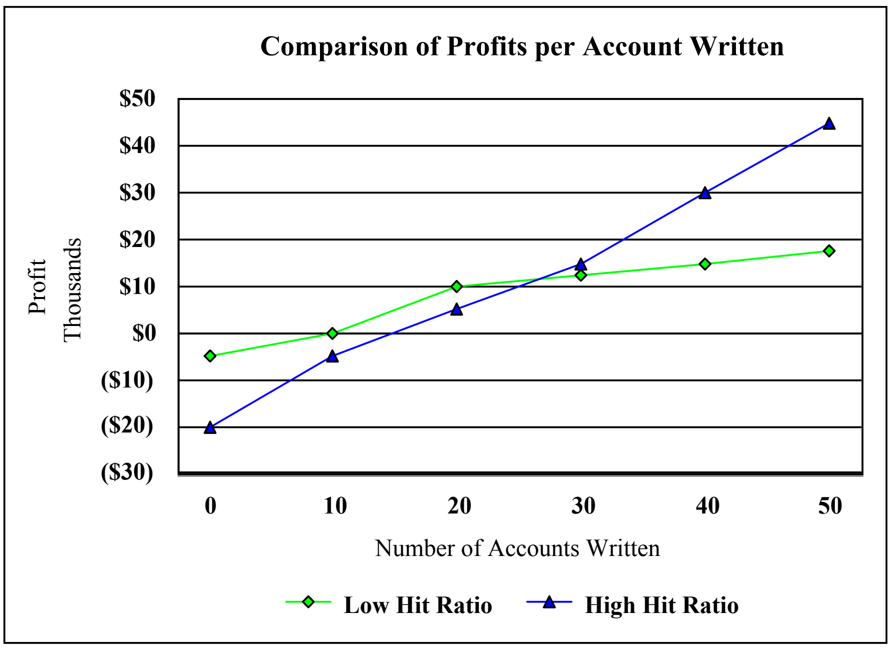
Tradeoffs
By Chris Burand

Cheetahs claim the title of the fastest land animal, but the tradeoff is they can only run fast for a short distance. In a long distance race, many other animals, such as gazelles and horses, can easily out-run them. Similar tradeoffs exist in our every day lives and in our insurance agencies. Two areas where tradeoffs occur in agencies involve hit ratios and cross-selling.

Hit Ratios

There are, at opposite extremes, two ways to sell. A person can use a mass marketing strategy with very low hit ratios or they can use a very highly qualified strategy with a high hit ratio. The low hit ratio strategy costs less up-front, but the potential payoff down the road is less. The high hit ratio strategy costs more up-front but the potential profits are also greater. With these two strategies, there is a tradeoff between the initial cost and the ultimate return. This tradeoff might look like the following graph (*for example only and not representative of an actual study*).



Which strategy is best? Well...it depends. There is not really a universal "best" strategy because the best strategy for an agency depends on the agency's strengths and abilities. If an agency does not have much working capital, it will need to invest less and get a quicker return, even if the ultimate return is significantly less. An agency must also consider its abilities. If it does not have the ability to work high hit ratio business, then that strategy does not make sense.

Cross-Selling

Many people advocate the incredibly high profitability of cross-selling, but is a cross-selling strategy better than a new account strategy if one is trying to grow? Again, it really depends on the agency's abilities and strengths. To determine which strategy makes the most sense, an agency should create a pro forma statement (which is a projection of what may result in the future based upon assumed actions in the present). Consider the following example:

	Cross-sells	**New Accounts**
Quotes	100	50
Accounts Written	25	13
Average Commission per Account	$1,000	$2,450
Total Commissions Written	$25,000	$31,850
Quote Costs		
Lead Generation	$100	$1,000
Advertising	$1,000	$2,500
T&E	$1,000	$5,000
Average Staff Time per Quote	3 hours	5 hours
Staff Cost at $20/hour	$6,000	$5,000
Benefits at $10 per hour	$3,000	$2,500
Total Quote Costs	**$11,100**	**$16,000**
Cost to Write Accounts		
Producer Compensation at 35%	$8,750	$11,148
Average Staff Time per Account Written	2 hours	2 hours
Staff Cost at $20 per hour	$1,000	$520
Benefits ($10 per hour)	$500	$260
Total Cost to Write Accounts	**$10,250**	**$11,928**
Total Cost of Accounts Written	**$21,350**	**$27,928**
Net Profit	**$3,650**	**$3,922**

An important key to developing a pro forma statement is to be as accurate and realistic as possible. For example, notice that I included a lead generation cost for cross-selling. No matter how an agency cross-sells, there is a cost involved in the process. The more successful cross-sell programs spend more time/money refining the list of potential cross-sell clients and do not try to cross-sell everyone. A quote is a quote so the cost is the same and the producers are going to be paid the same (and in many agencies, the producer's cost is higher on cross-sales because commissions are split between two producers for a total amount higher than if only one producer was involved, which doesn't make sense to a lot of people, but it happens quite often). Additionally, notice the average commission is less on the cross-sale accounts. I have observed that most policies an agency cross-sells do not generate as much revenue as the accounts they already have written. This is only one reason so many producers resist cross-selling. They do not want to mess up their account for a marginal amount of new commission.

An agency must also include staff time and benefits. Do not make the mistake of assuming this is an existing cost and therefore, there is no additional staff cost involved. If there truly is no additional staff cost involved, the implication is that you have staff sitting around with a whole lot of free time on their hands. In that case, an agency might make more money laying off staff. (A worksheet similar to the one above might be handy to test that tradeoff too.)

In the example above, the cost of cross-selling accounts is less but the profits are fairly equal. Depending on an agency's strengths and tradeoffs, the cross-sell profitability might be a lot higher or a lot lower than writing new business. But each agency must determine the answer based on their own numbers. *Don't make an assumption that cross-selling is all profits.*

Too often we make the assumption that high quality leads are the best answer, or that a large number of leads is the best answer. We assume that cross sales are more profitable than new account sales. But we rarely test the tradeoffs involved. Cheetahs are indeed the fastest land animal for a certain distance on flat grasslands but in a mountain forest, they would not be so fast. Cross-sales are often the most profitable sales when additional policies of adequate size are sold to someone that wants fewer insurance agents involved in their business and where a producer is willing to take the extra risk involved. What kind of sale makes the most sense for your agency?

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