Over the past few years, we have heard a lot of different explanations from a lot of different agency principals as to why they chose to operate their own insurance agency. With remarkable consistency in the course of these conversations, two things have been made perfectly clear. First, most agency principals started in sales and still like the thrill of the sale. Second, they were willing to take the risks of entrepreneurship in order to reap the financial rewards of ownership. In other words, to make money.

At The Manhattan Group, we have seen more than enough evidence that the agencies most likely to fail are those agencies who neglect to take control of the financial end of the business. These failures have not gone unnoticed, and an increasing number of agency owners and managers know their Personnel Expense Ratio, their Current Ratio, their Trust Ratio, as well as all the corresponding ‘benchmark’ statistics.

While these statistics are inherently useful as a diagnostic tool and for monitoring changes in financial position over time, in the final analysis (if you will excuse the pun), most of these measures are concerned with analysis of cash flow out, rather than analysis of cash flow in (sales). An understanding of both are necessary if you really want to take control of your agency’s finances... and make money.

1. **Track your annual commissions by line of business.**
Many financial statements report an agency’s commission income in a simple, one line aggregate. However, it’s simply not enough to know your aggregate commission income at year end. Make sure you individually monitor income from each key segment from which you generate income. By analyzing commission trends for each segment separately, you will spot weaknesses as well as opportunities as they arise. In addition, tracking performance by key business segment will help you allocate your financial resources properly.

Knowing whether your aggregate commission has increased or decreased relative to historic results, and how the changes in your aggregate commission income compare relative to your peer group is fine. But while this data may make you work harder, it won’t help you work smarter.

2. **Track (and improve) your renewal retention ratio.**
Track your renewal retention rates by segment. Changes in your renewal retention rates may explain, at least in part, any upwards or downwards trends in commission income. If it appears that your renewal retention ratio is eroding, make sure that internal factors are not the root cause. Remember that the true cost of a lost client includes the cost of lost referrals as well.
Improving renewal retention rates should be at least as important as acquiring new business. Why? Because its more profitable! Say Agency X develops $5 million in annual written premiums in year one, at an average commission of 13%, for a gross income of $650,000. If that agency has a retention rate of 80%, in year two the agency will lose $1 million in premiums or $130,000 in commission income. If the original budget called for the agency to increase gross commissions in year two by 10%, from $650,000 to $715,000, it would have to write $1,500,000 in new premium to stay on target.

Now, consider Agency Y. Like its neighbor, it developed $5 million in annual written premiums in year one at an average commission of 13%. However, with its retention rate of 90%, in year two it will only have to write $1 million in new premium to stay on target, since it retained $500,000 more in premiums and $65,000 more in commission income due to its higher retention rate. When you add to this equation the fact that it is considerably less costly to service the existing business than it is to acquire the new business, the value of enhanced retention is clear.

By the way, when Agency Y buys Agency X, the first thing it will do is increase the retention rate to 90% for a cool $65,000 in incremental commissions (at least) for which it paid nothing. Think about it.

3. Determine where your sales profits are coming from.
Granted, most agencies are simply not large or specialized enough to be run and managed on a profit center basis. Yet there is considerable value in taking the time - on even the most crude basis - to determine the relative profitability of the agency’s key lines of business, or even blocks of business. We have worked with more than one self-described commercial lines focused agency that turned out to be nearly entirely dependent on the profits generated from its personal lines business. Don’t assume that the line of business generating the largest gross commission income is either the most profitable or generating the most profits. If you do, you run the risk of killing the cash cow through benign neglect.

With respect to contingent commission income, most if not all of it should fall to the bottom line. If your expenses have escalated to the point that a considerable proportion of the contingent commission income is consumed by operating expenses, you are walking a tightrope without a net. Enough said.

4. Track your average account size and rounding ratios.
The real value of determining your average account size is that, at renewal time, it focuses attention on those accounts that develop a ‘below average’ commission. This should lead to a determination of the actions to be taken to increase the size of the account. Ultimately, it may lead to the determination that the agency cannot ‘afford’ the account.
Determining and monitoring your average account rounding is a useful tool for bringing your average account size up as well as enhancing your retention ratios. A simple way to measure your account rounding is to divide the number of policies of each type (i.e. homeowners policies) by the total number of accounts written (i.e. personal lines). Make it a real priority to fully round the accounts. If you're writing the homeowners but not the umbrella, that account is halfway out the door. Furthermore, changes in the mix of rounding over time can give you clues about how the demographics of your customer base may be changing.

In addition, it is a fact that the life of an average monoline private passenger account is more than doubled with the addition of the homeowners policy. And if you can write the life insurance, the life of that account almost doubles again.

5. Accounts Receivable are not Sales
Accounts receivables are liabilities until paid, and until they are paid, they are not sales. In addition, the more quickly that accounts receivable are paid, the more opportunity the agency has to generate ‘float’ - the difference between what has been collected from clients and what has yet to be paid to the companies, as well as generate some interest off that float. Unfortunately, all too often the customer is permitted to float on the agency and the agency has no opportunity to generate float itself.

In addition to generating a monthly aging schedule for receivables, it can be useful to generate a similar schedule by account executive or producer. The problem may lie with the client, or over time it could become apparent that a particular producer is far more comfortable selling insurance than he or she is with selling the payment practices.

Lastly, don’t carry an uncollectible receivable on the books ad infinitum. As painful as it is, strictly establish and adhere to a fixed age over which all receivables will be written off. Otherwise, your financial statements will present an inaccurate view of your working capital position, among other things.

Granted, few of the items outlined above are going to be reported on your annual financial statements, per se. But if the ultimate purpose of a financial statement is to help you manage your business, and your business is sales, then some level of fundamental, old-fashioned sales analysis is needed if the financial statements are really going to work for you.