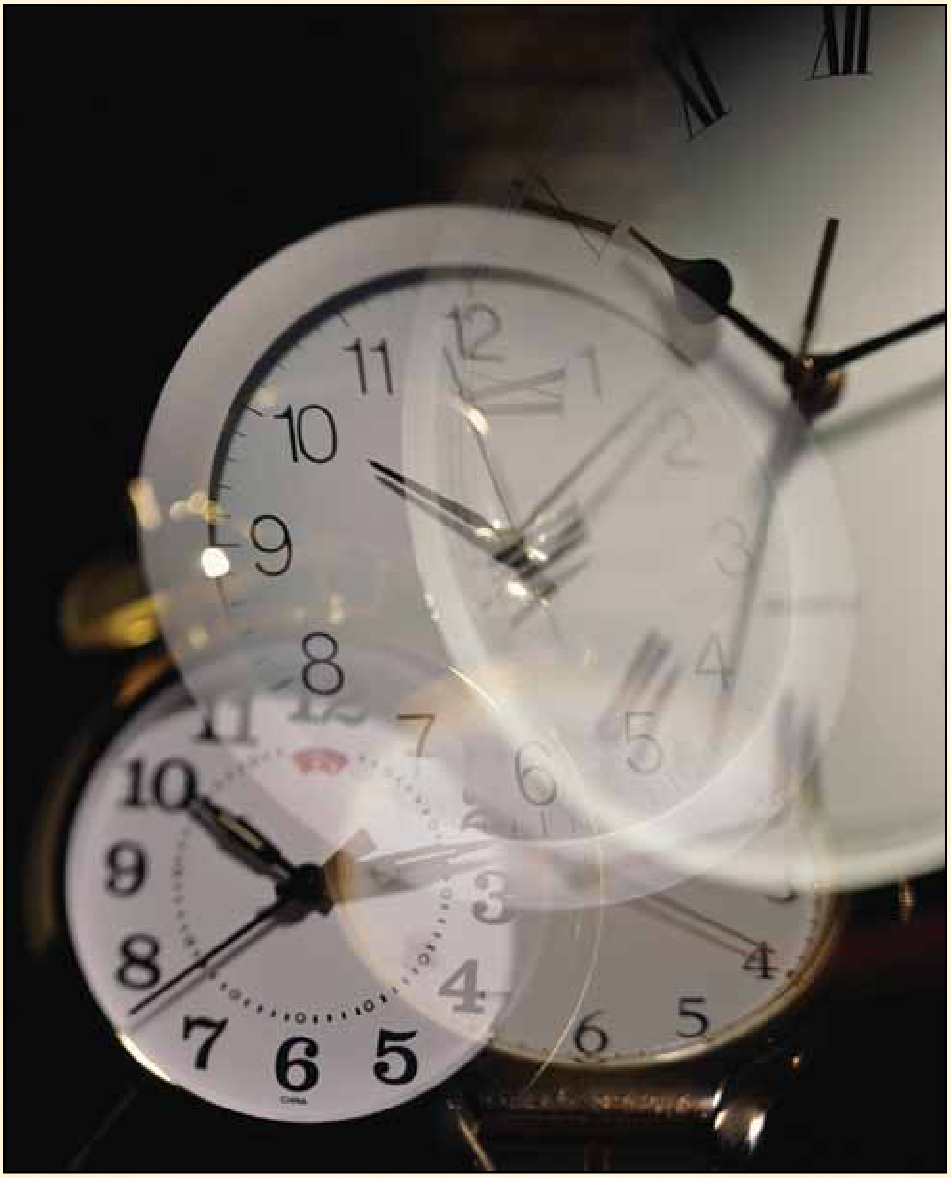
Mold your agency's direction with short- and long-term plans

By Daniel P. Menzer, CPA

We're halfway through 2012. Do you know how your independent insurance agency is doing relative to its 2012 budget, or its 2011 strategic plan, or even whether you're making headway toward your long-term-exit strategy goal? If the answer to any of these is something other than "Yes," it's time to think about putting more emphasis on planning for the business, not just running the day-to-day business. In the words of that great American philosopher and former baseball player, Yogi Berra: "If you don't know where you're going, you will wind up someplace else."

Planning isn't just for the Fortune-500 companies. In many ways, effective planning is much more important to the long-term success of smaller privately owned businesses because it often addresses some personal issues of the principles. The problem is most small businesses are run by sales-type entrepreneurs, which can be a good thing for growing the business, but often not the best skill set for the development and management of the strategic aspects of the business model.

Studies have shown that less than 20-25 percent of professional, independent insurance agency owners plan for the perpetuation of their agency. This often results in the owner(s) having to sell to a third party in order to reap any final rewards from their life-long business pursuit. Planning for



the business doesn't have to be overly involved or confusing, but it should dig deep enough into the business and the principal's needs and goals to create some objectively measureable points of reference. If budgets are one end of the planning process, succession planning and retirement considerations are at the opposite end. As the average age of agency principals continues to increase, for many, retirement is much closer than you think.

Sound business planning includes short-term plans (annual budgets), two- to five-year plans (strategic plans) and long-term planning (more than five years). These individual plans should all be linked together and continuously monitored and adjusted over time as goals are met, circumstances change and new goals are established. Many agencies establish budgets for the revenue and expenses anticipated in the upcoming year, but little else. While this is a good start, it is one step in the whole planning process that helps businesses prosper and principals accomplish their long-term goals.

The short-term planning for tactical and budget issues primarily is an operational function, often handled by the controller in conjunction with the sales team in larger agencies, or the agency principal(s) and other key employees in smaller agencies.

Answers to the following questions should be incorporated into the budgeting process:

- What are renewals likely to be next year?
- How much new business can we honestly expect to book?
- What are our costs going to be to produce and service the business and meet the needs of our customers?
- Are the revenue and expense projections consistent with the long-term goals of our long-term plans and our stakeholders, or does something need to change?

However, the opposite end of the spectrum requires a more insightful thought process by the senior management and ownership team. These questions are independent of the ones listed above:

- When I/we are ready to retire, do I/we want to sell externally, or perpetuate internally?
- When do I/we want to begin and/or end the retirement and business transition process?
- What should I/we be doing now to facilitate accomplishing these goals?

In between these two time horizons lies the strategic-planning component, when questions such as the following need to be addressed by both the operational and stakeholder perspectives in conjunction with each other:

- Do we have the resources needed to continue meeting the needs of our customers and accomplish the long-term goals of the agency and its owners, in terms of financial, personnel, operational efficiencies and technology, etc.?
- What potential changes in the core industry structure do we need to evaluate to determine the impact on our customers and our operations?

• Which segments of the business do we need to invest in, and which do we need to consider adjustments to in order to maximize profit returns?

The budget should be a reasonably detailed analysis of current-year revenue and expense information from which to base next year's financial projections against. The budget process generally can be segregated into four major components:

1.) Revenue
   a. Renewals by producer by account by month
   b. Identification of known new and lost business
   c. Projections of unknown new and lost business
2.) Compensation
   a. Staff salaries
   b. Producer compensation based on revenue projections
   c. Employee benefit costs
3.) All other operating expenses
   a. Employee direct expenses (e.g., travel & expenses, auto, communications, etc.)
   b. Controllable operating expenses (e.g., supplies, postage, equipment, etc.)
   c. All other overhead expenses (e.g., rent, insurance, IT, etc.)
4.) Capital and operational investments

Using this level of detail as the basis for revenue and expense budget information can provide management with great insights into the agency and set forth the foundation for longer-term projections. Review of the budget assumptions and sensitivity analysis of changes to internal or external factors (e.g., staffing levels, investment alternatives, economic and insurance marketplace forecasts, etc.) helps management to stay on top of the key-performance indicators.

Budgets should not be "pie-in-the-sky" projections; as that serves little purpose for management or measuring progress toward longer-term goals. Realistic projections and goals, in particular new and lost business targets for each producer, are critical to building a successful plan. As the planning process extends beyond the annual budget, being able to project when new producers and support staff should be brought on board to supplement the growth, as well as supporting the long-term-exit strategy, becomes an important business management tool. As the planning horizon gravitates from next year to two to four years and beyond, obviously the level of details in the plan have to change, but the mindset of using realistic assumptions and careful identification of needs becomes even more important.

What many agency owners may not consciously realize is that the sale of their agency is more often than not the result of a poorly planned and implemented perpetuation strategy, leaving them no other option but selling. Certainly, this is not true in all cases as many of the best planning strategies for a successful perpetuation also are key strategies owners can use to maximize sales proceeds.

However, not positioning the agency for perpetuation properly all but guarantees a sale will be required for the agency principal to capitalize his or her value.

The key to proper planning for the principal(s)' exit strategy is to prepare the agency for the next set of owners, whether it's an internal buy-out or external sale. The No. 1 priority of any perpetuation plan is people—having the right people in place to take over the leadership, management and sales engine of the retiring principal(s). This is not something that happens overnight, and without it, the perpetuation plan cannot succeed. Similarly, for an external sale, there is nothing a buyer wants more than to feel comfortable that there is a viable replacement for the selling principal. Agency owners must plan well ahead of their target exit date to accomplish this goal.

Another important consideration is always financial: How can the agency owner maximize his or her investment return given the choice of buyers? Agency owners must understand that an internal perpetuation will almost never yield as high a purchase price as an external sale, so it has to be a conscious decision to sell internally and walk away with less cash in the bank.

Regardless of the buyer, the value of any professional, independent insurance agency is directly related to the level of profitability of the business, so the more that can be done over time to improve the *pro-forma* earnings of the agency, the more valuable the agency becomes. In a perpetuation scenario, agency owners also should consider the amount of capital retained in the business. Future owners need to have sufficient financial resources in place to meet the obligation of a buy-out just in case the ideal projections and plans don't materialize exactly as anticipated.

Establishing the long-term goals and plans, supported by the tactical budgets and strategic planning is critical for agency principals to be able to position their agency for their exit. Proper planning and execution for an internal perpetuation often will create the best opportunity for an external sale. Failure to build a viable perpetuation strategy will leave only one exit strategy, selling to or merging with a third party. The difference of having exit options versus one path really comes down to whether agency owners took the time and effort to plan ahead.

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