Agency Financial Management
by Chris Burand

Agency financial management can make or break an agency. With a little preparations and a proactive approach, good financial management can substantially add to an agency's profits. Financial management is a very broad topic, so for the purposes of this article I will focus on three critical aspects: managing accounts receivable, knowing and managing how much the agency spends to make a sale, and obtaining sufficient capital to grow.

Accounts Receivable

Frequently, agencies find themselves with many overdue accounts, consistently late paying accounts, and/or bad debts. Each of these accounts receivable problems costs the agency money.

First, let's look at overdue accounts. Imagine your agency has $10,000 consistently overdue and the going interest rate is 10%. In this scenario, you are giving your clients an interest free loan that costs you $1,000 annually in lost interest (using simple interest). Meanwhile, at the industry's average profit margin of 7%, the agency only makes $700 on the $10,000. Therefore, by giving these interest free loans, the agency *loses 3% on those accounts*. Look at your overdue accounts and before you continue to let them slide, ask yourself if you are in business to sell insurance or to be a bank giving interest free loans!

The next trouble area is consistent late payers. On $500 in commissions, an agency makes a $35 profit at the industry average of 7%. If an account pays late two or three times per year, the agency will probably spend extra postage, office supplies, labor expense, overhead, telephone costs, possibly even travel costs, and definitely frustration on the account. These extra costs commonly total $5 to $50. Suppose the agency spends something in the middle, say $20. On the $500 in commissions then, the agency will make a whopping $15 and could possibly even lose money. And what if the commission is only $200 and the potential profit is only $14? Why work so hard to lose money? Let your competitor lose money on that client!

Finally, bad debts obviously can be a killer and need little explanation. However, do not underestimate how damaging they are to your bottom line. To make $10,000 in profit at a 7% profit margin, the agency has to generate $142,857 in revenue. Therefore, to make up $10,000 in bad debt, the agency has to generate an additional $142,857 in revenue!

Actively manage your accounts receivable. Stay on top of your overdue accounts, do not pay producers until they collect the premiums, keep track of your consistent late payers, and get rid of the accounts that cost you more than you make. Poor management of accounts receivable can destroy an agency. Good financial management can boost your profits and give you a healthier bottom line.

Cost of a Sale

How much time do your producers and CSRs spend to sell an account? What do lost sales cost your agency? How much management time, marketing expense, overhead costs, and labor expense goes into every sale? Very few agencies can answer these questions, but knowing the actual cost of a sale is critical because based on APRS data, the average agency spends $1.03 to $1.11 for every commission dollar generated! In fact, the results of our Cost of Sales Analysis often show agencies spending as much as $1.90 for every commission dollar they generate!

To help get your costs in line, the first step is to take a detailed look at all the costs of making a sale, including lost sales. An in-depth look at your costs will reveal if too much is being spent and if so, it will pinpoint where to trim the excess and uncover opportunities for improvement in many areas such as productivity, hit ratios, retention, and account targeting.

Capital to Grow

Agencies need to grow and growth requires capital. With good financial management, an agency can obtain capital from the best source and at reasonable rates.

First, what sources of capital are available? Most capital is supplied by agency owners, either out of their own pockets and/or from the agency's retained earnings. This form of capital is the most expensive because the dollars are after-tax dollars and none of it is tax deductible. The cheapest form of capital is usually debt because the interest payments are tax deductible and a lender has less risk than a stock holder. Therefore, when possible and reasonable, debt is the preferred method for financing agency growth.

The next question then is: where to get a loan? Many banks and thrifts will not lend to an agency because they believe agencies lack sufficient tangible value in case of default. This is ironic because many banks believe agencies are good acquisitions while other banks will not even lend to them! If you do go to a bank, be prepared to prove your agency's tangible value by having an appraisal from a qualified insurance agency consultant. Also present the bank with a strong business plan that shows you are committed to growing your agency.

Another alternative is insurance companies and they will often offer much better deals than any other source. In return, most companies want more business and they will not loan to just any agency. The agency needs to have a large book of business with them and/or the company has to believe the agency will build a large book with them soon. To convince a company the agency is a worthwhile investment, present a strong business plan to the company and ask them how they will work with you to achieve the goals outlined in the plan. If a company believes the agency has potential, I have seen them give agencies loans below market interest rates and even forgive the principal if things work out well. The first step though, before a company will consider lending money, is the agency has to ask!

The final consideration is to get a good interest rate. The difference between a 5% and a 10% interest rate on $100,000 over three years is almost $2,800 per year, which at a 7% profit margin is worth $40,000 in revenues. Therefore, before approaching any lender, take the necessary steps to present your agency as a low risk, good investment.   Also, shop for the best rate and always ask for a lower rate. Be aware of loan initiation fess, mandatory offsetting accounts, and other buried costs.

Help yourself to a more secure and brighter future. Actively practice good financial management for your agency and watch your bottom line grow!

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NOTE: None of the materials in this article should be construed as offering legal advice, and the specific advice of legal counsel is recommended before acting on any matter discussed in this article. Regulated individuals/entities should also ensure that they comply with all applicable laws, rules, and regulations.

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