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## Broadening the Shareholder Group Key to Modern Internal Perpetuation

To our friends and clients,

In 2010, the typical \$10-\$25 million [Best Practices](#) firm had 8 shareholders. Now, fast forward 11 years. Go through the massive influx of private equity capital and the accompanying consolidation. Consider the ever-rising brokerage valuations. Add in the robust free-agent market and the unprecedented opportunities for producers to monetize their books of business. What you'll find, when you look at it today, is that the typical \$10-\$25 million Best Practices firm has ... 8 shareholders.

Thanks to the evolution of capital availability and the upswing in valuations over the last decade, internal perpetuation is harder. Although the basic tenets of remaining independent are the same, today's environment requires tweaks to the model. One of those tweaks is increasing the number of shareholders. Firms need to think differently about their shareholder group for three primary reasons.

The first is basic buyer affordability. We've written extensively about buyer affordability being critical to internal perpetuation, as buyers almost always have to come out-of-pocket some amount to fund their share purchases. However, the run-up in valuations has hit buyer affordability hard. The average valuation multiple for firms that Reagan values each year has increased almost 40% since 2010. But according to the [Best Practices Study](#), total

being asked to fund much larger portions of their purchase on an out-of-pocket basis from current income, savings, or other investments. Expanding the shareholder base is an obvious solution to address this issue. More buyers means lower out-of-pocket costs on a per shareholder basis, which can drive affordability and demand.

The second point to consider in broadening the shareholder group is the retention element. Retaining key producers – and future shareholders – is mission critical on the path to remaining privately held. But in today's capital-rich, free-agent environment, retention has only become more challenging. Many well-capitalized brokers are employing producer “lift-out” strategies designed to fuel growth. A producer lift-out is a tactic whereby an agency recruits another firm's producer or an entire production team by offering significant up-front economic incentives. Many privately-held brokers have lost up-and-coming producers (and future shareholders) to these lift-out tactics and the up-front cash and equity payments they provide. Broadening a firm's shareholder base can help curb the lift-out threat, as shareholders are less likely to depart given the economic rewards of share ownership and the stronger restrictive covenants that typically accompany stock ownership.

Finally, broadening the shareholder group gives firms a chance to go on the offensive in the battle for talent. A limited shareholder group can make shareholder status appear less attainable to a producer recruit. Broadening the shareholder group, though, generally leads to a more accessible and quicker path to share ownership, which can be a key selling point in recruiting producers. Firms need a continual supply of new talent to remain independent – and broadening the ownership group is a key piece of that strategy.

Note that there is a balance here. Share ownership is a powerful tool and we don't recommend that agencies are cavalier with ownership opportunities. We also understand the oft-used argument against broadening ownership that it is dilutive to current ownership interests. But this argument may be short-sighted in today's environment if the goal is to remain privately held for the long run. We find that many of our largest and most successful privately-held clients have employed this strategy of broadening their ownership groups beyond the traditional industry standard – and it has worked. The shareholders wind up owning a smaller percentage of a much bigger pie, and they protect their perpetuation goals in the process.

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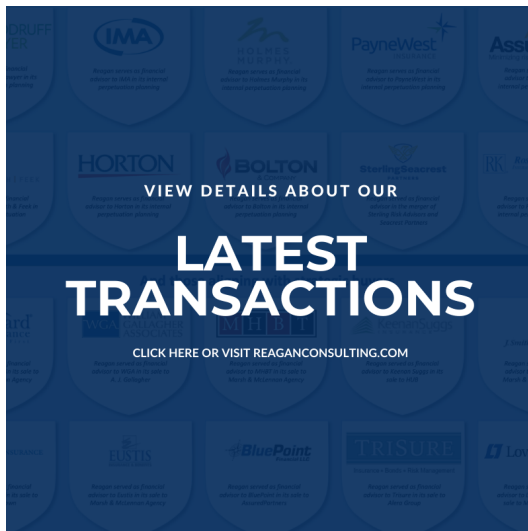
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