Best Practices for Growing an Insurance Agency

Michael Mensch, CBI, M&AMI
Merger & Acquisition Master Intermediary
Agenda

1. Introduction
2. Managing Finances
3. Keep & Grow What You Have
4. Find New Ones
5. Buy Someone Else’s
6. Final Thoughts

Your moderator
Michael Mensch
Introduction

• An industry report recently listed the following as attributes needed to succeed as an insurance agency:
  1. Carrier access
  2. Networking and marketing skills
  3. Product knowledge
  4. Technological capabilities
  5. Versatility
  6. Regulatory compliance
Introduction

• In simpler terms though, agency success is contingent upon:
  1. Effectively managing finances;
  2. Keeping the business you have;
  3. Obtaining new business; and
  4. If you really want to grow, acquiring someone else’s agency.

• Those four topics are the focus herein.
Managing Finances

• Most agencies fail to grow due to a lack of capital or financial mismanagement.

• Need to continually reinvest in growth (i.e. don’t strip out the profit).

• Considerations
  1. Your business’s financial model
  2. Proper accounting
  3. Budgeting and cash management
  4. Monitoring productivity
Managing Finances

• What is a financial model?
  – The allocation of money to cover specific expenditures.

• What is a financial benchmark?
  – A comparison of your operating performance against industry averages.

• Why should you know these things?
  – Maximize profitability and value.
  – Maximize productivity.
  – Budgeting for the future.
Managing Finances

Agency Expenses as a Percentage of Revenue

<table>
<thead>
<tr>
<th></th>
<th>Sales Driven</th>
<th>Marketing Driven</th>
<th>Blended</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SALES EXPENSES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commissions</td>
<td>20-25%</td>
<td>0%</td>
<td>10-15%</td>
</tr>
<tr>
<td>Meals, travel and entertainment</td>
<td>1-2%</td>
<td>0%</td>
<td>1%</td>
</tr>
<tr>
<td>Marketing, advertising and promotion</td>
<td>1-2%</td>
<td>3-6%</td>
<td>2-3%</td>
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<tr>
<td><strong>OPERATING EXPENSES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries &amp; wages</td>
<td>20-25%</td>
<td>20-30%</td>
<td>25%</td>
</tr>
<tr>
<td>Benefits (PR taxes, insurance, 401k)</td>
<td>5-7%</td>
<td>6-8%</td>
<td>5-8%</td>
</tr>
<tr>
<td>Occupancy (rent, utilities, R&amp;M)</td>
<td>5-8%</td>
<td>5-8%</td>
<td>5-8%</td>
</tr>
<tr>
<td>Phones &amp; technology</td>
<td>2-3%</td>
<td>2-3%</td>
<td>2-3%</td>
</tr>
<tr>
<td>Printing, postage &amp; supplies</td>
<td>1-2%</td>
<td>2-3%</td>
<td>2%</td>
</tr>
<tr>
<td>Business insurance</td>
<td>1.0-2.5%</td>
<td>1.0-2.5%</td>
<td>1.0-2.5%</td>
</tr>
<tr>
<td>Other</td>
<td>3-5%</td>
<td>3-5%</td>
<td>3-5%</td>
</tr>
<tr>
<td><strong>TOTAL EXPENSES (rounded)</strong></td>
<td><strong>60-80%</strong></td>
<td><strong>45-65%</strong></td>
<td><strong>55-70%</strong></td>
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<tr>
<td><strong>NET PROFITABILITY</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>20-40%</td>
<td>35-55%</td>
<td>30-45%</td>
</tr>
</tbody>
</table>

*Exclusive of owner's salary and benefits, depreciation/amortization and interest on debt. Most applicable for agencies with revenues > $300k.

This summary is based upon my own analysis of agency financials and reported statistics from The National Alliance Research Academy.
Managing Finances

• Optimum profitability found when revenue is stable:
  – Growing businesses – reinvest capital (new employees, marketing, etc).
  – Shrinking businesses – struggle to manage costs while revenues are declining.

• An agency operating:
  – On the low end of profitability – might have structural problems (often in compensation).
  – On the high end of profitability – the business might be run very efficiently or could be a sign that not reinvesting in growth enough.
Managing Finances

• CSRs
  – Compensation
    • Salary or hourly base wages
    • Incentive bonuses
    • Benefits: Sick/vacation time and insurance
  – Total compensation < 35% of revenue

• Producers
  – Compensation
    • Can vary by the market and their responsibilities
    • May include a draw for newer producers
  – Should be 40%/30% for new/renewal
  – Avoid giving ownership rights
Managing Finances

• Accounting
  – Most bookkeepers and accountants:
    • Have a difficult time with agency financials.
    • Create financials from bank statements.
    • Don’t reconcile with the management system or carrier statements.
  – Recommendations
    • Track monthly revenues per carrier statements.
    • Track agency bill deposits and commissions.
    • Compare against company financials.
  – When to hire a CFO?
    • $2.0M of gross – Probably too early
    • $7.0M of gross – Definitely needed
Managing Finances

- **Budgeting**
  - Create a base line budget for each year based on prior year income and expenses

### Revenue

<table>
<thead>
<tr>
<th></th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>June</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commissions</td>
<td>$36,000</td>
<td>$39,000</td>
<td>$45,000</td>
<td>$42,000</td>
<td>$38,000</td>
<td>$44,000</td>
</tr>
<tr>
<td>Other</td>
<td>$720</td>
<td>$780</td>
<td>$8,000</td>
<td>$840</td>
<td>$760</td>
<td>$880</td>
</tr>
<tr>
<td><strong>Total Revenue</strong></td>
<td>$36,720</td>
<td>$39,780</td>
<td>$53,000</td>
<td>$42,840</td>
<td>$38,760</td>
<td>$44,880</td>
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</table>

### Fixed Expenses

<table>
<thead>
<tr>
<th></th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>June</th>
</tr>
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<tbody>
<tr>
<td>Wages</td>
<td>$17,308</td>
<td>$17,308</td>
<td>$25,962</td>
<td>$17,308</td>
<td>$17,308</td>
<td>$17,308</td>
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<tr>
<td>Rent</td>
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<td>$1,800</td>
<td>$1,800</td>
<td>$1,800</td>
<td>$1,800</td>
<td>$1,800</td>
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<tr>
<td>Utilities</td>
<td>$420</td>
<td>$420</td>
<td>$420</td>
<td>$420</td>
<td>$420</td>
<td>$420</td>
</tr>
<tr>
<td>Phones</td>
<td>$650</td>
<td>$650</td>
<td>$650</td>
<td>$650</td>
<td>$650</td>
<td>$650</td>
</tr>
<tr>
<td>Supplies</td>
<td>$450</td>
<td>$450</td>
<td>$450</td>
<td>$450</td>
<td>$450</td>
<td>$450</td>
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<tr>
<td>Software</td>
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<td>$900</td>
<td>$900</td>
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<tr>
<td>Insurance</td>
<td>$2,500</td>
<td>$2,500</td>
<td>$2,500</td>
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<tr>
<td>Advertising</td>
<td>$ -</td>
<td>$1,250</td>
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<tr>
<td>Marketing</td>
<td>$500</td>
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<td>R&amp;M</td>
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<td>$450</td>
<td>$450</td>
<td>$450</td>
<td>$450</td>
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<tr>
<td>Other</td>
<td>$725</td>
<td>$725</td>
<td>$725</td>
<td>$725</td>
<td>$725</td>
<td>$725</td>
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<tr>
<td><strong>Total Expenses</strong></td>
<td>$25,703</td>
<td>$28,953</td>
<td>$41,857</td>
<td>$25,703</td>
<td>$28,003</td>
<td>$25,703</td>
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</table>

### Net Income

<table>
<thead>
<tr>
<th></th>
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<th>March</th>
<th>April</th>
<th>May</th>
<th>June</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Income</td>
<td>$11,017</td>
<td>$10,827</td>
<td>$11,143</td>
<td>$17,137</td>
<td>$10,757</td>
<td>$19,177</td>
</tr>
</tbody>
</table>

*Include owner’s salary and benefits
Managing Finances

• **Cash Management**

1. Keep > 3 months of working capital
   • Helps you survive unforeseen events, seasonality or market cycles.
   • Allows you to invest in growth or acquisitions.

2. Don’t spend what is not yours
   • Always remain in-trust with carriers
   • This includes accounts where you are paid in-full on semi-annual or annual commissions

➢ Failure to follow these two rules could lead your business into a fast decline.
Managing Finances

• **Financial Metrics**

1) *Days of Working Cap* = \( \frac{\text{Cash} + \frac{A}{R} - \frac{A}{P}}{\text{Annual Expenses} \div 365} \)

2) *Trust Ratio* = \( \frac{\text{Cash} + \frac{A}{R}}{\frac{A}{P}} \)

3) *Tangible Net Worth* = \( \frac{\text{Tangible Assets} - \text{Liabilities}}{\text{Net Revenue}} \)

4) Rule of 20 = \( (\text{Organic Growth Rate}) + \left( \frac{\text{EBITDA Margin}}{2} \right) \)

• **Targets:**
  – (1) DWC > 90  
  – (2) TR > 1.0;
  – (3) TNW > 0.12  
  – (3) Rule of 20 ~ 20
Managing Finances

• Monitoring productivity
  – Of marketing dollars
    • Cost per lead and closed sale
  – Of CSRs and producers
    • Revenue per person and margin per person

<table>
<thead>
<tr>
<th></th>
<th>PL CSR</th>
<th>CL CSR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commissions per</td>
<td>$120k - $160k</td>
<td>$200k - $350k</td>
</tr>
<tr>
<td>Accounts per</td>
<td>750 - 1000</td>
<td>250 - 400</td>
</tr>
<tr>
<td>Compensation per</td>
<td>$35k - $45k</td>
<td>$45 - 60k</td>
</tr>
</tbody>
</table>

– Of accounts and lines of business
  • Premium, revenue and policies
  • Average, high and low tenure of accounts
  • Number of policies per customer
Keep and grow your base

- Why retention matters

Model assumes 10 policies per month initially plus 1% growth per month (33 new policies per month at the end of 10 years).

Difference after 10 years:
- 80% to 88% = 26% more policies
- 80% to 96% = 66% more policies
Keep and grow your base

• Questions to ask yourself:
  1. How much does it cost to acquire a customer?
  2. How much revenue is lost?
  3. Which agency is likely more profitable?

• Probable guesses:
  1. At least $100
  2. At least $400
  3. Agency with 96% retention is netting 10% more of revenue than agency with 80%.
Keep and grow your base

• Where do customers go when they leave?
  – Direct writers
    • Consumers that use an agent claim they do so because they like dealing with a person they can visit (39%) or have always used an agent (31%) - i.e. they don’t really want to use a DW!
    • Don’t give up on them – most have buyer’s remorse!
  – Other agents
    • Unless the current agent is lacking in markets, they are most likely not satisfied with service.
Keep and grow your base

- Elements of Service

- Accountability
- Communication
- Professionalism
- Convenience
- Responsiveness
- Likeability
Keep and grow your base

• **Elements of Service:**
  – Communication
    • Education
      – About coverages and claims
      – About disaster preparedness
      – About market updates
      – About the agency and staff
      – About ways they can reduce their rates
  • Consumers are 10% less likely to shop if they hear from their agent regularly, and increased communication improves retention by 5%.\(^1,2\)
  • Email and social media venues are cheap.
  ✓ Let them know you appreciate their business!
Keep and grow your base

• **Elements of Service:**
  
  – **Convenience**
    • Should be part of your value proposition.
    
    • 83% of agencies do not have online portals.³
    
    • 42% of agencies have no self-service tools online like paying bills or making policy changes.
    
    • 62% of agencies do not offer online quoting.
    
    • Most people buy from direct writers because it’s more convenient.

✓ Make it easy for them to do business with you!
Keep and grow your base

- **Elements of Service:**
  - Likeability
    - Attitude/enthusiasm
    - Empathy
    - Personality
  - Processes should be written and followed for consistency.
  - Communication should be professional.
  - Clients should have account managers.

➢ Create a *customer experience*. 
Keep and grow your base

• Solicit feedback
  – How would customers rate (1-10):
    • How well their needs were met.
    • How well their coverage was explained.
    • How well the price matched the quality of coverage that they received.
    • Their overall experience with the agency.
    • The likelihood they would refer you.
  – Find out:
    • Who serviced them.
    • If they have other insurance needs.
    • Someone they know that might be interested in your services.
Keep and grow your base

- **Solicit feedback**
  - Understand the feedback
    - An 80% or better is needed
    - A “satisfactory” rating is not
  - Act on the feedback
    - Change processes
    - Train/eliminate staff

➤ Customers are 50% more likely to shop their policy if they deem your service as just satisfactory.¹

For more information on surveying customers see: [www.netpromoter.com](http://www.netpromoter.com)
Keep and grow your base

• Cross-selling
  – Retention rates increase 5-10% when you hold more than one policy for a customer.$^{3-6}$
  – Cheapest means to increase revenue.
  – 25% of consumers don’t even think to do it.$^1$
  – Train staff to ask about other insurance needs in the initial sale.
  – You’ve earned the right to ask when they give you a 90% or better score on your Customer Survey!
  
  ➢ Promote testimonials of clients that have given your agency multiple policies – makes an easier segway.
Keep and grow your base

• **Building your team**
  
  – Quality service is based on good people.
  
  – Hire people that:
    • Have the **right attitude**.
    • Are of **good moral character**.
    • **Like to learn** and will listen.
    • **Need to work**.
  
  – Invest time developing people
    • Discuss goals, expectations and responsibilities
    • Set up training and mentoring processes
    • **Multiply your influence** – seek the top 20%
      
      Respect → **Admiration** → Loyalty
Keep and grow your base

• Building your team
  – Cultivate a friendly, competitive environment
    • Use production-based compensation.
    • Have regular meetings and share successes with the group.
    • Have social gatherings and give awards.
  – Incentivize growth
    • Set goals on individuals & teams.
    • Add incentives for higher production.
    • Add incentives for longevity.
  – Create accountability
Keep and grow your base

• And if that doesn’t work... outsource
  – Carrier service centers
    • Typically charge 10% of the commission
    • 24/7 availability
  – Wahve (www.wahve.com)
    • Semi-retired insurance agents for hire
    • Work from home part-time
  – ReSource Pro (www.resourcepro.com)
    • China-based processing and support staff
    • 24/7 availability
Find new ones

• Marketing for new business
  – Game plan
    • Assess the market
    • Identify target
    • Develop your value proposition
    • Promote your business
  – Some numbers:
    • Average agency spends 3-5% of revenue on marketing.\textsuperscript{3}
    • Roughly 65% of agencies report having no formal marketing plan.\textsuperscript{7}
    • Over 55% of agencies do not track where their leads are coming from or their ROI.\textsuperscript{7}
Find new ones

• Push Marketing
  – Interruption-based marketing
Find new ones

• Pull Marketing
  – Reputation-based marketing
Find new ones

• Methods that work
  – Pick a method and I’ll tell you about an agency that found success with it.
  – It all comes down to finding the best method to reach your target prospect.

• Trending Marketing
  – Study marketing.
  – Pay attention to new methods.
  – Look to future trends to stay ahead of the curve.
Find new ones

• Marketing Online
  – Stats on agency website functionality:
    • 12% of agencies still have no website
    • 54% of agency websites are not mobile-ready
    • Over 65% of agencies do not have customer testimonials on their website
    • 38% of PL agencies and 49% of CL agencies are not using Social Media
    • 67% of agencies do not have a blog
    • Over 50% of agencies do not have in-depth content on their website
    • 39% of agencies are not using local search tools
Find new ones

• Specialization
  – “There are riches in the niches” - anon
  – Only 14% of agencies have a website targeting an industry or product segment.³
  – The number of specialized agencies rose by 10% from 2010 to 2013.⁸
  – Benefits:
    • Faster organic growth
    • Higher retention and profitability
    • Better competitive edge
Find new ones

• **Strategy for specializing:**
  1. Assess market opportunities
  2. Test the waters
  3. Assign a practice leader
  4. Build your marketing plan
     • Set up DBA and website
     • Create marketing materials
     • Align with referral partners
  5. Promote your specialization
  6. Become an “expert”

✓ You’ll only find success if the specialization is an **area of passion!**
Find new ones

• **Tracking Key Metrics**
  – Within your business:
    • New leads and policies written
    • Close ratio by sales staff
    • Total new premium, revenue, policies and clients
  – Of your marketing:
    • Source of leads
    • Close ratio based on sources
    • Email campaign stats
    • Website traffic
    • Social Media followers
Find new ones

• **Gurus that I follow (in alpha order):**
  – Scott Addis, *Beyond Insurance*; Sales training
  – Dave Chaffey, *Smart Insights*; Internet marketing
  – Brent Kelly, BrentMKelly.com; Blogging
  – Dave Kerpen, *Likeable Local*; Branding
  – Chris Paradiso, *Paradiso Presents*; Digital and social media marketing for agencies

➢ Study what others are doing and have done successfully!
Buy someone elses

• The *fastest way to grow*.  
• Benefits  
  – Good return on your invested capital  
  – Growth in revenue and cash flow  
  – Enhanced value of your agency  
  – Potential synergies:
    • New appointments  
    • Higher carrier compensation  
    • Opportunities for cross-selling  
    • Expense reductions  
    • Trained staff  
    • Broader brand exposure/market share
Buy someone elses

**Challenges**

- Finding real opportunities
- Competing with other buyers
- Bridging the trust-gap
- Structuring the deal (finding the $$ too)
- Performing a thorough due diligence
- Closing the deal

**Can take months to get a deal moving**

- Be patient
- Keep communicating
- Understand the seller’s motives/issues
# Buy someone elses

<table>
<thead>
<tr>
<th></th>
<th>Agency 1</th>
<th>Agency 2</th>
<th>Combined</th>
<th>Adjustments</th>
<th>Pro Forma</th>
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<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td>$1,000,000</td>
<td>$500,000</td>
<td>$1,500,000</td>
<td>$ -</td>
<td>$1,500,000</td>
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<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Comp &amp; Benefits*</td>
<td>$500,000</td>
<td>$250,000</td>
<td>$750,000</td>
<td>(50,000)</td>
<td>$700,000</td>
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<tr>
<td>Marketing</td>
<td>$40,000</td>
<td>$20,000</td>
<td>$60,000</td>
<td>-</td>
<td>$60,000</td>
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<tr>
<td>Occupancy</td>
<td>$45,000</td>
<td>$27,500</td>
<td>$72,500</td>
<td>-</td>
<td>$72,500</td>
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<tr>
<td>Insurance</td>
<td>$20,000</td>
<td>$10,000</td>
<td>$30,000</td>
<td>(5,000)</td>
<td>$25,000</td>
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<tr>
<td>Professional</td>
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<td>$10,000</td>
<td>$30,000</td>
<td>(5,000)</td>
<td>$25,000</td>
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<tr>
<td>Phones &amp; Techn.</td>
<td>$30,000</td>
<td>$15,000</td>
<td>$45,000</td>
<td>(10,000)</td>
<td>$35,000</td>
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<tr>
<td>Other</td>
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<td>$35,000</td>
<td>$105,000</td>
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<tr>
<td><strong>Total Expenses</strong></td>
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<td>$367,500</td>
<td>$1,092,500</td>
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<td><strong>Adjusted EBITDA</strong></td>
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<td>$132,500</td>
<td>$407,500</td>
<td>$487,500</td>
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*Includes owner/management compensation

Price of Agency 2 $800,000
Other Costs $40,000
Down Payment $160,000
Loan Amount** $680,000

New EBITDA $487,500
Annual Loan Pmts $(161,578)
After Debt EBTDA $325,922
Additional Cash Flow $50,922

**5 year financing at 7% Before Tax Return on Capital 32%
Buy someone elses

• Make sure you fully understand:
  – Risk factors
    • Revenue trends or changes
    • Revenue concentration
    • Non-compete agreements
  – The cash flow based on deal structure
    • Make a monthly cash flow projection.
    • Earn-outs and bank financing don’t work well.
  – Taxes
    • You can’t write off principal payments.
    • If you plan on reselling the agency within 5 years, ask an accountant about “amortization recapture”.
Buy someone elses

- Cash flow projection

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<tbody>
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<td>Rent</td>
<td>$ 1,800</td>
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<td>Utilities</td>
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<td>Phones</td>
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<td>Supplies</td>
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<td>Software</td>
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<tr>
<td>Insurance</td>
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<td>Advertising</td>
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<td>Marketing</td>
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<td>R&amp;M</td>
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<td>Other</td>
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<td>$ 725</td>
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<td>Total Expenses</td>
<td>$ 23,451</td>
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<td>$ 38,478</td>
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<table>
<thead>
<tr>
<th>Net Income</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
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<tbody>
<tr>
<td></td>
<td>$ 13,269</td>
<td>$ 13,079</td>
<td>$ 14,522</td>
<td>$ 19,389</td>
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<table>
<thead>
<tr>
<th>Loan Payments</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$(10,891)</td>
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</table>

<table>
<thead>
<tr>
<th>Cash Flow</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
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<tbody>
<tr>
<td></td>
<td>$ 2,378</td>
<td>$ 2,188</td>
<td>$ 3,631</td>
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</table>

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Summary

• Substantial growth requires a four-pronged focus:
  1. Managing your finances
  2. Keeping and growing what you have
  3. Adding new clients
  4. Acquiring other agencies

• In your area, at least one agency has likely grown by leaps and bounds so you can be the next success story...
Some last thoughts

• Traits of successful agency owners:
  1. High risk tolerance
  2. Financial discipline
  3. People-oriented
  4. Delegate well
  5. Students of their business
  6. Have a pulse of their business
  7. Action-based

• Many high-growth agencies have multiple principals with compatible skill sets.
Questions or Comments

- Thank you for your time and I hope that you found this information useful.

- Please direct any questions or comments to:
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  Website: www.agencybrokerage.com
  Blog: www.agencybrokerage.net
  LinkedIn: www.LinkedIn.com/In/MichaelMensch
References