

WHO HAS THE GREENER GRASS?

A Comparative Look at the Allstate, State Farm, and Independent Agency Opportunities from the perspective of the Agency Owner

Ownership – Who has the best deal?

At a gathering of insurance professionals there would likely be as many answers to this question as there are agents in the room. This because to some degree comparing the ownership demands, overhead structure, profitability, risks, opportunities, etc. of owning an independent agency, an Allstate agency, and a State Farm agency is very much like comparing apples and oranges. Just as the old saying “America and Britain are two countries separated by a common language,” so too are these various venues for insurance agency ownership separated by a common product.

The point is that just because it is neat and easy for a wishful neighbor to look at the yard next door and observe that its commission rate is better (thus its proverbial grass is greener) does not make this relatively simplistic observation true. For instance, what if our wishful neighbor were to find out that he would have to be willing to work roughly 12 hours a day, or tolerate 70% overhead, or deal with multiple insurance carriers and their multitude of forms and processes, or would not be allowed to sell his agency at retirement? A good bet is that he might begin to see that his narrow commission observation comes with a lot of undesirable strings attached. It brings to mind another old saying, “You don’t get something for nothing.”

Within the Allstate Family one will hear a good deal of talk regarding agency ownership and commission opportunities outside of Allstate. In particular it seems opportunities involving independent agency ownership and ownership of a State Farm Agency are popular focuses of discussion. However, my gut tells me that the full experience of being an Insurance Agency Owner cannot be fully appreciated by simply looking at the base commission rate received by an individual agent.

Since my interest was piqued, I took a stab at comparing what I see to be the three main agency ownership opportunities in the market today. The three ownership opportunities are:

Allstate (10% base)

State Farm (8% base)

Independent Agency (15%)

What am I trying to accomplish with this article? Well, after lending \$500 Million to over 1,000 Allstate Agents for agency purchases, I have a strong knowledge of the Allstate opportunity. So, I wanted to take this

CONTACT THE AUTHOR

Paul Clarke, Executive VP and COO | (800) 456-2779 | paul@ppcloan.com

opportunity to learn more about the independent agency and State Farm Agency ownership opportunities. Most importantly though, I wanted to get a feel for which opportunity is the best. And by best I mean the best to me. Certainly, everyone will have their own opinion of which opportunity is the best for them.

My personal expectations for what makes a good ownership opportunity for any business are:

- I want to make money (profit) in step with my efforts
- I want it to be easy to get in and out of the business (easy to start and easy to sell)
- I want the business opportunity to be within the framework of a true entrepreneurial opportunity. My definition of entrepreneurial opportunity is:
 - I have the freedom to manage business operations as I see fit
 - The business should be an asset on my balance sheet – meaning I can sell it at market value at anytime
 - I want the upside potential to be in step with the downside risk associated with owning a business

So, if you are considering entering the Insurance business, and can't decide which opportunity is right for you, I hope this article helps just a little. If you are currently an Agent with Allstate, State Farm or an Independent Agency owner, I hope this article gives you some comfort or clarification about whether or not the grass is really greener on the other side.

Let's start by taking a quick look at some basic Background information on these three opportunities. In each section, I will give my own personal grade (A – F) based on how the opportunities did or did not meet my criteria listed above:

OVERVIEW:

	# AGENTS	CONTRACT	CONTRACT RESTRICTIONS	BASE COMP.	PROFITABILITY	TAX STATUS
ALLSTATE	10,000	R3001	Exclusive	10% + Bonus	50% to 65%	Ind. Contractor
STATE FARM	17,000	AA05	Exclusive	8% + Bonus	40% to 65%	Ind. Contractor
INDEPENDENT	37,500	Var. Carriers	Independent	12 - 15%	28.5%	Owner Choice

CONTACT THE AUTHOR

Paul Clarke, Executive VP and COO | (800) 456-2779 | paul@ppcloan.com

Although Base Commission Percentage is important, clearly a 50% commission is of no consequence if the business has 99.5% overhead. So the next factor to be considered in determining the relative value each ownership opportunity offers is the average base overhead expense required to operate the business.

Essentially an Owner must ask the ultimate question any business owner must ask - "How much money will I make?" The above chart shows "Profitability" which represents the amount of discretionary cash flow available to the owner after all necessary operating expenses to run the business have been paid (not including debt service).

With regard to business profitability, Allstate and State Farm have a significant edge on Independent Agency Owners. This is due in large part to the staffing costs of an Independent agency typically running at just over 50% of revenues.

For me, Allstate is superior to State Farm with regards to commission income and profitability, and it comes in the form of a more consistent Base Commission Percentage. Allstate Agents currently get a base commission rate of 10%, which provides a higher degree of income stability, and subsequently a more consistent profit margin over those State Farm Agents who receive a base commission of 8%.

When Allstate modifies its base commission to 9% starting in 2013, this will serve to bring more instability to the income and subsequently the profitability received by Allstate Agency Owners, as a greater portion of income will be shifted from fixed compensation to contingent compensation. On the other hand, instability is not always bad as some agents will be surprised to receive more income than they previously expected. At the end of the day, I feel the majority of Allstate Agency Owners will adapt nicely to a 9% base commission rate as this change in compensation will likely not result in any wild swings in income that would affect Allstate Agents' ability to efficiently operate their business.

With regard to Contract Restrictions, Independent Agency Owners have the most flexibility to shop a client's business within their various suite of carriers. Allstate and State Farm agents are exclusive and must live with the current price of their suite of products as set by their exclusive carrier.

***Independent Agency Owner's Profit listed above was taken from the Insurance Agents & Brokers of America annual Best Practice Study, which shows the average adjusted profit for Independent Agents with Revenues under \$1,250,000 to be 28.5%.

CONTACT THE AUTHOR

Paul Clarke, Executive VP and COO | (800) 456-2779 | paul@ppcloan.com

AUTHOR’S GRADES (OVERVIEW):

Allstate Insurance = B+

State Farm = B

Independent = C

GETTING IN THE BUSINESS

	APPROVAL	INTERN PERIOD	PROBATION PERIOD	PURCHASE?	START-UP?
ALLSTATE	Interview Process	No	No	Yes - Free Market	Approved Location
STATE FARM	Interview Process	9 Months	12 Months Min.	No	Approved Location
INDEPENDENT	Apply to Carriers	No	No	Yes - Free Market	Anywhere

When it comes to getting into the business, Independent Agency Ownership gets an “A.” There are many companies available to assist a new agent with regards to signing with carriers, picking a location or purchasing an agency. Often, the only barrier to purchasing a positive cash-flowing Independent Agency is an absence of quality third-party bank financing.

With Allstate, once you become an approved buyer, you can negotiate and purchase any agency you desire, or you have the option of opening a start-up agency at a location to be approved by Allstate. You sign the R3001 contract to be an agent prior to your first day open, so there is no internship or probationary period.

In my opinion, State Farm has some significant weaknesses with regard to getting into the business. Once you are an approved agent with State Farm, you cannot simply purchase a positive cash flowing agency. If a desirable agency comes available, you can put your name in a hat and then cross your fingers and hope State Farm selects you for this opportunity. It might even be the case that State Farm assigns you only a portion of the agency you desire, while giving a portion of the agency to other State Farm agents.

As a State Farm Agent, if you are selected to operate an existing agency or choose to a start-up, you must first complete a nine month internship. At the end of the intern process, you may be terminated; however, if you successfully complete the intern process, then you become a TICA (Term Independent Contractor Agreement) for a period of one year. This is essentially your probation period, where State Farm judges your performance as an agent. If you meet their standards, you become an actual State Farm Agent and sign an

CONTACT THE AUTHOR

Paul Clarke, Executive VP and COO | (800) 456-2779 | paul@ppcloan.com

AA05 contract, which signifies you are now an agent with State Farm. If you fail to meet expectations during your TICA period, State Farm reserves the right to terminate your TICA contract and not promote you to an agent. This can be very painful financially, as TICA agents have already signed a lease and often taken on debt to cover business operations, along with purchasing the necessary furniture, phone and other equipment to run their agency.

AUTHOR’S GRADES (GETTING IN THE BUSINESS):

Allstate Insurance = B+

State Farm = F

Independent = A

GETTING OUT OF THE BUSINESS

	ABILITY TO SELL	EASE OF TRANSITION	SALES PRICE?	CASH AT CLOSING?	TRAILING BENEFITS?
ALLSTATE	Yes	Medium to High	2.5X Commissions	75% to 100%	No
STATE FARM	No	Low	\$0	8% + Bonus	Defined Benefit
INDEPENDENT	Yes	Medium to High	1.5X Commissions	0% - 10%	No

In a SURVEY* of Independent Agency owners who purchased an agency, only 15% borrowed money from a bank. Three times this amount utilized seller financing, while the remaining sales were consummated with cash, stock or other collateral sources. Getting out of your Independent Agency seems easy on paper, however, with the risk of little to no cash being received at closing, this decreases the value of Independent Agency Ownership based on my desire to have an Entrepreneurial Opportunity that is easy to get out of.

With Allstate Insurance, Agents are regularly selling their agencies for 2.0 to 2.5 times Commissions and are receiving the bulk of the sales price in cash at closing. The availability of bank financing is relatively strong for Allstate Agents, so true value is often transferred in the form of cash at closing from Buyer to Seller. As a worst-case liquidation value of the business, Allstate will purchase the agency back from the agency owner for 1.5 times qualified commissions (Termination Payment Provision or TPP Value). Only 90 days’ notice is required for agents to put their agency back to Allstate. This represents a very unique base floor value, which may often allow an agent to get cash for their business in excess of what an Independent Agent may receive

CONTACT THE AUTHOR

Paul Clarke, Executive VP and COO | (800) 456-2779 | paul@ppcloan.com

without any hassle of finding a buyer or going through the sales process.

State Farm has essentially a “Defined Benefit Plan”, which they call the Annual Investment Payment Program (AIPP). There is a five-year vesting period, and then a percentage of your commission is returned to you in year seven, based on year six performance. These in arrears payments can be received for up to 20-years, so long as the individual remains an agent with State Farm during the entire time period. To me, this plan seems more like a bonus program as agents do not continue to receive additional contributions to their retirement from State Farm once they reach retirement age.

*The SURVEY was produced in the book “Maximizing Agency Value II,” produced by the Academy of Producer Insurance Studies.

Furthermore, State Farm Agents have no ability to sell their agency. This has resulted in many State Farm agents hanging on to their agencies well past their desired retirement age as they don’t have the opportunity to cash in their years of hard work for a lump sum transition sales price.

AUTHOR’S GRADES (GETTING OUT OF THE BUSINESS):

Allstate Insurance = A

State Farm = C

Independent = B

OTHER BUSINESS ASPECTS

	TERMINATION	SUPPORT	CORPORATE AD SPEND	SALES EXPECTATIONS	PRODUCT MIX?	FLEXIBILITY
ALLSTATE	With/Without Cause	Extensive	\$32,000 p/Agent	Yes	Bonus contingent	Low/Medium
STATE FARM	With/Without Cause	Extensive	\$30,000 p/Agent	Yes	Required	Low
INDEPENDENT	Carrier Discretion	Extensive	None	Yes	Owner Discretion	High

With all three business opportunities, carriers can terminate your contract with or without cause at any time. This means more risk for Allstate and State Farm Agents as they are both exclusive with a single carrier. In

CONTACT THE AUTHOR

Paul Clarke, Executive VP and COO | (800) 456-2779 | paul@ppcloan.com

my experience, both State Farm and Allstate have been relatively consistent and conservative in using their rights to terminate agents.

All three business opportunities also come with Sales Expectations from their carrier(s). Bonus money and trips are at stake, along with the ability to stay with the carrier if base sales goals are not met for extended periods of time.

State Farm is a little unique with regards to the product mix as State Farm agents are not only expected to sell P&C / Life, but also Health Insurance, Mutual funds, and various banking products (through State Farm Bank), including auto loans, CD's and saving accounts.

At the end of the day, Independent Agents possess the most freedom and flexibility to run their business how they see fit. Independent Agents can set their own hours of operation, can choose to sell or not sell any product, they staff in accordance with their own standards, market at their own discretion, and can move a customer to another carrier if it benefits themselves and their customer.

Support for the individual agent is very strong at both Allstate and State Farm. Not only does each of these two major carriers provide various levels of management whose sole job is to assist the agents, each of these major carriers spends millions of dollars in advertising each year without charging a franchise fee to the individual agent. Per the

J. D. Power and Associates Insurance Information Institute, State Farm spent approximately \$30,000 per agent in 2009, while Allstate Insurance spent approximately \$32,000 per agent during the same time period. In contrast to Independent Agency owners who shoulder 100% of their advertising burden, the spending by Allstate and State Farm allows the individual agents to realize strong close rates in price proxy markets, while maintaining very profitable businesses.

AUTHOR'S GRADES (OTHER BUSINESS ASPECTS):

Allstate Insurance = B

State Farm = B-

Independent = A

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Paul Clarke, Executive VP and COO | (800) 456-2779 | paul@ppcloan.com

FINAL ANALYSIS

ALLSTATE INSURANCE:

Pros:

- Very Profitable Businesses Model
- Relatively Easy to get in and out of the business
- Financing Readily available
- Corporate Support / Marketing
- Worst case liquidation value of agency is 1.5X qualified commissions back to Allstate

Cons:

- Exclusive Agreement with Single Carrier
- Some Restrictions on business management & product mix sold

INDEPENDENT:

Pros:

- Freedom to Manage Business Operations
- Very Easy to get in the business
- Can shop clients with various carrier relationships

Cons:

- Lack of Consistent / Quality Financing Available, which often results in true value not always transferred at the time of closing in the form of cash from buyer to seller
- Not as profitable to the agency owner as Allstate or State Farm

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Paul Clarke, Executive VP and COO | (800) 456-2779 | paul@ppcloan.com

STATE FARM:

Pros:

Relatively Profitable Business Model
Corporate Support and Marketing

Cons:

Hard to get into the business
No Ability to Sell the business
Little reward at the time you get out of the business
Restrictions on business management & product mix sold

If I had to rank these three opportunities based on my guidelines listed above, here would be my list:

1. **Allstate Insurance**
2. **Independent Agency Ownership**
3. **State Farm**

When looking at State Farm I really don't see Agents as truly owning their businesses. Yes, State Farm Agents get paid as independent contractors, but they never have the ability to sell their business. In theory, they can never truly actualize the effort they put in to grow their business. Would you borrow money to spruce up a house you were renting? I do not understand why State Farm Agents take on debt to operate a business they truly rent and will never own. State Farm simply just doesn't meet the sniff test when it comes to a true entrepreneurial opportunity.

For me the dollars and cents associated with owning an Allstate Agency outweigh the freedoms that Independent Agency Owners have. With Allstate, I like the profit margins Agency Owner's realize. With the right sized agency and good expense management, it gives the owner an opportunity to substantially save for the future. This strong profit margin also gives Allstate Agents the ability to weather through times, assuming the individual agent is not spending all of their take home pay during the good times. Being frugal is always recommended in any of these business opportunities.

CONTACT THE AUTHOR

Paul Clarke, Executive VP and COO | (800) 456-2779 | paul@ppcloan.com

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“Maximizing Agency Value II,” produced by the Academy of Producer Insurance Studies.

Insurance Agents & Brokers of America annual Best Practice Study.

J. D. Power and Associates Insurance Information Institute



Paul Clarke, Executive
Vice President and COO
Phone: (281) 419-0400
Email: paul@ppclean.com

CONTACT THE AUTHOR

Paul Clarke, Executive VP and COO | (800) 456-2779 | paul@ppclean.com