ReaganView

Does Your Agency Have an Addiction Issue?

To our friends and clients,

Addiction is defined as a psychological and physical inability to stop consuming a chemical, drug, activity, or substance, even though it is causing psychological and physical harm. We have spoken to countless firms regarding their growth and perpetuation plans and many of them have an addiction – an addiction to profit distributions. And while this analogy is certainly dramatic, the addiction to these distributions by agency owners can have adverse consequences to an agency's perpetuation and growth plans.

We are fortunate to work in an industry that generates significant cash flow yet does not require a significant amount of cash flow to operate the business on a day-to-day basis. We routinely see firms distributing over 75% of their EBITDA annually to their owners. That is where the addiction starts.

We believe agency owners should be paid out of three buckets: 1) commissions based on the book of business they manage as any producer would be paid, 2) a salary for the management duties they perform (the cost to the agency if it had to hire someone to perform those same duties) and 3) a distribution of their pro-rata percentage of profits of the business after the agency has retained enough of the profits to invest in the growth of the business and facilitate its perpetuation. It is bucket #3 where the addiction lies.

Historically, many firms were able to distribute the 85%-90% of EBITDA. The owners were young, the business was growing, and limited investments were needed. However, times have changed. Now owners are faced with increasing investments in new producers, building or acquiring tools and resources, funding perpetuation, investing in technology/big data and being opportunistic on the M&A front. The dollars to fund these initiatives come from only one place – bucket #3 – profits that would otherwise be distributed to the owners. For some owners, this is simply a non-starter. They are addicted to distributions. In their minds, the distributions have become part of their compensation and they have built their lifestyles around their total income.

an agency will need to find a third-party partner that is willing to invest in the business and solve the perpetuation issues. A partnership is not a bad thing. It is just the reality of the distribution addiction. Does your agency have an addiction issue?

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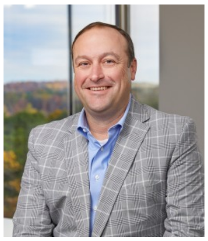

ReaganView is Reagan Consulting's forum for providing an occasional perspective on issues and opportunities relevant to the insurance distribution system

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