

BENEFITS SELLING

The authority for brokers and agents selling core,
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Navigate the perfect storm with segmentation

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These days, managing small group health insurance can be an unhealthy business proposition for independent, small and regional insurance agencies. While some agencies are thriving, others feel the impact of commissions that have decreased or remained flat in recent years.

Simultaneously, service requirements have increased, because plans have become much more complex and small businesses typically lack sufficient human resources support, and broker responsibilities to educate clients have escalated. It requires tremendous resources to manage such accounts -- efforts that could be more effectively spent on sales or focusing on other areas of expertise. Some agents find themselves caught in a completely different situation. They enjoy servicing these clients more than the challenge of writing new business. As they lose customers through attrition, revenues begin to erode. This "let it bleed" mentality does not bode well for the future.

There are other significant factors impacting the industry. The country's economic downturn has created challenges no one could have anticipated. The number of unemployed and uninsured has reached record highs. Many small businesses can no longer afford to offer health insurance coverage to employees; larger operations utilize more temporary and part-time staff, reducing the need for comprehensive benefits packages. As a result, market demand is shrinking. Meanwhile, carriers are consolidating. For example, eight years ago in Dallas, there were about 20 carrier choices. Today there are only seven; four of those have captured 95 percent of the market. Across the nation there are fewer choices for small businesses and prices are increasing rapidly. It's becoming more difficult for agents to differentiate themselves from competitors with these marketplace dynamics.

Other trends also are at play. The average age of independent agents is in the mid-50s. Many are approaching retirement; others simply want to get out due to persistent challenges. While the number of experienced professionals is aging, fewer young people are attracted to the field. The withering talent pool diminishes options for those who want to groom a successor or sell their business to another individual who they feel will take care of the client base they worked so hard to cultivate. Another complication impacts agencies whose owners are considering selling their business. Other firms are seldom interested in acquiring small accounts for the same reason the

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agency wants to unload them.

At the same time, a great unknown situation looms over the industry. The new presidential administration plans to introduce legislation that could have far-reaching ramifications, adding further obstacles to success or forever changing the provision of health coverage — particularly for individuals and small businesses. Another issue of concern: potential changes to capital gains taxes, which could impact profits expected from the sale of a business. Currently set at 15 percent, President-elect Barack Obama is in favor of increasing the rate.

SEGMENTATION: A SOLUTION FOR TODAY'S CHALLENGES

Many brokers want to make a change, but they don't know where to turn. The immediate priority is to continue producing income. Some have adapted a savvy approach to the future: segmentation. They analyze their business to determine which accounts are most profitable and focus only on accounts that meet certain thresholds. They might segment their business by number of lives or by revenues. Some want to continue selling small group business and have a partner service the accounts; other agents want to limit cases to large accounts; some professionals want to get out of health insurance entirely and focus on property and casualty or financial services. Most agents desiring a change have one important caveat — they want to ensure that any company assuming their caseload will take care of their customers.

Regardless of how they want to proceed, the key to making this work is finding a company that will buy existing small accounts or partner with them to provide service. Because each situation is unique, and agents have a variety of motivations, let's take a look at some real-life examples that provide insights into how these arrangements might work:

CASE STUDY NO. 1

A Northeastern benefits agency wanted to focus on larger, more profitable accounts. When the company began building its business more than a decade ago, agents would sign any size account just to bolster the bottom line. After the firm was established and operating with more than a dozen employees, it became apparent that the attention required to service small customers prohibited growth with more profitable large accounts. The bottom 40 percent of their caseload delivered only 5 percent of revenues. The organization decided to focus on selling to businesses that had more than 15 employees, but didn't want to abandon the clients who had been loyal to them during the agency's formative years. The firm's principal consulted with another agency to create an arrangement that would benefit all constituents. The agency sold its small accounts to the third party, providing these customers access to an unparalleled range of products and services. At the same time, the firm gained the ability to restructure with improved profitability and efficiencies, as well as the flexibility to concentrate on a new scope of business.

CASE STUDY NO. 2

With \$800,000 in annual revenues, a Midwestern agency specialized in property and casualty insurance, yet health benefits comprised about 30 percent of its business. The entrepreneur who built the company believes that cross selling is a tremendous asset — to the agency and to his customers. However, because his clients have a broad geographic reach, operating in 45 states, it was extremely difficult to stay abreast of carrier dynamics. The firm could no longer adequately service health benefits accounts, yet wanted to maintain this insurance offering and even wanted

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to expand this business segment. The owner understood the advantages a third-party's national platform would bring to his business and wanted a cash infusion to pay off agency debt. The companies designed an agreement that provided immediate cash for the sale of existing health benefits accounts under a specified threshold.

CASE STUDY NO. 3

A financial planning agency operating since 1980 found a great formula for business success. Prospects opened their doors to learn more about the agency's insurance products. After they established a dialogue, agency representatives turn the discussion to financial planning — their preferred area of specialization. With more than \$3.5 million in annual sales, the firm was carrying a book of about 65 health benefits accounts valued at \$175,000 that bogged down resources and time. By selling that block of business to another agency, they found an effective solution. Through the third-party's suite of services, the small employers gained access to price advantages, superior service and health insurance coverage typically only available to large companies. The agency continues with its same approach, but now refers the smaller health benefits leads to a third party.

SELLING IS AN OPTION

Others prefer to get out of business altogether. Because of expected changes to capital gains taxes, there might be no better time to sell. Capital gains encompass the difference between the amount paid for a business and the price for which it is sold. The maximum tax rate on long-term capital gains (defined as gains on assets held for more than one year) is set at 15 percent. The provision that lowered it from 20 percent expires on Dec. 31, 2010. Unless this rate is extended — and few think that it will be with Democrats controlling the White House and Congress — it is likely to rise, diminishing profits expected from the sale of a business. At minimum, in 2011 — only two years from now — capital gains taxes will revert to the 2002 rate of 20 percent.

Even if a business wants to sell, it is difficult to find a buyer. In response to the financial and banking crisis, big companies have little access to capital and there is less private equity available to finance other deals. In addition, many of the big brokers that were formerly in a position to purchase agencies are publicly traded companies struggling with diminished stock prices. They are re-evaluating their strategies and not in an acquisition mode.

Many factors impact selling price. Among the top ones: profitability, leadership, historic growth rate, carrier content, talent and the unique niche the seller occupies. This is how it worked for one company:

CASE STUDY NO. 4

The 60-plus-year-old owner of a successful California-based insurance agency, who cared deeply about his clients and staff, considered retirement and began exploring options to sell his business. He discovered the acquisition market was limited for firms such as his that specialize in small accounts. He had heard about another agency's focus on small group health insurance and contacted the company to learn more information. A representative met with him to determine his needs and assess his organization, which generated \$750,000 in annual revenue from a caseload of about 175 accounts. He pursued an agreement that enabled him to retire with a healthy sum of money. In addition, his clients have access to a broader range of products and

will benefit from an enhanced service experience. The owner took care of his employees as well — two of them wanted to continue working and the new agency hired them as members of the account service team, providing added continuity for the agency's customers.

Selling and servicing health insurance accounts has traditionally been the foundation of many agents' businesses. Yet times have changed, particularly related to small group accounts. A variety of economic, market, political and industry changes have coalesced to create the perfect storm. Segmentation — or sale — might be the ideal solution to make sure your business or retirement plans don't falter.

As vice president of acquisitions for Digital Insurance, Brian Jones is responsible for leading the company's strategic expansion into succession planning solutions and acquisition strategies for independent agents and agencies focused on the small group marketplace.