

Producer Compensation

By Chris Burand

Past articles in our industry publications incited many calls from anxious agency owners. The articles were, unfortunately, very misleading. Each inaccurately concluded that big agencies paid producers better than small agencies. One article even concluded that big agencies could afford to pay more, so they did.

The articles were based on a study which found that producers in big agencies (agencies with more than \$10 million in revenue) were paid an average of \$116,487 while producers in smaller agencies (less than \$2 million in revenue) averaged only \$47,170. WOW! These averages would be news—IF they had significance. But in our industry they do not. They are *worthless statistics* that can lead readers to several wrong conclusions such as:

1. Big agencies pay more for the same work.
2. Producers should not work for small agencies because small agencies do not pay enough.
3. Larger agencies can afford to pay more.
4. Smaller agencies need to pay producers more to keep up with the larger agencies.

These conclusions are not accurate because they are based on the wrong measurement. For example, consider the first error: Big agencies pay more for the same work. The study actually points out that *large agencies pay between 4 and 12 percentage points less commission.*¹ If producers in small agencies average a 35% commission rate, 4 to 12 percentage points less equals *11.4% to 34.3% less wages for the same work!* How can anyone claim large agencies pay more when producers in large agencies are paid a lower commission? The answer? By focusing on dollars when percentages are the more important measure.

Percentages are the more important measure because most producers are paid commission. By comparing dollars earned instead, a reader could easily infer that producers at big agencies are paid more for the same results but the real reason they make more is because producers in big agencies sell more! Based on the results shown in the study, producers in big agencies average at least 147% more in commissions than producers in small agencies. When a percentage is applied to a larger number (like bigger books), the result is more money (compensation). The reality is producers in large agencies, while they *make* more, are actually *paid* less.

Consider this scenario: two producers are both paid 30%. Producer one's book is \$500,000 and producer two's book is \$250,000. Producer one makes \$150,000 and producer two makes \$75,000. Is producer one paid more? NO! They are both paid 30%. Producer one makes more because he sells more but he is not paid more. The difference between the words "pay" and "make" may seem trivial, but these two words have very different meanings that when

¹The articles actually state 4-12 percent (not percentage points) less commission. However, based on average book sizes and average dollars earned, I believe commission rates in large agencies are most likely 4-12 *percentage points* less.

misapplied can lead to wrong conclusions and very bad decisions.

A producer's compensation is not like that of a staff person's. If one CSR gets paid a salary of \$50,000 and another gets paid a salary of \$25,000, one CSR is paid twice as much as the other. "Paid" and "make" are synonymous when discussing staff compensation. They are not synonymous when discussing commissioned sales people.

From an agency manager's perspective, which would you prefer: a producer with a big book paid at a lower commission rate or a producer with a small book paid at a higher commission rate? Consider the following scenarios:

Producer's Book	\$1,000,000	\$500,000
Producer Compensation Percent	20%	30%
Producer Compensation Amount	\$200,000	\$150,000
Money Left to Pay Other Bills	\$800,000	\$350,000

If I were an agency manager, I would much rather have the producer that *makes* more because the revenues and profits are so much greater.

What do big agencies do to enable their producers to sell more? The simplest and often overlooked difference is they are big. Big accounts like doing business with big agencies. Other important factors include more carriers, more alternative markets, more support staff (especially in marketing), and better management. This is like a great running back—no matter how good he is, he will gain more yards behind a good line than a mediocre line.

While big agencies pay producers less (even though their producers make more), their profit margins are not significantly larger. All the extra support, better management, and even extra carriers cost money. The difference though is that 9% of \$1,000,000 is a lot less than 9% of \$1,000,000,000.

The purpose here is not to tout the benefits of large agencies over small agencies. Such a statement would greatly over-simplify the situation. Numerous factors other than size contribute to a successful agency. Nor is the purpose to suggest that all great producers work in large agencies. That again would be a grand over-generalization. The purpose, however, is to stress the importance of taking a logical look at producer compensation.

Producer compensation is key to small agencies' success and survival, so when a headline screams that big agencies pay producers more, many small agency owners will conclude they need to pay their producers more so their producers do not leave for the big shops. Rushing to pay their producers even more only compounds their problem because most small agencies already over-pay too many lousy producers.

For example, if an agency pays 35% for \$100,000 commissions, the following chart shows how the agency is paying way too much:

*GPS, APIS, 2002 national average of agencies with \$1 million to \$2 million revenue

Book	\$100,000
Producer Compensation	\$35,000
CSR (agencies average one CSR per producer)	\$35,000
Benefits (*15% of wages)	\$10,500
Sales Expense (*5% of commissions)	\$5,000
Administrative Expense (*24.5% of commissions)	\$24,500
Total Expense	\$110,000

Very few agencies even need an experienced producer selling less than \$200,000 in commissions. In most cases, the agency would be better off without the producer.

Big agencies do not pay more for the same work as small agencies. Whether you are a producer or an agency owner or manager, look carefully at the all the facts and consider the correct measures before making any decisions regarding producer compensation.

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