



Cookson Walker Consulting

Facing Down Uncertainty

Are brokers on top of their own risks?

By Bruce Rabik and Eric Walker

It is often joked that doctors make the worst patients. It is also likely that insurance brokers make the worst risk managers when it comes to their own firms. Focusing all their time on the needs of the customer means that many brokers tend to ignore the risk factors associated with their own organizations.

Risk management is typically defined as the process of identifying, assessing and monitoring, and controlling risk, which minimizes loss and potentially adds value to the business.

Risk management is really about dealing with and managing uncertainty -- and faced with volatile market cycles plus the trials and tribulations of small business ownership, insurance brokers can surely be said to have more than their share of uncertainty.

Financial

Being a broker is hard work. The great temptation, therefore, is to hire more people to do the work in order to lessen the load of existing staff and to provide the best customer service possible. Having too many employees and paying them too much are probably the most common errors that brokerage principals make.

The key is to remember the “magic of 60 per cent” – that is, no more than 60 per cent of commission dollars (excluding contingents, etc.) should be spent on total people costs. There is a theoretical explanation why 60 per cent is recommended, but the important thing is that it does work in actual practice. All across Canada, the more profitable brokerages adhere to that rule. In fact, many brokerages using best practices spend less than 60 per cent, especially in government auto provinces.

Monitoring other key financial measurements, such as the working capital position (particularly in provinces where there are no requirements to self-regulate trust positions), profitability and growth is also important. However, there is risk sometimes in the way that many brokerages do that. Many simply compare financial statements for different time periods to determine the change in commission dollars, yet the current insurance cycle or local economic conditions could be masking the fact that some of these same brokerages have a static or even declining client count.

In monitoring growth, it is critical that brokers look at the change in policy count over time and the average commission on those clients. The average commission change (after discounting for rate changes) will indicate success or failure in the actual selling effort, such as cross selling and up selling.

Personal

The divorce rate is five times higher for owners of failing small businesses – as if you needed another reason to not let your brokerage collapse! That statistic reflects the fact that being the owner of an insurance brokerage can take a personal toll on your physical and mental health as well as your relationships.

When it comes to health issues, there is life and disability insurance to offset the risk but there is no coverage to deal with the consequences of a busted marriage. Besides personal turmoil, there can be considerable expense involved in dividing up marital assets, which, typically, include the brokerage.

Making your spouse at least an informal partner in your business interests can help in reducing marital stress. Many brokers have included their wives and husbands in their firms for this very reason.

Partnerships

Many brokerages have several owners/partners. It is sobering to note that business partnerships have an even higher failure rate than marriages, with breakdowns eventually affecting almost half of all business unions.

A lot of the strain in business partnerships often has to do with the real or imagined perception that one partner is not contributing his or her share, and things often come apart when that issue is not resolved. There are formulas that prescribe how to adjust owner compensation based on contribution levels, for example, but they are often ignored because of the fear of causing offense and creating more friction.

Partnerships need to be worked at somewhat like a marriage. Expectations must be communicated and common interests and values recognized. “We discussed everything except for the important things” is a common refrain in the wake of folded partnerships.

It’s important that partners share their aspirations and goals for the firm and, as a result, agree on personal and corporate targets in order to achieve those objectives.

It is especially important that all partners accept some level of accountability for those targets. That reduces the risk of misunderstandings over individual contributions. An outside facilitator for business planning or for partnership disputes can help avert the danger of such issues becoming too personal and beyond resolution.

Lonely broker syndrome

Notwithstanding the recent round of consolidation in the industry, many brokerages continue to be owned and managed by one person. These owner/managers typically spend most of their day dealing with clients and underwriters. Often, how well their brokerage’s performance measures up against other brokerages gets scant attention. Gossip and the cocktail circuit are inadequate sources for that kind of competitive information.

This lack of knowledge about brokerage performance leads to a kind of isolation. It also means that a broker may not be aware of risks to the brokerage in terms of how it is operating and what challenges must be faced given current market conditions.

Many brokers deal with this isolation by joining brokerage associations, which certainly have worthy goals. However, the correlation between direct involvement in brokerage associations and the performance of one's own brokerage is often negative. That is, the time working for the association is time not spent on clients, prospects and the brokerage in general.

It does not have to be that way. Brokerage associations could perhaps do a lot more for their members by spreading knowledge about brokerage performance and market conditions. The "best practices" program, for example, has largely failed to bring about any change in the state of knowledge about brokerage performance. An exception appears to be in New Brunswick, where many brokers have been organized into support groups around the best practices program, which is a much more effective mechanism for transferring knowledge than a one- or two-day seminar.

In fact, it appears that the best way to fight the "lonely broker syndrome" and get the scoop on brokerage performance is to join a broker self-help group. There are a number of such groups across the country, some of which have been in existence for many years. The best promote strong social connections and a sharing of knowledge. Some share financial statements, leading to meaningful conversations about who is doing better and why.

Often, such groups become advisory resources, with the members assisting each other in dealing with difficult issues, such as a choice of computer systems, structuring employment contracts and so forth. It could be argued that membership in a brokerage self-help group is almost a requirement for any brokerage practicing good risk management.

Computer systems

Computer systems typically represent the largest tangible asset that brokerages have and most are well protected with technical backup support (although one common failing is that most brokerages do not conduct test restores of their data to ensure that their backup systems are in fact working). The largest risk to brokerages related to computers (aside from a total loss of premises and equipment) is related to how they use their systems.

After making a large investment in computers most brokerages then put little into making sure that they are taking full advantage of their systems. Brokerage staff members, on the whole, receive little training and are unaware of many features.

The risk to the brokerage is that little or no return on investment is realized. It almost does not matter what system brokerages choose because so many are using only a fraction of their capabilities. The battle goes not to the broker who picks the best system but to the broker who gets the best out of whatever system is selected.

Employees

The goodwill of a brokerage (that is, what the brokerage is worth) resides in the skill and expertise of the employees in serving customers and, from a risk perspective, there are several considerations with regard to staff.

With a serious shortage of qualified people in most parts of Canada, there is significant risk in employee turnover. For instance, many brokerages are missing sales opportunities or, more seriously, losing clients because producers have inadequate support from under-qualified or overworked customer service representatives.

The best risk management technique for employee retention is to create a work environment that compares favourably with your competition. Frankly, that is not that difficult.

The most common complaints from CSRs, for example, are that management doesn't know what is going on at their level, that they are buried under paper and that they are short-staffed. Establishing standardized and structured workflows, providing sufficient resources for staff training, communicating with employees on a regular basis, and showing empathy during tough times will improve staff retention.

Staff should be paid fairly but excessive compensation is not necessary. We often relate the story of one brokerage that consistently underpaid staff but was very flexible in terms of time off, which was very much appreciated by the many employees who were the primary care givers to their children. Flexibility about what is important to staff will demonstrate empathy while creating structured work flows and procedures will reduce stress.

By practicing good risk management techniques, brokers can ensure the success of their firms and buffer themselves against hard markets, increased competition and other elements of these times of uncertainty.

Bruce Rabik and Eric Walker are senior partners at Cookson Walker.