

An Ongoing Debate — Big Books or High Growth?

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An ongoing debate among some agencies asks which of the following situations is preferred: having producers with a larger-than-average book of business, or having producers who focus on new business growth resulting in significantly higher-than-average internal growth. To settle this “Great Debate,” Marsh/Berry and Co. conducted a study comparing the results of these two types of agencies. Before we discuss the results, however, it’s important to understand each group’s profile.

Group 1, “Big Books,” includes those agencies where the average amount of commercial lines commission handled by each producer exceeds \$400,000. Commercial lines is the primary revenue source for most agencies. For agencies in our database, commercial lines commissions represent, on average, 60 percent of revenues. Group 2, “High Growth,” consists of agencies that had internal growth in commercial lines of 15 percent or greater. It’s important to note that the growth criteria used to form the High Growth group looked at internal growth only; the group doesn’t include agencies that grew as a result of an acquisition or merger.

things that stand out. The first are growth rates, but this was a point of differentiation in forming the groups. Another is revenue per employee, but the Big Book agencies are more productive because of the effectiveness of the producers — the criterion used to form this group. The one that needs further investigation is pre-tax profit, since the High Growth Group’s pre-tax profit percentage is four percentage points higher than the Big Book agencies’. This is mainly due to Total Payroll

Which is better?

To answer this question, let’s look at some statistics. Table 1 compares items from the Big Book and High Growth Groups’ respective income statements as a percentage of revenues. Table 2 illustrates some other common statistics for the agency groups.

The information in Tables 1 and 2 shows very few differences between the two groups. The mix of business is similar and most of the income statement items as a percentage of revenues are the same or very close. There are, however, a couple of

Table 1 - Comparison of Income Statement Items

Ratio	As a percent of revenues	
	Big Book Group	High Growth Group
Commercial Lines Commission	64%	60%
Personal Lines Commission	5%	7%
Life & Health Commission	17%	16%
Contingent Income	6%	6%
Total Payroll	55%	52%
Total Benefits	9%	8%
Total Selling Expenses	4%	4%
Total Operating Expenses	17%	17%
Total Administrative Expenses	4%	5%
Pre-Tax Profit	7%	11%

Table 2 - Common Statistics

Ratio	As a percent of revenues	
	Big Book Group	High Growth Group
Revenue per Employee	\$115,100	\$94,800
CL Commission per CL Producer	\$550,400	\$358,600
CL Commissions per CL Service Person	\$200,900	\$213,200
Total Commissions & Fees per Service Person	\$196,100	\$178,000
Total Commissions & Fees Growth Rate	9%	23%
Commercial Lines (CL) Growth Rate	8%	18%

since most of the other expense percentages are the same or similar.

When looking at the payroll categories that make up total payroll — executive, production, service, and support — service payroll for the High Growth Group is three percentage points lower than for agencies with producers who handle Big Books — 15 percent versus 18 percent. The remaining payroll categories — executive, production, and support - are the same, or are slightly lower for agencies with Big Book producers.

As a result of further investigation using our database, service personnel payroll as a percentage of revenues is lower for two reasons. First, High Growth agencies, on average, pay their service personnel less — \$30,000 per service person — where the Big Book Group pays an average of \$37,600. In relationship to the books of business handled by each group of service personnel, High Growth service personnel receive 17 percent of commissions and fees handled, compared to 19 percent for the Big Book agencies. Second, Big Book agencies have more customer service personnel as a percentage of total personnel (55 percent) than the High Growth Group (51 percent).

What does this mean?

Agencies that have producers with Big Books of business have built an infrastructure to support their ability to handle those books. These agencies have fewer producers and have more highly paid service personnel. It is also more likely there are account executives assisting the producers. Big Book agencies also write larger accounts than the High Growth agencies, since their average commercial lines account size is \$3,800 versus \$2,200 for High Growth agencies. The result is that producers in agencies with Big Books (handle bigger books of business) receive a higher average payroll — \$155,500 — than the producers in the High Growth agencies — \$97,300. However, Big Book agencies have slower growth and less pre-tax profit as a percentage of revenues, which is illustrated in Table 2. So, which is better?

In our opinion, the best way to measure the better situation is to compare the Reward Ratios, illustrated in the graph below. If you recall, this ratio measures how well an agency is satisfying the financial and growth requirements of the owners. It 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 reward to those producing results.

High Growth agencies have a higher Reward Ratio, although their average payroll per producer is lower, for a couple of reasons. First, there are fewer producers in Big Book agencies than in the High Growth group, while production payroll as a percentage of revenues is about the same for both groups — 25 percent. This means that about the same amount of payroll, on a relative basis, is being spread across more producers in the High Growth Group than in the Big Book agencies. In addition, after conducting further research with our database,

we found that High Growth agencies had more new producers (producers who have been with the agency less than three years) than the Big Book agencies. This explains why High Growth agencies have more growth and why payroll per producer is lower.

Neither situation, however, is really better than the other, since these two groups represent stages that an agency can go through. That is, the Big Book Group represents agencies that have producers with mature books of business and a service personnel infrastructure to support it. Sooner or later, these agencies will need to invest in new producers if they wish to continue to grow and be successful. If this investment is not made, the agency will level off and become stagnant. With the addition of new producers, the average size of a producer's book will decline, but the expectation is that growth will be higher than average. If they do it right, these agencies will be classified as High Growth.▲

