An Excellent Strategy: Hire Incompetent Producers

by Chris Burand

The strategy of hiring incompetent producers was recommended to me by a <u>group</u> of agency owners who thought my advice that no producer is better than a bad producer was:

1. Just wrong
2. Too harsh
3. Short-sighted

I have seen some consultants make the same case so I thought I should have an open mind and reconsider my position.

Their point was that every commission dollar sold is worth (pick a multiple) 1.3 or 1.5 or 2.0 times. That makes every commission dollar a commodity. A commodity is defined as something of value but it is interchangeable. For example, one barrel of West Texas crude is priced the same as all other barrels of West Texas crude of the same grade. Therefore, from these agency owners' perspectives, one way to build value is to put as many commission dollars on the books as possible because the value is same regardless of whether the sales are personal lines or commercial. The value is the same regardless of whether the sales are profitable or unprofitable. The value is not affected by whether the accounts carry more or less E&O risk. <u>ALL</u> sales carry the same value in this perspective.

Some people will argue I have taken their point too far, but that is impossible. Remember, their point was that poor producers, meaning unprofitable producers, still have enough value to justify keeping them. This means that even if the producers' sales have a -20% profit margin, which is common, they believe these sales have the same effective value as books of business with a 20% profit margin.

An interesting facet of their point is that their strategy is quite relevant if the agency can grow fast enough and sell themselves quickly enough. More than one such flip has made an agency owner wealthy. The key is how long the producer is with the agency before the sale. Let's say that at the end of five years a producer has generated $150,000 commission. The profit on this book is (using industry standards for agencies with $1 - $2 million in revenue):

Book of Business	$150,000
Annual Expenses	
Producer Commissions @ 40%	$60,000
CSR	$35,000
Benefits (incl taxes @ 18.5% of wages)	$17,575
Total Compensation	$112,575
Selling Expense @3.82% of commissions	$5,730
Administrative Expense @ 20.02% of commissions	$30,030
Total Expenses	$148,335

This excludes all administrative wages such as the bookkeeper, receptionist, claims, and so forth. It excludes ANY owner compensation. It understates the CSR compensation too because the average commercial CSR makes much more than $35,000. If we include these real additional expenses proportionately, this book likely is still losing money in the fifth year, anywhere from $10,000 to $30,000. Losses in the prior years were even greater as the book was built.

Over five years then, the agency has likely lost between $75,000 and $150,000 net dollars. Using $75,000 and a one times multiple and an agency sale in year five, the agency still nets $75,000 (($150,000 times 1.0 times) - $75,000) = $75,000.

But if the agency hangs on too long or the five-year loss is too great, this strategy fizzles. So to make this work financially, the agency owner has to have a firm and fast exit plan.

Going back to the original strategy, is the strategy posed by this group of agents a false strategy? Why not hire quality producers initially? Then the agency gets profit and value simultaneously. Besides, who in their right mind would pay the same multiple for an unprofitable book versus a profitable book? Let's use an EBITDA example. If the profit is $25,000 and the EBITDA multiple is six, then the value is $150,000. What is the value of a book with a profit of $-25,000 and six times?

Why would someone pay the same multiple for a low profit book as a high profit book? For example, pay five for the former and seven for the latter. Maybe the thought is the books all average out. Why do they have to average out? If one focuses on quality producers that generate profit and value, then why should all the books not be valued at a seven times EBITDA, for example?

A poor producer cannot take an entire book, even most of a book with them if fired. If they were so good, they would not be fired. So agency owners can alleviate the issue of whether unprofitable producers are necessary by eliminating them and then reassigning their books to staff or other producers at lower commission rates, which is common when books are transitioned between producers. This is a key secret to the success some serial acquirers have achieved. They completely understand that poor producers are completely unnecessary so when they buy, they fire and they keep the business but make it profitable. Even if 20% is lost, that is 20% losing money versus 80% making money.

I truly feel for agency owners struggling to find quality producers. If it was easy, everyone would do it. Is hiring poor producers really the solution though? My experience, and I've seen the hard data, is that when agency owners properly prepare their agencies for finding quality producers, use the right interviewing tools and tests, and create a quality development/management plan, successful hire percentages quadruple. All the work, and it is a lot of work, is upfront before the hire and given all that agency owners already have to do, finding the time and energy for this key element is not so easy, but it is essential if the goal is to truly build profit and value.

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