Agency Acquisition: How to avoid buying a lemon — Seven hidden issues that can derail your acquisition

By Rick Dennen

Most fans of the 1960's top-rated television series, the Andy Griffith Show, recall the episode when Barney Fife purchased his first car. Against the advice of the discerning Sheriff Taylor, the deputy is duped into buying what is presented as a perfect, well-maintained car by a sweet, elderly woman who turns out to be a shyster. The car, Barney painfully discovered, was an embarrassing lemon worth far less than the price he paid for it.

Thanks to online vehicle history reports and state lemon laws, that's rarely the case today. Unfortunately, the same can't be said about insurance agency acquisitions. While it wouldn't be fair to compare most agency sellers to the conniving, duplicitous lady who fooled Barney, potential buyers should go into acquisitions armed with as much knowledge as possible.

Buyers and sellers report disappointment with an acquisition 70-90 percent of the time, according to the Harvard Business Review (www.hbr.org). The disappointment usually stems from a failure to uncover key aspects about the business they purchased. In other words, they didn't dig deeply enough to discover caution signs.

To avoid buyer's remorse, here are the areas to review closely before you move forward with a major acquisition.

Employees: Buyers should get to know all the employees and what role they play in the agency. Staff usually makes the difference between a mediocre and a great insurance agency. Relying on an organization chart and job descriptions to conduct this research isn't sufficient. By spending time with employees, asking questions and observing them doing their jobs, buyers can understand each employee's strengths, weaknesses and job responsibilities. They can learn even more by comparing what employees say about themselves and the company to what others say about them and their work. It's also important to know employees' perceptions about the potential sale/purchase and their understanding about how they will be impacted, especially for those with rights to commission streams.

Customers: Buyers should become acquainted with the customer base before making a purchase decision. This starts by reviewing the customer list, along with revenue, product purchases, producer, and length of time with the agency. Identify the key customers and meet with them to hear their experiences with and feelings about the agency. Buyers can take it a step further and join agents on calls to get a close account

of what customers are like and the strength of their relationship with the agency. Conducting a general web search of the agency, competition, and region can also reveal issues that customers might feel uncomfortable sharing.
No buyer plans to acquire an agency only to see customer retention take a sharp dive after the deal is completed. To keep happy customers, it's critical to develop a transition plan that introduces new owners to customers and addresses any questions or concerns they might have. Knowing the customers will allow buyers to develop and execute the right plan for a smooth transition.

Operations: Buyers should have a grasp of the agency's operations so there are no surprises about how the agency truly functions. By visiting the agency's offices, buyers can get a feel for procedures, workflows, software, accounting systems and customer service. They can see how relationships with carriers affect the day-to-day business. This is the only way buyers will truly know about inefficiencies or other issues that will have to be addressed.

Financials: Buyers should dig deeply into financials. Because insurance business owners are usually sales people first and foremost, they tend to focus on commission statements and reports to get a picture of the agency's financial viability. A thorough review of all financial aspects of the agency is essential, so buyers should consider hiring a certified accountant to help. Buyers should analyze audited financials and tax returns for at least the past three years, along with budgets (actual vs. budget), contracts, commission statements and retention reports to identify trends.

Cash Flow: Buyers need to know how much capital is required to keep the agency operating and how much they will need during the transition. Look at finances from a monthly or yearly perspective, but remember to map out a plan for the first few months after the purchase. Some buyers, for example, don't realize the Purchase Sale Agreement allows the seller to get all the commissions earned up to the time of sale. This can result in a cash flow shortage and reduce future projections. If possible, buyers should also negotiate so the seller can remain involved until a smooth transition is achieved, minimizing agency revenue losses.

Contracts: Buyers should carefully review all significant contracts. Attorneys can provide critical expertise in evaluating and determining enforceability of all employee-related contracts, non-compete and non-solicitation agreements, leases, vendor relationships and any other contracts. Buyers should also contact all carriers to determine if contracts and rates will remain the same or can be merged with existing contracts for same or better rates.

Motives: Buyers should discover the true motives for selling. While owners will offer several reasons for selling, they may not forthrightly share financial struggles, declining sales, failing relationships with carriers, or other reasons that can potentially reduced the value or price of their agency. To know the full truth, buyers will have to take the steps mentioned in this article and carefully assess whether the pieces to the puzzle fit. Any discovery that doesn't align with seller explanations should be further researched.

Finally, these steps will require an investment in both time and money, but uncovering the true state of an agency ensures buyers make the right decisions for success.

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