

To Sell or Not to Sell?

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To sell or not to sell -- that is the question many independent agents are asking themselves these days. Consolidation and changing industry dynamics have made it challenging for small agencies and independents to thrive – particularly those specializing in small-group benefits. Even those who are presently doing well have concerns about the long-term viability of their business. At the same time, many agents are nearing retirement age.

In this environment, how can proprietors devise exit strategies to gain maximum value while protecting their customers? This article provides an overview of current trends and exit strategies to guide you through the decision-making process.

Current Affairs

Before focusing on your personal situation, take a look at the big picture. The political climate is changing in ways that may not favor the insurance industry. Health insurance is a big issue in the presidential election. Senator Hillary Clinton is proposing a major overhaul of the system with her “American Health Choices Plan.” And, while the House did not override President Bush’s veto of changes to the State Children’s Health Insurance Program, Clinton and other politicians envision future modifications. Originally conceived as a way to insure children from poor working families who don’t qualify for Medicaid, discussion continues about ways to further expand the program to families with greater incomes. There are fears that this will divert funds from the private sector to government plans.

While these issues are still evolving, states such as Massachusetts already have taken actions that change the status quo. In addition, California has made some changes and more are on the way. While the initiatives vary, small businesses often are impacted by these new mandates. As other states explore similar ventures, more small businesses may have access to “pools” to provide coverage in certain situations.

Even cities are jumping into the business. San Francisco provides access to health care for uninsured residents who meet federal poverty guidelines through an unusual approach that involves service at specified clinics. The program is being expanded to include any uninsured party, regardless of income. As reported on September 19 in The San Francisco Chronicle, “‘Healthy San Francisco’ is estimated to cost about \$200 million a year and will be paid for with a combination of city and state money, participants’ co-payments and quarterly fees figured on a sliding scale, and contributions from employers who don’t provide health insurance for their workers.”

While there are numerous issues that may impact the way we do business, the insurance industry itself is undergoing consolidation. Carriers are joining forces or being acquired, especially those offering life and P&C. There has also been activity among health insurance providers, and hospitals and physicians are uniting to address marketplace challenges. This action sometimes creates fewer options for health care, meaning your clients’ choices are diminishing.

As a result of these trends, insurance brokers are doing exactly the same thing. Six years ago in Dallas, for example, there were about 15 significant players. Today, there are five or six. Small, independently owned agencies are beginning to feel the crunch. With fewer carriers, there are fewer products – particularly those designed for small employers. It is becoming even more difficult to distinguish your offerings from your competitors' or offer the breadth of selections provided by larger companies. Although no one can predict exactly what the future holds, one certainty is clear: as Bob Dylan says, the times they are a-changing.

Let's Get Personal

Aside from politics, legislation and industry issues, there are other trends at play that may impact your decision regarding the best time to sell. These are more personal. The slump in the housing market may mean it's not time to downsize and sell your current home – but it could be the ideal moment to purchase the place you want to retire – or a vacation home. Because it's a buyer's market and developers are offering enormous incentives, some extra personal capital could make your purchase stretch even further. You may be able to get the location, square footage or builder's extras that could turn your next house into a dream home. And an infusion of cash from the sale of your agency might make it affordable to maintain two homes until market conditions become more conducive to sellers.

Agents need to closely consider the following factors when making the decision to sell:

- **Tax Implications**

Currently, tax on the sale of an agency, depending on legal structure, is 15%. With a new administration about to be elected, this could change. For better or worse. Or not at all. But, at present, you are dealing with a known sum.

- **Cash-Flow Needs**

Have you grown accustomed to a certain lifestyle? Have you determined your monthly cash needs? Do you have sources of retirement income other than the sale of your agency? You should consult a financial planner to understand your financial needs.

- **Shrinking Commissions**

Commissions have decreased or remained flat over the past several years, but the service requirements have increased. With new product types entering the insurance space, agents are required to provide more education and ongoing service to their clients. Higher service requirements with smaller commissions are becoming the norm.

Exit Strategies

As sole proprietors consider exit strategies, there are a variety of options before them.

- **Family and Friends**

Many owners consider handing down or selling their agency to family or friends. This decision is often tied to strong and complex emotions. Many times this occurs because the individual takes tremendous pride in the business that he or she built, and there is a desire for the entity to "live on." In addition, the agent may have designed the firm as a family business to provide financial security, income and employment for relatives. They perceive the business as an extension of their ability to take care of those close to them. Finally, most proprietors harbor similar feelings about their customers. They perform an essential function for people they have come to care for over the years. Often their clients are neighbors and friends – people they run into at the grocery store or church. They are not about to turn over their business to a stranger unless they are certain their customers will receive superior service. When mulling over exit-strategy options, owners considering selling to family or friends find themselves grappling with one huge dilemma: How will their replacement achieve long-term success with the forces at play in today's marketplace?

- Regional Firms

Selling to – then becoming employed by -- a regional firm appeals to those who want to eliminate the day-to-day travails of running a business, yet are not ready to stop working. This plan of action offers great benefits... and some challenges. First, you receive money from the sale. Second, you ensure your clients are well-served because you are still there to take care of them. If problems arise in this situation, it is usually because the former owner is used to calling the shots. Now you have to answer to someone else; you are no longer in control. There is another issue if many of your clients are small employers. Most regional agencies are not interested in buying firms that cater to businesses with two to 50 employees; they want accounts with 50 or more lives. In addition, it is almost impossible to find national firms seeking to grow in this sector. As a result, it is difficult for many independent agents to find interested buyers.

- Sell and/or Partner with a Small-Group Specialist

This option provides several advantages. If you select the right company, you gain the same benefits offered by regional firms. You receive an immediate infusion of capital or, if preferred, payment over a period of time, particularly if you arrange to stay on board during a transitional phase. You also protect your customers – something that causes concern to most agency owners in this position. In fact, due to improvements in technology and infrastructure designed to handle small accounts, they will likely experience an enhanced level of service. In the best-case scenario, your customers can gain access to price advantages, an unparalleled range of products and the superior service usually reserved for large employers.

In addition, you may be able to further improve your own income during the transitional period by maximizing renewals. Not quite ready to sell? Consider a partnership. It is possible in some circumstances to create a joint working relationship. The new company can manage a piece of your business, giving you more time to focus on specific accounts or more flexibility to enjoy life. One primary issue remains: There are a limited number of companies seeking to purchase or partner with agencies that serve small employers. Digital Insurance is one of a few in this specialized sector.

The Bottom Line

Most agencies do not know how to properly value their business. Current valuation practices are subject to numerous factors, including market fluctuations. However, the following formulas serve as rough guidelines:

- Large agencies: Operating profit of five to six times earnings before income tax and appreciation (EBITA).
- Small agencies: Roughly one-and-a-half to two-and-a-half times annual commissions. The amount may increase if the seller is willing to stay on after the sale, and a higher multiple may be secured if payment is distributed over time.
- Independent agencies: Typically one-and-a-half to two times annual commissions. If the seller remains and/or payment is extended over time, once again the potential exists to earn more money. Typically, the buyer pays 50 to 70% of the purchase price at closing.

The subject of exit strategies is being raised more often as independent agency owners reach retirement age or grapple with concerns about the long-term viability of their business. Although there are multiple issues to consider, ultimately three basic questions should be addressed:

- 1) How much will I make if I sell my business?
- 2) When is the right time to sell?
- 3) Will the buyer take care of my customers?

Once you find satisfactory answers, you'll know the strategy that is right for you.