Virginia
Regulatory Hot Tip 2016 –8

Professional Insurance Agents Association of Virginia and DC, Inc.

Trials and Tribulations (and a little advice)
in Selling Your Insurance Agency

You Sell for a Living, So Why Not Sell Your Insurance Agency Yourself?

It seems pretty straightforward, right? You wake up one day, decide you're ready to exit your insurance agency, and set about finding a buyer. You probably already have a few leads in mind. You'll call them up, invite them to coffee, make a little small talk, and, when the time is right, plant the seed. Later on you'll follow up, gauge their interest and proceed as you would with any of your clients. Odds are at least ONE of the folks you prospect you'll eventually close, right? You're a well accomplished business owner and salesperson. Probably be out of there in three months, maybe six, and with a cool half-a-mil in your checking account… right?

Hopefully to the vast bulk of folks reading this, the above scenario sounds far too good to be true, because, for most small business owners, it's not reality. The process of selling a business is long, cumbersome, riddled with pitfalls, totally

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The author of this Regulatory Hot Tip, Jason L. Savedoff, ASBC of RVA Advisors, PLLC, endeavors to provide accurate and authoritative information about the subject matter covered as of the date of publication. However, the substantive information and any statutory authority contained in this Hot Tip should be verified as they are subject to change with the passage of time. Mr. Savedoff provides this Hot Tip with the understanding that he is not rendering legal, accounting, or other professional advice or counsel. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

RVA Advisors, PLLC is Richmond's only Accredited Small Business Consultancy. Its services include fractional CEO and COO engagements along with ad hoc consulting, coaching and business intermediary (brokerage) services. Prior to launching his consultancy the author worked in investment banking, insurance and investments and commercial real estate and has started, operated and sold/franchised successful businesses across several industries.

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lacking in guarantees, and, statistically speaking, the sale of your business will fail 8 out of 10 times. [1]

Why Do So Few Businesses Successfully Transition?

There are a myriad of reasons why only 20% of all businesses for sale ever actually sell. Below I'll touch on three of the most common.

FSBO=Buyer (and Seller) Beware!

For Sale by Owner (FSBO) transactions are estimated to have less than a five percent chance of reaching close, and that is primarily for one reason; the business owner has never completed the sale of a business, and so is unfamiliar with the process. That lack of expertise is akin to driving a car down a pothole-riddled dirt road in the middle of the night without any headlights... you're going to hit every rut on that entire road. If you do actually make it (the five percent of folks who do), you'll feel like you went ten rounds with the late great Muhammad Ali!

Another consideration in FSBO transactions is that a business owner is often emotionally invested in her/his business. This makes it difficult to be objective in the face of a buyer whose aim it is to point out all of the flaws in your business in order to get a better price. Have you ever noticed how the Realtor selling your house wants you out of the house while it's being shown? The reason is that they don't want you to have an emotional response to anything being said by a prospective buyer. They need you to remain as objective and reasonable as possible because they know that emotions sink deals.

Financing? What Financing?

Financing is the most prominent hurdle in any transaction. In the case of insurance agency financing it's made an even higher hurdle because very few commercial banks are equipped to lend against a book of business. Banks, now as ever, want tangible assets as collateral.

Traditionally, an insurance agent would have paid cash for an acquisition, with some of the purchase price being held as a note by the seller. However, most sellers in the current market prefer to exit the business with no strings attached, and willingness to hold a note is often limited to small principals with short terms.

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(1) Parker, Richard. How to Buy a Good Business at a Great Price. Ft. Lauderdale: Diomo Corporation, 2016. Print.

More recently, alternative financiers have popped up that specialize in insurance agency products, including acquisition funding. While more expensive than bank lending, they are able to collateralize an insurance agency's revenue stream and provide reasonably priced funding with flexible terms. However, most have a requirement of 20% cash down, which cannot be borrowed funds. This means that for a $500,000 acquisition a buyer will need at least $100,000 in her/his checking account to procure this type of funding. This puts these products out of the reach of many looking to grow their agencies.

To add to the complexity of the financing of insurance agencies, some savvy buyers are now attaching retention provisions to the final sale price of an insurance agency. In practice, this means that the seller will receive some lump sum at closing and a future payment structure based on retention of agency clients as of closing. This requires the seller to have a vested interest in the success of the buyer, as those retention rates will directly, and often severely, effect the total sale price owed the seller.

Cooking the Books

"Just a little off the top and keep it full on the bottom," my grandfather used to instruct his barber when I went with him to the shop as a boy. Never mind that grandpa had a combined total of about 50 hairs on his head, very few of which were on top.

It turns out that the same strategy grandpa employed to keep his hairdo looking its best is the same strategy many business owners use to manage their profit and loss (P&L) statement. The "little off the top" refers to moneys received that never flow through the business, but do flow into the pocket of the business owner. The "keeping it full on the bottom" means running personal expenses through the business to reduce net profit, and thus tax exposure.

While this sort of system will certainly help reduce taxable income, it does so at the expense of the sellability of the business. Moreover, very few financing entities are forgiving of tax returns that show significantly less profitability than the "real" financials indicate. And since most financing entities look at at least three years of agency tax returns, of sellers AND borrowing buyers, if one or both agencies don't look squeaky clean it can spell big trouble for the transaction.

<u>How Do We Increase the Chances of an Insurance Agency Selling?</u>

The assemblage of a competent team of experienced advisors is key. A Business Intermediary is an important first hire, and differs from a business broker in that a broker simply lists a business and finds a buyer. An Intermediary plays the same role, but will also help you prepare your insurance agency for sale the way a stager would ready a home. IDEALLY, your Intermediary would also have a consulting certification from the Association of Accredited Small Business Consultants, or a comparable body. These Intermediaries have been fully vetted and can bring a great deal of added value, which translates to a higher sale price, better terms, and a faster transition.

For example, an insurance agency owner should be wary of any broker who does not provide a formal valuation, appraisal or Broker's Opinion of Value. The days of selling businesses by rule of thumb should be a thing of the past (although, sadly, are not yet fully behind us). A valuation conducted by a qualified Business Intermediary will incorporate a detailed cash flow analysis, an appraisal of real estate and any business personal property and a comparative analysis of the sales prices of other agencies comparable to yours. The result will be a valuation anchored in defensible research and is much more credible to buyers and their financiers.

Other important hires are a CPA and attorney who are familiar with small business transitions. Just because your current CPA and attorney have been with you for years doesn't mean that they're the best service providers to help with an insurance sale. Just as you wouldn't ask a dermatologist to remove your appendix, do your homework in finding the right professionals for the right tasks.