

MarshBerry.com 15 Key Ratios

The asterisk (*) means lowest performance is best.

Average Collection Period *

Number of Days in the Period (365) divided by Accounts Receivable Turnover

The average collection period indicates how long, on average, it takes the agency to collect receivables. The shorter this period is, the less working capital the agency needs to obtain from other sources, such as investor capital. An agency with a short average collection period, then, should be more profitable because it has a lower cost of funds. An investor would value an agency with a shorter collection period higher because this indicates an efficient staff and a well-disciplined customer base.

Cash Management Ratio *

The Sum of Aged Accounts Receivable 60-90 Days and Aged Accounts Receivable Over 90 Days divided by the Difference between Average Accounts Payable - Insurance and Average Accounts Receivable - Insurance

All other collection formulas pertain to the agency's overall handling of receivables and payables. The cash management ratio isolates the cash an agent can generate interest from (agency float) and the cash an agent can pay interest on (customer float). Agency float is the temporary cash pool created when payables exceed receivables. Since this cash difference has been collected from customers but not yet paid to insurance carriers, it should be available for temporary investment. Customer float is the cash drain an agency experiences when it must advance funds to its carriers on behalf of customers whose accounts receivable have aged beyond 60 days. In essence, the customers are floating on agency cash. The agent must borrow this money from either the agency float, working capital, retained earnings or a bank. In any event, potential investment income is lost. Agencies having very high (poor) cash management ratios and little working capital are in great peril.

Contingent Consistency Ratio

The current year's Contingent Income as a Percentage of the current year's P&C Commissions divided by Contingent Income for Two Years (this year and last year) as a Percentage of P&C Commissions for Two Years (this year and last year)

Here, contingents as a percentage of P&C commissions for the current year are compared to contingent incomes percentage of P&C Commissions for the past two years. If this ratio is greater than 1.0, then Contingents are up from the prior year as a percentage of P&C Commissions. If the ratio is less than 1.0, then Contingents are down from the prior year as a percentage of P&C Commissions.

Defensive Interval (Days)

The Difference between Average Total Current Assets and Average Total Current Liabilities divided by the result of Total Expenses divided by 365

The obligation of agencies to make cash expenditures before the cash from customers flows in to cover these expenses creates a need for working capital. Working capital is defined as current assets minus current liabilities. How much working capital an agency needs depends upon its cash collection abilities. Good collectors generally need enough working capital to cover expenses incurred over a 30-60 day period while poor collectors generally need 60-90 days working capital. The defensive interval measures how many days of working capital an agency has. Compare your

The defensive interval measures how many days of working capital an agency has. Compare your defensive interval to your average collection period to determine whether your agency maintains an appropriate level of working capital.

No absolute guideline can be established to determine appropriateness because too many other factors influence an agency's cash needs. However, a "rule of thumb" range might indicate 90 days of working capital necessary with a receivables ratio of 1.0 and 30 days necessary at a .50 receivables ratio.

Employee Marginal Profitability

Revenue per Employee minus Total Payroll per Employee

This is a meaningful measurement of productivity since the marginal profitability is the contribution per employee to the overhead and profit of the agency. To improve this ratio either revenue per employee must increase, payroll per employee must decrease, or a combination of both must be achieved. This is a better measure of productivity than revenue per employee as it reflects the payroll expense of the agency and isolates the contribution to overhead and profit by each employee. In short, it measures the worth of their efforts rather than the mass of their efforts.

Non-Compensation Expenses as a Percentage of Total Commissions & Fees

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The Sum of Total Selling Expenses, Total Operating Expenses and Total Administrative Expenses divided by Total Commissions & Fees

Non-compensation costs within an agency essentially represent overhead, a critical cost to control. This percentage should decrease or, at worst, remain relatively stable over time. If not, the agency is failing to realize economies of scale.

P&C Servicing Cost per Dollar of P&C Commission *

Servicing Costs (Service Payroll plus Total Operating Expenses) divided by Total Service Personnel. The result is multiplied by Total P&C Service Personnel and then divided by P&C Commission Income.

The result measures the agency's ability to leverage its cost of service against the overall productivity performance of personnel. In most agencies this cost should not exceed \$.40 and in no event should a \$.50 measurement be tolerated. Close observation of this measure over time is mandatory. An increase indicates that either service payroll or operating expenses are increasing faster than P&C commissions or P&C commissions are declining relative to expense growth. Whichever is the case, this ratio can help you quickly pinpoint the problem.

Reward Ratio

The sum of Executive Payroll, Production Payroll and Pre-Tax Profits divided by Gross Revenues

This ratio measures how well an agency is satisfying the financial and growth requirements of the owners. The reward ratio provides a comparison between agencies regardless of whether the profits are paid out in various forms to owners or retained as tangible net worth. Since pre-tax profits in a privately owned agency are normally only an indication of how much the agency chooses to retain, the real reward of ownership is better illustrated by adding executive and production payroll. This is truly the short-term rewards to those producing results.

Aside from family and lifestyle considerations, the two most important goals an agency owner can have are short-term return on investment and long-term return on investment. We have just discussed the short-term reward. Long-term returns (maximum fair market value when an owner's

interest is sold or transferred) can be measured similarly. Perhaps the best indicator of the probable return to a prospective owner is the actual return to an existing owner. Think about it. Then concentrate on maximizing both returns.

Support Staff as a Percentage of Total Employees *

Support Personnel divided by Total Personnel

This ratio measures the relationship of an agency's support personnel to total agency staff. It is another method for measuring either the productivity or staffing adequacy of support personnel.

Tangible Net Worth Ratio

Average Tangible Net Worth divided by Net Revenues

The ultimate measure of an agency's balance sheet stability is its tangible net worth. Tangible net worth (TNW) is the well from which future capital investments must be drawn and from which future growth will be financed. It is therefore critical to maintain a TNW balance in some proportion to the agency's size as calculated by dividing net revenues into TNW. As is the case with working capital, tangible net worth is an essential part of the agency's value. It assures continuity of capital from an investor's standpoint and therefore translates to stability.

A great number of investors in the marketplace (most notably the national brokers) maintain a TNW to Revenue Ratio of 30% or more. Were they to place a value on any agency, it would be expected that the seller's balance sheet have equal ratio strength to that of the buyer. In the absence of such parity, a debit to value would occur.

Total Commissions & Fees Growth Rate

The Difference between Total Commissions & Fees This Year and Total Commissions & Fees Last Year divided by Total Commissions & Fees Last Year

This calculation illustrates an agency's growth in Total Commissions & Fees. Total Commissions & Fees includes Life & Health Commissions, P&C Commissions and Fee Income.

Total Commissions & Fees per Employee

Total Commissions & Fees divided by Total Personnel

This calculation eliminates the unpredictability of contingent and investment income to measure overall agency productivity. Thus, this is a truer measurement for evaluating agency productivity and is easier to monitor improvement and make comparisons to other agencies.

Total Commissions & Fees per Production Person

Total Commissions & Fees divided by Total Production Personnel

Total P&C commissions, fees and life & benefits per production person is a consistent measure which allows for comparison of producer productivity from one agency to the next. Producers or owners who are effectively delegating their servicing load should have higher than average performance in this area. As is the case with many such measurements, results may also be dependent upon the size of an agency's average commercial account. Using commissions and fees as a measurement base is far more reliable than using net revenues as a base. Net revenues include income items generally influenced by changes unrelated to employee performance. To properly analyze production personnel productivity, these income items (contingents, investment earnings and

miscellaneous income) should be removed from the measurement base. What remains is the core of an agency's business.

Total Commissions & Fees per Service Person

Total Commissions & Fees divided by Total Service Personnel

The result of this calculation focuses on productivity of the service personnel by allocating all commission and fee income to each service person.

Trust Ratio

The Sum of Average Cash, Average Investments and Average Accounts Receivable - Insurance divided by Average Accounts Payable - Insurance

The trust ratio measures an agency's ability to meet account current payments owed to the insurance carriers. An agency should strive to maintain a trust ratio of 1.0 or higher. A trust ratio below 1.0 indicates a shortage of funds needed to meet payments to carriers.