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Get your ducks in a row

Ten mistakes owners make when selling an agency

Selling your insurance agency is a big decision. There are many things to consider including timing, price, the ideal buyer, structure of the deal, client retention, impact on your employees and your role after the sale. It took you years to grow a successful business. You should devote enough time and energy to selling it to ensure that you maximize the value of your life's work. Although most agency owners know this, many do not take the necessary action to plan for the sale of their business, and therefore make avoidable mistakes. Here are the most common things agency owners do *not* do.

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No 1: They do not plan far enough ahead for the sale. Most merger and acquisition advisers recommend that owners start planning for the sale of their business at least five years before they would like to sell. If you do this, you may be able to increase the value of your business; earn more money on the sale; or reduce the amount due in taxes. For example, a C corporation may find it advantageous to convert to an S corporation for tax purposes. Electing S corporation status will eliminate the double taxation problem that C corporations face during an asset sale. However, per IRS regulations there is a five-year transition period before the owner can receive full S corporation treatment for assets sold and avoid the "built-in-gains" tax. If you fail to make this change in advance, you may not receive the full benefit of changing the business structure. At least a portion of the gain on the sale will be subject to taxation at both the corporate and individual level if the sale is completed in less than five years of the S election.

No. 2: They do not hire professionals. You can save a lot of time and money by having the right team working with you on the deal. Doing so will help you to be better prepared and know what to realistically expect during the sales process. This includes an M&A consultant, lawyer and accountant with experience in the insurance industry. For planning purposes, it is important to get your accountant involved early in the process. There can be tax consequences of the timing of the liquidation of the corporation. For example, often a liquidating S corporation will sell some of its assets on an installment basis. If the installment obligation is distributed to the shareholders, it is treated as a disposition of the obligation at its fair-market value, which accelerates gain recognition. However, there is an exception to this rule. If the sale, from which the installment obligation arises, happens during the 12-month period on the date the plan of liquidation is adopted, and the liquidation is completed during the 12-month period, the S corporation does not recognize the gain or loss when the installment receivable is distributed as part of the liquidation process. If the seller takes advantage of this exception, gains on the installment proceeds will not be recognized until payments are collected. If your accountant is not aware of the sale until after it occurs—and a plan of liquidation has not been adopted and submitted to the IRS before the sale—you will not be able to take advantage of this exception.

No. 3: They do not understand the factors that will determine the buyer's offer. Most agencies will sell within 1.25 to 2 times their revenue. Although a buyer's offer may seem within the normal range, it does not mean you should not evaluate whether the offer is fair. Buyers take a lot more than revenue into consideration. For instance, they will look at the lifetime value of your clients—the higher the expected client retention rate, the higher the multiple. Employment contracts will be reviewed, as well as team performance indicators and closing rates. Underwriter and supplier relationships will be analyzed to determine if you are on good terms. Your facility and technology platforms will be assessed. They will review your accounting systems and methods to determine if they are compatible with their own systems. Financial statements and audit reports will be scrutinized. Relationships with banks and lending institutions will be examined. A buyer's assessment of the health and well-being of your agency will affect the offer. Owners can lose a lot of money by not questioning a buyer's perceptions.

No. 4: They do not have a proper business valuation. Ensure that you know what the real value of your agency is so you set realistic goals and can maximize the value when you put the deal together. Having a valuation performed by a firm with experience working with insurance agencies and brokers is one of the first steps you should take. This will give you a realistic picture of what buyers are really paying in the current environment, as well as what your agency is worth. Since most valuation reports include a comparison of what similar agencies are worth in your geographic region, you will have a point of comparison. Asking for an unrealistic price may kill a deal before it gets started. On the other hand, you also do not want to leave money on the table.

No. 5: They do not conduct an operational review. Review your policies, processes, procedures and contracts. The valuation could have identified areas for improvement or potential issues that could arise during a sale. Focus on fixes to increase the value of your business. Take the time to identify risks and vulnerabilities while there is still time to address them. The value of your agency can decrease based on the age and employment status of key employees and top producers; dependency on large accounts; industry niches or carriers; overreliance on certain insurance markets; key performance indicators; contracts and leases; as well as many other factors such as the building facility and technology.

No. 6: They do not time the sale based on market conditions and contingent commission payments. Owners will make more money and receive more favorable terms in a seller's market than a buyer's market. If there are too many agencies for sale, offers will be lower than you may want. On the other hand, if your agency is one of the few agencies on the market in a highly desirable area, you may be able to structure a much better deal. Regardless, never rush into a close. You must take the time to assess the offer; conduct due diligence; and consider if you want to seek additional potential buyers. In addition, consider the timing of sizable commission payments. Whenever possible, ensure they are paid to you before closing on the sale. If this is not possible, your agreement with the buyer must clearly specify who has the right to contingent commissions received after the effective date of the sale.

No. 7: They do not find the right buyer. It's important to do a compatibility analysis to ensure that the buyer is a good match, that he or she has similar expectations, and he or she shares your philosophy on running the business. Selling your business to someone who will change the company's culture could have a negative impact on client and employee retention. Since most agency-sale agreements are based on retention, losing clients or key employees could reduce the amount of money you earn. Reduce the risk of this happening by making sure the buyer knows how to meet or exceed expectations, as well as the importance of delivering on-brand experiences. You should also have employment agreements so key employees stay on after the sale.

No. 8: They do not confirm the owner's role in the business after the sale. Consider selling a few years before you want to retire or leave the agency to ensure a successful transition of ownership and your book of business. This also will help to secure the funding of your retirement. Often the buyer will enter into an employment agreement with the seller to guarantee that the seller will be around (for two to five years) to transition the business. Staying involved in the agency is important to retention. Have your role clearly defined in the sales agreement, as well as your exit strategy. If possible, do not give up the authority to make or, at least have input on, business decisions particularly if they affect retention. Work closely with the new leadership team to make certain that changes are in alignment with your agency's culture, operating procedures and policies. Most buyers will want you to sign a noncompete agreement, which will limit your ability to work in the insurance business for a specific number of years in your geographic region. Consider your personal and professional needs before signing such an agreement to ensure you are not prohibited from earning a livelihood.

No. 9: They do not get tax advice from a certified public accountant. There are many ways to structure a deal to minimize the tax impact for both the buyer and seller. A CPA with experience in the insurance industry will know the best approach to take to reduce your tax obligation. For example, if an escrow is set up as part of the sale, the structure and wording of the escrow agreement will determine if the escrowed amount can be deferred under the installment sale rules. Or if it is a stock sale, a section 338(h)(10) election can be made. This election is to the buyer's advantage because the sale is treated as a hypothetical asset sale for tax purchases. The buyer gets the benefit of recording assets acquired at the purchase price and depreciating or amortizing assets acquired including goodwill. Conversely, a section 338(h)(10) election often will be a disadvantage to the seller, resulting in higher taxes. If the buyer has requested that such an election be made, the seller will want the purchase price to be increased to cover the additional taxes. Advice from your accountant as to the additional amount needed will be crucial in this type of situation. You also should review how the buyer wants to handle contingent commissions closely. The agreement may call for the buyer to have the right to collect and retain contingent commissions received after the effective date of the sale. If this is the case, you will want to time the sale so that the majority of contingent commissions received are paid to you prior to the sale date.

No. 10: They do not structure the deal. Most deals are asset transactions based on the retention of business. Owners should use caution to limit their exposure. What took you a lifetime to build up can be destroyed if the deal is not structured properly. You will want to make sure the retention period is reasonable and that there is a good plan of transition to reduce the risk of a mass exodus of your clients and/or employees. Larger buyers also may want to reduce their risk and limit the cash outflow of a purchase by paying all or part of the sales price in stock instead of cash. If this is the case, you will need to consider the overall financial health of the buyer and whether the shares of the purchaser are privately held or traded on a public stock exchange.

After investing so much into starting and growing your insurance agency, you should plan for its successful sale. Doing so will have a long-term impact on the future of your business, as well as your retirement and livelihood.

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