Agency Owners: Protect Your Hard-Earned Value by Insuring These Seven Risks

By David W. Tralka

It's one of the great ironies of agency ownership: Principals spend their entire career solving other people's insurance needs, yet sometimes they fail to take care of their own. They're brilliant at identifying their clients' risks, but they often fail at protecting the agency they've built. It's a classic "the cobbler's children have no shoes" story.

To be fair, owners are busy, so they don't always think about the risks of running a business. Or they can't imagine those risks apply to their agency. As successful as they may be, they can be blind to the impact of a cyber attack, the sudden loss of a large client or the departure of a top producer.

Analyzing your business risks, and taking steps to reduce or eliminate them, will ensure your agency remains prosperous and grows in value. If you're an agency owner, here are seven risks you absolutely need to address:

1. **Cyber Risk.** Most agencies don't take the risk of cyber intrusion as seriously as they should. They don't believe it will happen to them. Understand that cyber risk isn't limited to your own computer systems. You are vulnerable to breaches every time you interact electronically with an outside entity. That could be trusted advisors like accountants or attorneys, or even clients, vendors and carriers. It can be a significant risk, and the onus of protection falls upon you.

   How you communicate internally and train your staff is critical to reducing cyber risk. Protect information through strong passwords, multifactor authentication, encryption and other rigorous protocols and procedures. Sure, employees hate to change their passwords, or maybe they even share the same password. Don't let that happen. Change passwords on a regular basis; encrypt sensitive data when transferring it. Have set procedures for collecting, storing and disposing of personal data. Follow cybersecurity best practices.

   You'll never eliminate cyber risk entirely because the bad guys are always a step ahead. But just putting in some common-sense protective measures will reduce your exposure. Cyber is a big deal because it has real costs. In its 2019 "Annual Cost of Cybercrime Study," Accenture found that online criminal activity costs organizations millions in losses each year. The most expensive threats were malware, web-based attacks and denial of service.

2. **Unforeseen Death/Illness of a Partner.** Use tools, such as life insurance, disability income insurance or a funded buy-sell agreement, to insure against a partner or key employee dying or becoming disabled. These types of arrangements will protect your agency from unforeseen or tragic circumstances. At the same time, make sure you are building or retaining the next level of management so there is a succession plan if someone dies or is incapacitated. This may involve the use of equity incentives or a deferred compensation plan, and it ensures there is someone ready to step into the shoes of a key person who is no longer there.

3. **Reputation Risk.** Your reputation is critical to your long-term success in your community. In the insurance business, it's all about trust. The best agencies consistently communicate how things work to their staff, clients and carriers, so they eliminate mistakes and miscommunication. Ensure that your team is on the same page and well trained. Keep clients and carriers supportive of your efforts. Set expectations for your clients and staff so you minimize surprises. Documenting your workflow process and training your staff provides a level of comfort for your employees and your clients, and it demonstrates that you're running your agency effectively and are a good company to do business with.

4. **Economic/Market Risk.** On a regular basis, evaluate your strengths and weaknesses, and opportunities and threats. The old SWOT analysis is a tried and true approach to assessing your competition and identifying potential new markets. It's a good idea to gather your staff to ask some basic questions about your client base, what's happening in the local business community and your local housing market. Consider the demographics of your clients. Do you see trends that might help or hinder your ability to retain existing business or generate new business? Do you have clients or staff nearing retirement? What impact will it have on your agency's long-term health? Evaluate the concentration risks in your client base and community, including the potential loss of a key employer in your area or the loss of a major client that could cripple your agency in the short run.

5. **Interest Rate Risk.** Interest rates are always moving around. Agency principals should be evaluating their growth plans and looking at any current debt they may have. Lock in fixed-rate loans, and refinance existing seller notes and any existing floating-rate debt you may have. If you own commercial real estate that your agency is housed in, take a look at the benefits of refinancing or taking out some equity. Keeping a floating note is fine when rates are low, but it's also an opportunity to lock in the lower cost of capital. Remember, rates will eventually go up.

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6. **Concentration/Personal Wealth Risk.** The most significant asset any agency owner has is their stake in the agency. Most small-business owners have 70% or more of their net worth tied up in their business. With agency valuations continuing to increase, taking some of that equity off the table can help you diversify your personal holdings while still maintaining control of your business. Start by identifying key employees who may be future owners and communicating with them about your plans. Then put together a strategy to sell some equity to the next group of owners — it's a good retention tool for key people. Think of it as a liquidity event for current owners. Don't let all that equity you've built become a concentration risk. It's your retirement nest egg, and you need to find ways to tap it and diversify.

7. **Long-term Succession.** Every agency will eventually change hands one way or another, yet surveys show that as many as three-quarters of businesses don't have succession plans. Your goal should be to increase your agency's long-term value so you will earn more money when it comes time to sell or transfer ownership. Agencies that are willing to invest in technology, training for their producers and a high-quality staff will be more attractive to a buyer. Those are the agencies that will have more options to grow, increase value and sell at higher multiples. Look at ways you can create sustainable cash flow over time. This is what drives agency valuations. You may need to trim expenses or update your agency management system to become more efficient. Look at how much it costs to generate new revenue. Some streams of business may generate more income than others. At the same time, start grooming your successor. Give them an equity stake in your agency. Make sure you have a succession plan!

The same advice you give your clients about reducing risk applies to your own agency. Don't be caught unprepared or under-insured. Take the time to assess your risks and protect your agency so that it will be there for you and the next owners well into the future. ■

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