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A CHANGING MARKETPLACE

Small Insurance Agencies Not Dead Yet, But Tide May Be Turning

2010 May Re-Spark M&A Frenzy

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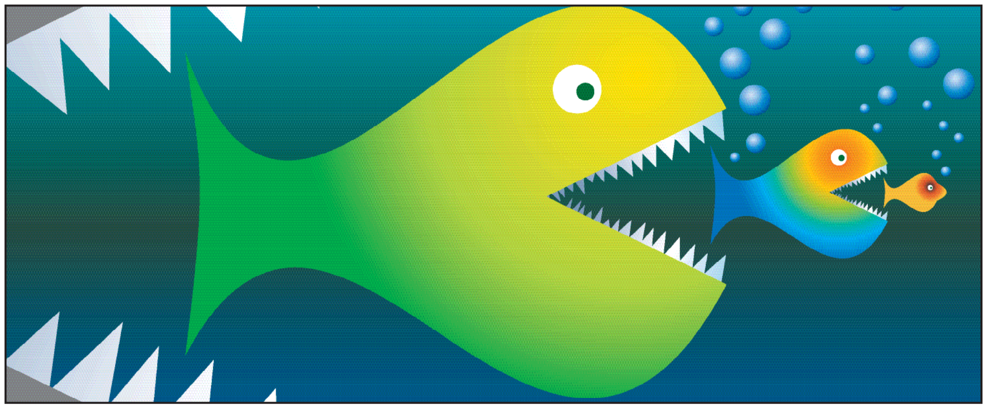

Fears of the much anticipated extinction of the small insurance agency may have been greatly exaggerated over the past few years, as the overall number of agencies in the U.S. held steady and small shops actually grew in number.

But that recent stability may be headed for a change, some consultants say, thanks to the changing marketplace for buyers and sellers of agencies. Credit is more readily available, acquisition prices are likely to get pushed up thanks to increased demand from buyers, and selling is more attractive now because of tax levels set to jump up by year's end.

These factors, combined with the perennial reasons leading to constant predictions of small-agency death – including a graying industry and increased competition from direct writers and giant competing agencies and brokers – may finally lead to more of those predictions coming true.

Content To Coast

For smaller shops – those with maybe four or fewer employees who bring in $400,000 in commission revenue a year – the market just wasn't right to sell for the past few years, said Everett Shaw, partner with Westbrook insurance consultancy B.H. Burke & Co. Inc.

In the early part of the decade, banks' interest in insurance was high, and they were buying agencies frequently and pushing up prices. But interest had waned more recently, leading to a dropoff in values. In addition, the larger merger market cooled after a fast and furious spate of deals from larger brokerages, he said.

Until very recently, it often made more sense for these small shops to hold out, keep coasting on their existing book of business, and wait for acquisition prices to go up.

"A lot of times they're saying, 'Eh, why don't I just hold onto this thing for a few more years,'" Shaw said.

That attitude, at least in part, may have behind the most recent stats on independent property/casualty agencies nationwide. The Independent Insurance Agents & Brokers of America's (or "Big I") most recent study, in 2008, showed that the number of agencies fell almost 15 percent in the decade between 1996 and 2006, to 37,500 from 44,000. But from 2006 to 2008, the number held steady.

But that stability may be short lived. Christopher Hughes, Hartford-based director of insurance distribution for New York-based Merger & Acquisition Services Inc., said he has already seen the number of deals pick up toward the end of 2009 and in the first quarter of this year.

CHRISTOPHER HUGHES

"Last year was a real tough year for everyone," he said. "The market was down, the valuation multiples [estimated selling prices] were down. Private equity firms weren't buying, bankers weren't buying – it was a real tough year."

'A Better Time To Strike'

Now, agents looking to sell have a strong incentive in the form of the capital gains tax, the tax agents must pay on profits from the sale of their agencies. The tax is currently set at 15 percent, but is due to jump to 20 percent this year unless it is extended by the Obama Administration. That 5 percent makes a big difference for potential sellers, Hughes said, who will have to pay a lot more if they wait until next year.

Other factors have made this a better time, he added. He agreed with Shaw that banks' yen for insurance had helped push prices up previously, as well as brisk interest from larger insurance brokerages.

Banks may have mostly lost interest in the insurance business, but there's evidence that bigger brokers are moving back into expansion mode. Brokerage juggernaut Marsh & McClellan has made major purchases in every month since November. That interest from larger players might be a sign of a revved-up market, and their interest will likely help push acquisition prices up again.

For agents looking to sell, "now will be a better time to strike," Hughes said.

Warren Ruppar, president of the Independent Insurance Agents of Connecticut, agreed that the past few years have been stable, with many agents choosing to hang on to their businesses. Start-ups have also helped the industry hold steady.

The 2008 national report from the Big I showed small agencies made up 17 percent of all agencies nationwide, up from 12 percent in 2006, reversing the consolidation of previous years.

The report speculates that, because many of these new shops popped up in coastal areas, they were formed to fill gaps when major insurers and their non-independent agents pulled back from the risk-heavy seaside. Also, agents who may have been acquired in earlier years may have started their own independent shops after their non-compete clauses expired.

Big I also has a program, called Eagle Agency, in which agents looking to go out on their own can work through the association's connections to establish their own book of business before launching their own agencies, Ruppar said. That helps give agents a leg up when starting out – especially since starting any business is not an easy venture, he said.

But as for the imminent death of small agencies, Ruppar said it's not a new prediction.

"I've been hearing that for 30 years." ■

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