Highest Price is Not Always the Best Offer
By Chris Burand

A Dilbert cartoon shows the boss telling Dilbert "I heard that you won't give marketing the information they need."
Dilbert replies, "I respectfully decline the invitation to join your hallucination."

I found this cartoon very funny because as a past employee of several Fortune 500 companies, I can attest that some requests for information grow out of someone's hallucinations. No other explanation exists for it!

I also find this cartoon very applicable to some insurance agency buyers. These people must be delusional when they buy agencies to think they can pay so much and ever hope to breakeven. They must hallucinating and/or their logic is seriously flawed and/or they are way too optimistic.

Many sellers may think, "The higher the price, the better. Right?" If the deal is cash and walk away, this is true. If the deal is based on renewals or stock though, it is critical to the seller whether or not the buyer's logic is solid. If the buyer does not meet their dreamily wrong projections, the seller will never see all, or maybe any, of the money they were expecting. This is exactly what happened to many, many funeral home owners who sold their companies to big consolidators. Two big consolidators' stock prices have dropped drastically and many owners who sold their companies for stock have lost big money. In our industry, I believe this possibility is especially strong with banks. Based on what I read, many banks' financials are not as solid as many people, including some bankers, believe. Also, based on what some banks are paying for agencies, one has to wonder if they are hallucinating.

Another reason to warily accept a high price is that many buyers believe they can afford a high price only because they run their own agency so poorly. For example, a buyer may offer to pay 40% more than any other buyer because they know they can cut 40% of the staff, 100% of the rent and utilities, and achieve many other economies of scale. They can cut staff because they themselves are overstaffed. They can cut rent because they have excess space from perhaps other growth plans that have failed. So if they cannot manage their own agency well, what makes you think they can manage your agency well? If part of the price depends on their managing your agency and/or their own agency well, do you really think you will get all your money? This problem is amplified if stock exchanges are involved.

Buyers often mistakenly think they can afford to pay extra because they will eliminate so much overhead. Very often though they are not calculating their costs correctly. For example, a buyer decided he could afford the seller's high price because he had extra staff and therefore could layoff some of the seller's staff resulting in higher margins. In other words, he had staff sitting around just twiddling their thumbs, so the buyer's projections did not apply any staff wages toward the cost of the acquisition. However, the cost of his staff should have been considered part of the acquisition rather than treating their wages as free. Slavery was outlawed 135 years ago and cash flow projections should show the real cost of staff.

In this situation though, if a CSR was paid salary plus benefits regardless of whether he or she had enough work to stay busy, no *marginal* cost would be assigned to the acquisition and indeed, the buyer could pay a premium because the profit margins would indeed be higher. A more important question should be answered first though. If the buyer runs an agency where CSRs do not have enough work, is an acquisition the answer to better profits or is better management the smarter first step?

To sellers looking for high prices, consider the likelihood of actually getting all your money. Lower offers may actually pay better. This is because you are possibly more likely to actually get your money. To buyers offering high prices, think hard about the economies of scale you are projecting and whether those economies will really be achieved. Also consider whether better management is a better answer to improving productivity and profits. Usually, it is. Study after study has shown that most acquisitions and mergers fail to attain the economies of scale projected. Few acquisitions warrant the prices many buyers are paying. A difference exists between growing and growing profitably. Which do you prefer? Buyers and sellers should both respectfully decline invitations to join anyone's hallucinations!

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