Are Your Producers Subsidized?
by Chris Burand

The average agency spends between $1.02 and $1.04 for every commission dollar earned (*Growth and Performance Standards*, APIS, 2000). The cost of producer generated new business is even higher. Our studies of the cost of writing business have found most agencies spend between $1.20 and $2.25 for every producer generated new business commission dollar! A lot of money is lost for every dollar earned! If an agency is spending $1.20, much less $2.25, on new sales and only $1.03 overall, the agency must be making money somewhere. Where does the money come from to subsidize producer sales?

Renewals: One source is renewals. Many contend that all businesses in all industries lose money on new sales. The loss gets erased with repeat sales, so why worry? Most insurance renewals are definitely less expensive than new business. Many agents believe renewals are more profitable because producers are usually paid less. While they are usually paid less, compensation alone is not that significant. Hit ratio is the critical factor. The hit ratio on renewals is usually in the high eighties versus 25%, at best, on new business. While hit ratio is the key to making renewals more profitable, poor hit ratios are what makes new sales so unprofitable. If a producer had an 85% hit ratio on new business, new sales would be almost as profitable as renewals in most agencies!

Even with greater profits though, a producer's repeat sales (renewals) are not usually profitable enough to turn an agency's loss into a profit. In fact, our studies have found some agencies spend as much as $1.70 for every renewal commission dollar earned!

House Business: Because renewal profits cannot carry producer new sales alone, another key source of subsidies is house business. House business is usually the most profitable business because no one gets a commission on it. It helps subsidize the entire agency and especially producers with small books.

Owner Subsidies: In many agencies, renewals and house business combined are still not profitable enough to cover losses on producer generated business (which is why the average agency spends between $1.02 and $1.04 for every commission dollar earned). Many owners must also subsidize their producers. Owners are often world-class salespeople with books of $350,000-$550,000 in commissions, but they do not pay themselves equal to what a non-owner producer with the same book would receive. As a result, they subsidize their unprofitable producers.

How big are all these subsidies? Here is an example. The scenario below is quite common:

Producer's book	$170,000 commission
Producer's cut	$68,000 (40% of the agency's commission)
CSR	$30,000 (the average agency has one CSR for every producer)
Benefits	$9,800 (10% of producer's and CSR's compensation, including employment taxes)

Sales Costs	$27,200 (16% of commissions, the national average for medium sized agencies*)
Operating Expenses	$61,200 (36% of commissions, the national average for medium sized agencies*)
TOTAL	$196,200
Profit/Loss	-$26,200

**Growth and Performance Standards*, APIS, 2000

Get $170,000, but spend $196,200! This does not even include management or owner compensation, staff other than the CSR, benefits for anyone other than the producer and CSR, profit sharing, or profit. The agency has to pitch in, or subsidize, $26,200, at the bare minimum, or 15% of this producer's book just to break even! The agency has to spend $26,200 to cover the producer's book, new business and renewals!

Independent agencies are pushing hard for more and more commercial sales and yet these sales are often the least profitable business in the agency. An agency can only write so many unprofitable accounts before the subsidies run out. To arrest this problem, agencies must know how much they spend to make a sale. Agencies must identify the hidden costs and recognize the subsidies provided by renewals, house accounts, and generous owners. They must pay producers for making profitable sales rather than any sale. Last, agencies must value their staff's time and the agency's resources adequately. By undervaluing their staff's time, many agency owners hire additional CSRs when none are required. For example, many agencies can do with one less CSR if they simply stop quoting over the phone and quoting every piece of junk a producer can scrounge up.

Limit subsidies and make each producer and department pay their own way. Your agency's profits will skyrocket by doing so!

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