Use Benchmarks with Care!

By Chris Burand

Benchmarking (measuring one's agency against an industry average or best practices' average) is extremely popular among consultants, journalists, and investment analysts. Lately, I am even seeing small agencies doing their own benchmarking. Taking so much interest in one's own agency is wonderful, a sign of a professional. Unfortunately, such effort is often misdirected because benchmarking is a largely ineffective management tool.

I understand this is a contrarian view, but read on. First, benchmarking uses an average set of characteristics to arrive at an average result. If the results for twenty agencies with $1.5 million in revenue with fifteen employees including two producers, writing 70% commercial lines, 30% personal lines, growing 8% annually, and having eighteen company contracts were averaged, the benchmark would, for example, be $97,000 revenue per person and 10% profit. An agency with those same characteristics is likely to have similar results.

If an agency's characteristics are different (for example, four producers instead of two), the equation and the result are both likely to change. If you benchmark your agency against an industry average and your characteristics are materially different, then to manage by those benchmarks does not make much sense. To paraphrase Chris Zook regarding a similar subject, he wrote, "Assumptions about [benchmarking] are often so powerful that they compel management teams to forgo the usual analysis and concept testing. This has proved to be a dangerous route." (Chris Zook, *Beyond the Core*, p. 103)

Benchmarks are too frequently copied without giving any consideration to what works and why it works. I see many agencies that subscribe to various benchmarking services assume they need to achieve specific benchmarks without any analysis of how their situation is unique. Companies have different business models, strategies, and environments which make their strategies for success different.

Therefore, a better application of benchmarks is to use them as a general target. For example, if your revenue per person is $50,000 versus an industry average of $105,000, something is probably very wrong. But if you are at $90,000, nothing is necessarily wrong and to push your agency to $105,000 may do more damage than good.

Second, why manage to an industry *average*? Why not aspire higher? Benchmark where your agency is today and where it needs to go. Then repeat the process each year. Even an agency that benchmarks against a Best Practices type of benchmark misses an opportunity because so often an agency climbs above the benchmark and then what? The agency often gets lost and loses focus. Make a goal to grow better a little every day, race your own race.

Third, those who use benchmarks often assume a cause and effect relationship when in fact, no correlation exists. For example, higher retention logically should result in higher profit. But I have never seen any proof that it does in independent insurance agencies. Maybe the costs of increasing retention outweighs the increased revenue. It is quite possible, and business literature is littered with examples of companies losing millions of dollars trying to improve retention just a little. A cost/reward ratio exists for everything and sometimes it is more profitable not to achieve higher benchmarks.

Revenue per person is a great example. Many people generally assume that the higher the revenue per person, the higher the profitability. The facts show a different result, however. Using the public data available for the following publicly traded brokers, a regression analysis of the data showed the relationship between revenue per person and profit was approximately zero in all cases. This means the results are random! There is NO correlation between revenue per person and profit for the publicly traded brokers. Why manage to higher revenues per person when profitability could increase, stay the same, or even decrease as a result?

		Growth Rate	**Profitability Ratios**		**Efficiency**
		Sales (TTM) vs TTM 1 year ago	Pre-Tax Margin (TTM)	Net Profit Margin (TTM)	Revenue/ Employee (TTM)
Aon Corp	OAC	-0.95	9.81	6.53	$211,094
Brown & Brown	BRO	21.47	31.07	19.16	$198,436
Hub International	HBG	24.64	12.81	5.82	$139,608
USI Holdings	USIH	26.06	6.05	3.55	$211,785
Willis Group	WSH	-0.35	19.81	13.10	$147,208
Arthur J. Gallagher	AJG	3.26	-0.19	1.93	$182,409
Hilb Rogal & Hobbs	HRH	8.76	13.79	8.34	$187,190
Marsh & McLennan	MMC	-0.93	4.90	3.25	$211,855
Industry		3.49	9.61	6.27	$213,240

Source: Reuters, March 24, 2006

Fourth, managing to a benchmark may conflict with the agency's goals. If the benchmark agency averages 10% profit and 8% growth, but your agency is growing 15% annually, it is less likely a 10% profit margin is feasible because extra growth requires extra expenses. Benchmarks should not be taken out of context, but they often are.

A great example with horrible consequences are agencies that measure CSR performance by commission per CSR. No agency should ever use this benchmark without proper context of average account size, the number of accounts serviced, and the number of activities involved. CSRs burdened with a lot of small accounts and accounts with considerable activity very often simply cannot achieve industry averages. This is especially true if the agency does not have good procedures, if the producers have poor hit ratios, and/or the agency's automation is lacking.

Benchmarking used in context and with a thorough understanding of correlations is a great tool for better management. Used wisely, an agency can greatly improve itself. But it is not easy and not nearly as easy as it seems. Use benchmarks carefully!

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