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The Economy and the Outlook for Independent Agencies

I have been bullish on the independent-agency business for a long time — on the basic strength of its business model (if you run it right, it makes money), its durability, and its ability to produce substantial shareholder value over the long run. And I still am.

But previous writings, seminars, and loudmouthing on the subject were undertaken in times of sustained and seemingly endless growth in the U.S. economy. We had recessions and some regional differences, but for most of the last 30 years we had a rising sea that lifted almost all the boats. Well, here we are now in Q4 of 2009, and, to paraphrase the creepy Steve Buscemi character in Fargo, *whoa daddy, we got somethin' different here!*

No one really knows for sure what the performance of the U.S. economy will be six months, a year, or two or three years from now. Too many moving parts here and abroad. But what is clear to me is that there is a chance, a really substantial chance unfortunately, that the economy, as the hipsters say, will break bad. In conventional econ language, this means a second-dip recession and maybe much worse.

We at BHBCo are valuation and consulting types, not economic forecasters. So I will keep the economics part of this to the basics and to what I think is indisputable, and then get on with the implications for agency owners and managers, and others who care about their success, such as the carriers they represent.

The gist of the general economic problem is this: The U.S. cannot change the relationship of our national debt to GDP (our national income) as radically upward as has been done recently and expect there to be no consequences. I make no political/ editorial comment on what the Fed has done to its balance sheet and the money supply or what the present and last White House administrations and Congress have done with the stimulus and TARP measures. The reality is that those things were done, and were probably necessary to avoid deflation and a real financial calamity in late 2008 and early 2009. We now find ourselves in a temporary lull and seem to have slipped into complacency, with people saying, *whew, glad that's over.* It's not over — and proceeding with your agency business plans as if it were over is ill-advised.

The U.S. economy can actually do okay with growing national debt, as long as the relationship with GDP stays within reasonable bounds. But the numbers involved in the present and planned deficits and the accumulating mountain of national debt are other-worldly. There is no doubt that corrective measures will be needed before too long, or the party is over, with very big implications for our country and the world. When you think it through and look at the numbers, there is really no argument against that conclusion. My biggest fear is that the ever-growing ideological and political acrimony in our country will cause the U.S. Congress to huff and puff and end up doing nothing constructive — the party's-over route. That will be a very bad outcome. But here is the more important point for

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ADDITIONAL BHBCo SERVICES

Most of our readers are familiar with our work in merger & acquisition advising, valuations, perpetuation consulting, and management consulting, but we want to remind you that on our team are **Jason Hoeppner**, who is a specialist in agency technology, workflows, and productivity; and **Dom Setaro**, who is a specialist in agency accounting and financial administration.

Recently Jason helped a 50-employee suburban agency convert to AMS 360 with entirely new workflows, created through the *POWER of Change®* process. And he is now doing similar work for a smaller metropolitan agency with a high-end personal-lines specialty that has just installed the new Applied Epic system.

Recently, Dom performed the financial due diligence for a client who acquired a specialist mga; and not long ago he helped install a cash-tracking system for a client with perpetuation debt and substantial agency-billed premium. Dom also looks over the shoulder periodically at the month-end work of new controllers in two of our clients.

you: Even if Washington pulls it together, sucks it up, does the right things, and helps preserve the prosperity of this old Union for another few generations (and I have faith we will do that), those measures will be painful for a long while for your customers and for you. I can't see or even conjure up any free-lunch way around this.

One of the frustrating pieces is that right when we need tax cuts, which have a very good multiplier effect on the general economy, we will have to face the political reality of tax increases, and the multiplier works both ways. I will leave it to the professional economists to estimate the impact on interest rates and unemployment, but I can't imagine how any of the communities you serve will not be affected tangibly before too long. One of the problems is that the reckoning is delayed, and so we keep taking more of the debt drug.

Getting the mix of policy solutions right will be a high-wire act. In a recent John Mauldin letter (a great resource, by the way), he referred to an inquiring somebody asking a knowledgeable somebody else: "Do you think the Fed's actions will cause inflation?" Response: "We better hope so." As of now (October '09), we just don't know how this will break.

Maybe some growth engine will come along and make all of this less painful. Our free-market economy has surprised us before with its strength and resiliency. Hope is a virtue, but managing a business requires more than hoping.

So, with that lovely picture painted, how should agency owners and managers lead their firms though an economic environment with declining incomes and rising fears?

- Aggressiveness. It may seem counterintuitive, but times of trouble are good times to expand, in units if not so much in income. It's a time to compete with the less hardy for customers and staff on a one-on-one level and for acquisition and combination opportunities. I don't see how biz-as-usual will yield anything other than several years of declining income — regular and contingent. So be aggressive.
- Dynamic Customer Focus®. Being customer-focused does not mean sloganeering or hanging a banner. It means being authentically interested on a micro (individual risk) basis, and on a macro basis – learning more about your book of business than you now know. Put yourself in a position that lets you anticipate which segments of your book are likely to be most and which least affected by an economic slide.
- Clear Expectations. It's game time. With all your key staff, be clear, first in your own mind and then with the individuals, about what your expectations are from each of them in 2010 and 2011. Having and expressing (and documenting) clear expectations is the foundation for either good performance or, if necessary, properly handled corrective action.
- Know Your Key Ratios. If you accept our advice to be aggressive amidst tough times, you should do so with a good understanding of your boundaries and targets for operating expenses and financial ratios. Those for financially leveraged agencies will differ from others. I am talking about six or seven critical items — not 50.
- Perspective. This has both a psychological and temporal aspect. The first is that the leader has to have judgment, and that usually means having a sense of humor. Big subject. The temporal aspect is that you have to think long-term. Most of the important things you do in 2010 won't bear much fruit for at least a year or two, and maybe later. Those of you who have worked with BHBCo for a while are probably worn out with the tortoise-hare analogy. Well, it will never be more apt than in the coming few years.
- Decisiveness. In difficult economic times, you don't have room to make many mistakes, but you don't need to bat 1000. Don't get immobilized. Get the facts, get input, apply perspective, decide, move on, apply skin thickener, and learn.

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A Few Thoughts on P/C vs. Employee Benefits. For those of you in the p/c world, take heart in the fact that what you do is and will continue to be mission-critical. You will get beat from time to time, but when you do, it will probably be by a better independent competitor. I see no major structural threat to your function. I am well aware of direct-writing alternatives in personal lines, but I don't see that as a major threat to your wheelhouse.

On the employee-benefits side, I can't be so sanguine. Actually, I don't think the threat to your income from so-called health care reform is as big as some do, but I have to acknowledge that I might have it wrong. Unfortunately, the architects of the proposed legislation do not understand or place enough value on the important advice and service you give to employers in communities throughout the country. There is probably no alternative but to keep a close eye on what unfolds in Washington and your state and then tool your agency operation to fit those employers and those products for which you can get paid for the value you bring to the deal.

In a follow-on piece, we'll talk about trends in agency value.

— *BHB*

Ink Spot

Follow your dreams, except for the one where you're naked at work.