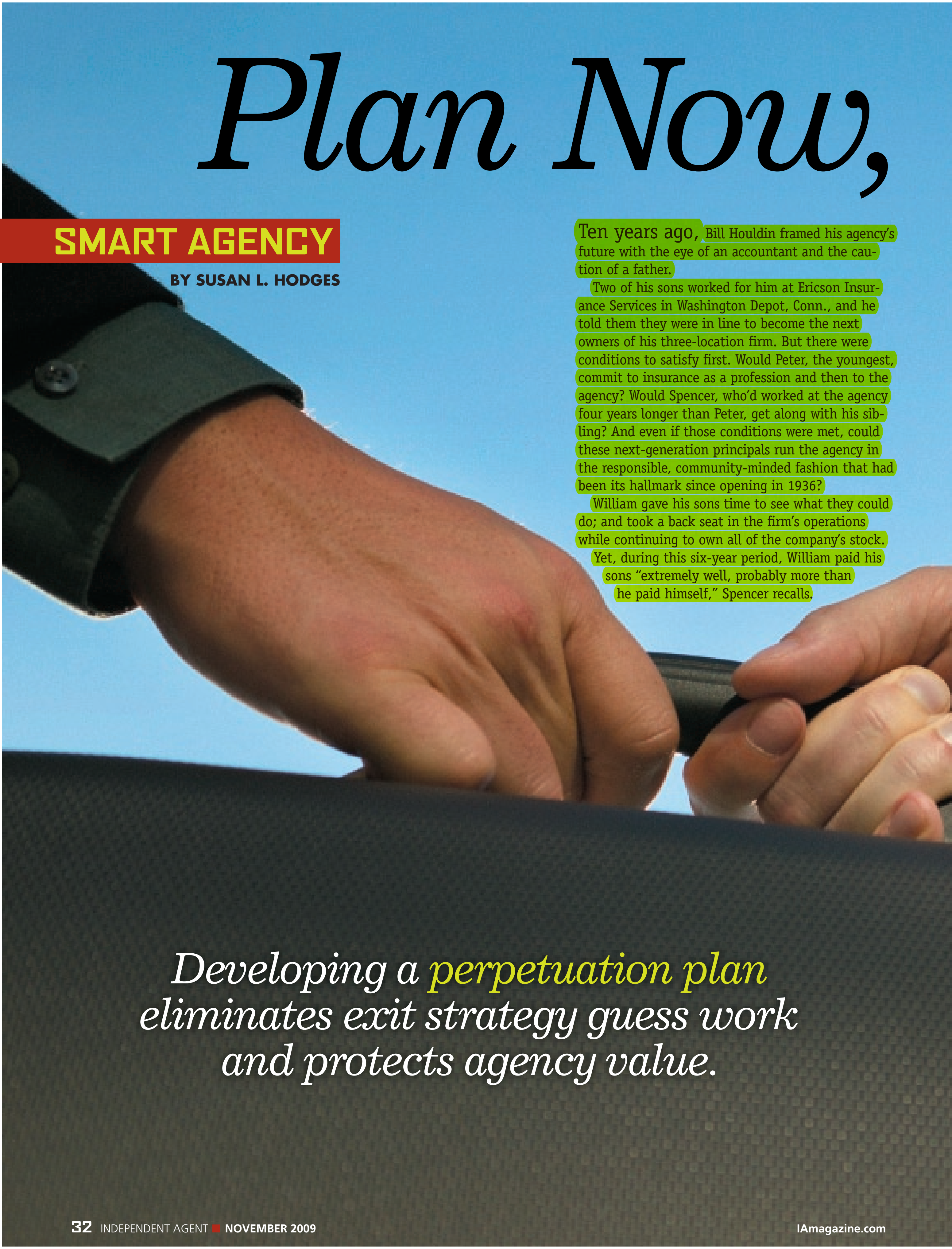


Plan Now,

SMART AGENCY

BY SUSAN L. HODGES

Ten years ago, Bill Houldin framed his agency's future with the eye of an accountant and the caution of a father.

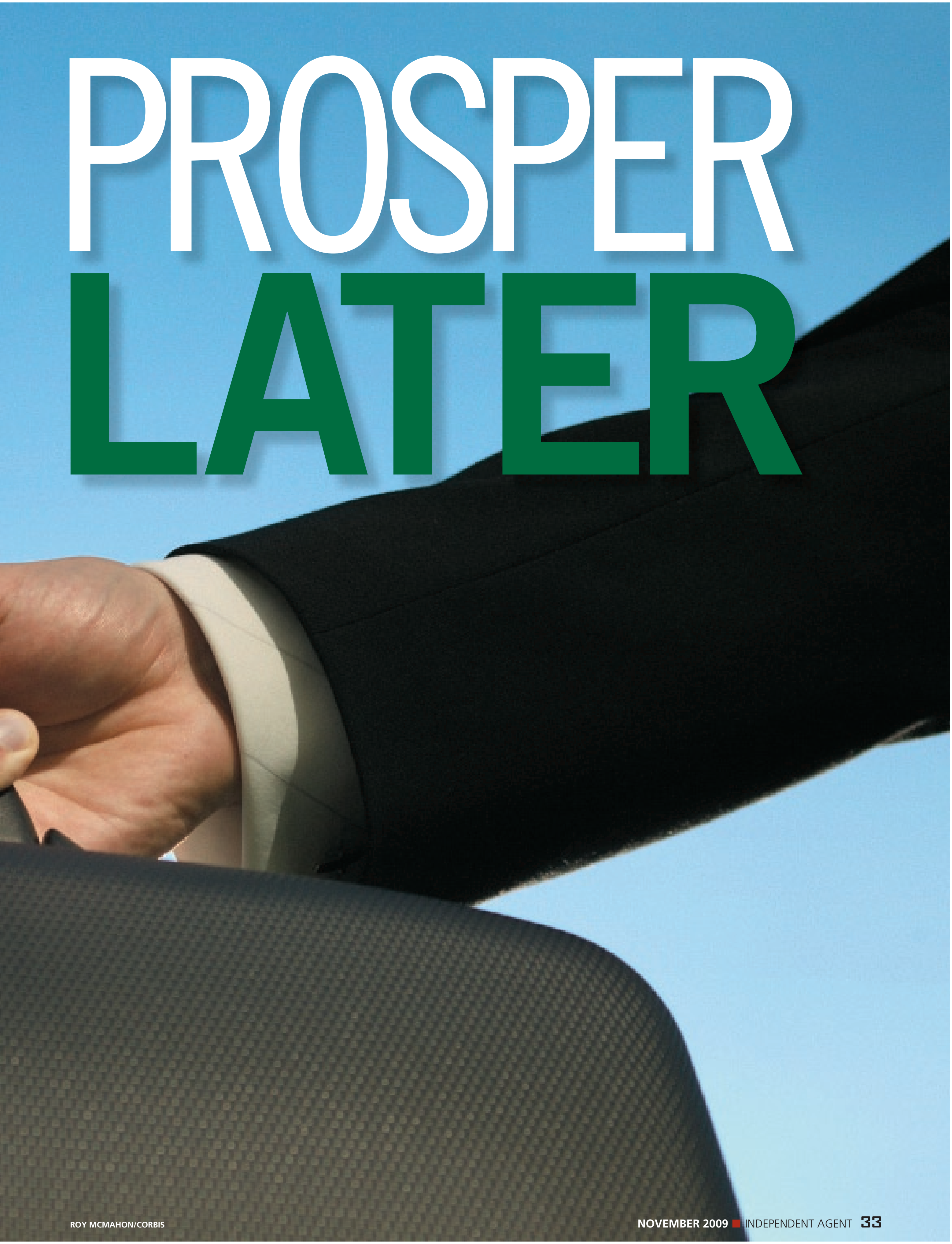
Two of his sons worked for him at Ericson Insurance Services in Washington Depot, Conn., and he told them they were in line to become the next owners of his three-location firm. But there were conditions to satisfy first. Would Peter, the youngest, commit to insurance as a profession and then to the agency? Would Spencer, who'd worked at the agency four years longer than Peter, get along with his sibling? And even if those conditions were met, could these next-generation principals run the agency in the responsible, community-minded fashion that had been its hallmark since opening in 1936?

William gave his sons time to see what they could do; and took a back seat in the firm's operations while continuing to own all of the company's stock.

Yet, during this six-year period, William paid his sons "extremely well, probably more than he paid himself," Spencer recalls.

Developing a perpetuation plan eliminates exit strategy guess work and protects agency value.

PROSPER
LATER



ROY MCMAHON/CORBIS

Then, three years ago, William officially stepped down. He and his sons, both still younger than 40, worked out an agreement in which each son would purchase 50% of the agency from their father over a 15-year period.

"He was very smart about the whole thing," recalls Spencer. "There are a lot of fathers who just won't give it up." But when Spencer and Peter decided to take the agency paperless, William saw that as his cue. "He had zero desire to learn how to use a computer," says Spencer with a chuckle. "So he packed up and left."

There are many adult children of agency owners who don't get along. And there are numerous distractions that keep many agency principals from determining how they want their agency to continue after they're gone. But there's one thing principals who've successfully perpetuated agree on—the most valuable resource for perpetuating is time. With time on your side, you can equip yourself and your agency with the tools needed for a successful future. With time to spare, you can even err in your plans and change direction—and still perpetuate your business profitably and efficiently.

Mentally Prepare Now

Rob Bouvier knows something about the relationship between time and agency perpetuation. The agency where he is president—Bouvier, Beckwith & Lennox (BB&L), in West Hartford, Conn.—has acquired several small agencies that didn't plan for perpetuation soon enough. "Perpetuation is the key to preserving the market value of your agency," says Bouvier, who is one of three siblings and two sibling in-laws to purchase his father's agency a few years ago. Without a perpetuation plan in place, "the heirs are behind the eight ball when they try to bring the agency to value," he added.

To retain its value, Bouvier says, an agency must have someone who can step in immediately upon the retirement or death of the owner(s) and start servicing clients. Without this person, service immediately deteriorates, and customer satisfaction along with it. A good perpetuation plan is so instrumental in maintaining an agency's value that owners who ride out the value of their book of business are sealing the deal for a cheaper agency sales price later.

BB&L founder Bouvier pondered his own perpetuation plan for awhile before sitting down with family and partners to work out the specifics. He decided to transfer agency ownership to three adult children and two sons-in-law, and that agency valuation and stock distribution would be handled by outside professionals. Bouvier says the transaction was complex and took several years to execute, but went smoothly. "It helps when you have thoughtful partners, as opposed to people who get caught up in their emotions," he observes.

Why an LLC Works

If you're the new owner(s) of an agency, you may want to consider restructuring the business legally to protect yourself and other new owners from mistakes of the past. Just as an old title problem can rear its head to bite new homeowners, errors made by past agency owners can return to suck the lifeblood from the newly perpetuated business.

Knowing this, Spencer and Peter Houldin set up a new Limited Liability Company (LLC) when they took ownership of their father's agency. The LLC bought the assets of the agency and thus became a new business. Consequently, the brothers had to negotiate new contracts with each of their carriers and recode every policy. They were also required to obtain new insurance licenses from the state of Connecticut. "But it was worth it," says Spencer. The LLC lessens the agency's errors & omissions liability and protects it from any legal problems that could arise from their father's business.

According to business developer and holding company Gaebler Ventures, of Chicago, an LLC affords all the benefits of a corporation but few of the drawbacks. Unlike corporations, LLCs do not file taxes. Instead, the profits or losses of the business pass directly through to the owners' personal income tax returns, on their Form 1040. A Form 1065 is filed for the LLC, and each member's taxable profit is listed on Form K-1.

Because the bottom-line profit of an LLC is not considered earned income to most members, it is not subject to self-employment tax. However, the profit share of the company's managing member is considered earned income, and as such is subject to self-employment tax.

Should new agency ownership consist of just one individual, though, an LLC will not be as beneficial. The reason: a sole owner will be taxed as a sole proprietor.

—S.H.

Everyone involved in BB&L's perpetuation approved a certain valuation expert, and Bouvier says the agency got what it paid for. "To transfer that many shares to that many people…it brought clarity to an otherwise cumbersome process," he says. Today the average age of a partner at this 60-employee, six-location firm is 42, and the next perpetuation is already being considered. "It's not imminent, but it's something we've planned for," says Bouvier. Buy-sell agreements are already in place, as are life and disability policies for each owner. "I give my father great credit," Bouvier concludes. "There are a lot of principals who, to the detriment of their agency, can't get past holding the reins."

Put It in Writing

Steve and Debbie Standridge, principals of Steve Standridge Insurance Inc. in Mt. Ida, Ark., gave up their reins last April by transferring 90% of the agency's ownership to trusts set up for their daughter and son. "When I'm about 65 or 70 (years old), I'll sign over the rest of it," says Steve. But in the meantime, he and his wife are already taking back seats in the agency's operations. "I'm just a salesman," says Steve. "And it feels good—actually, it feels wonderful."

Steve Standridge is only 52 years old, but his daughter and son, still in their 20s, are already agency vice presidents. "You've got to trust your children, and form a trust to protect the family," says Steve.

It only took four months from the time Steve and Debbie decided to create their plan until its completion. As Steve points out, the plan is basically a stock transfer. "Let your estate tax attorney take care of the estate part and the rest falls into place," he says.

The cost of setting up a plan is generally reasonable, too. Term life insurance for young adults may run several hundred dollars a year and group disability coverage for an entire agency probably won't cost much more. The largest expense likely stems from drawing up the buy-sell agreement, which must be done by an attorney, and may cost $2,000 to $3,000.

Consistently Build Value

Once a perpetuation plan is in place an agency should do everything it can to continue to build value. "Mindset is the biggest part of agency perpetuation," says Bob Medley, the retiring executive vice president at Medley-Turrentine Insurance in Oklahoma City. "You have to ask yourself where you'll be in 10 to 20 years. If you're not interested in transferring ownership, you'll have no choice at that point but to sell to someone else, so you might as well be involved."

Medley bought his agency from his father in 1973 and began thinking about his own perpetuation soon after. He knew he could make things easy for himself by simply focusing on business that came along. But he chose instead to add producers who could become future owners and stimulate agency growth by targeting a particular market: mid-size commercial accounts.

"Most agencies don't retain capital to assist in perpetuation, and most buyers don't have the resources to make a multimillion dollar purchase," Medley explains. To perpetuate in a way that will pay all parties the money they need, "current owners really have to want to put together a revenue vehicle that helps the new owners."

During his career, Medley targeted accounts that needed insurance consulting, but weren't so big that they hired professionals in-house. The strategy worked: the agency went from an even split of personal and commercial lines to almost exclusively commercial lines with a secondary market for group benefits. Premium volume increased exponentially, and now Medley is selling the business to his son Daniel and a partner, Brent Turrentine.

The new owners-in-process are purchasing Medley's agency stock over a multi-year period. One stock bundle is being bought during a five-year period and the remainder will be purchased after another 10 to 15 years to keep the transaction affordable for the buyers. At that time, tax laws and other conditions will help determine how the remainder is distributed. According to Medley, the biggest challenges of perpetuation are: finding buyers who can envision growing an agency so that 30 or 40 years later they can take advantage of that growth; and having current owners willing to take a 20-year payout for what they built in the past 30 or 40 years.

"I have always felt that I was the steward of this business, and would transfer it on to others," says Medley. "If you can arrange something that benefits all parties, so much the better."

Always Search for New Talent

You might say Marc Baker, president and CEO at Elliott, Powell, Baden & Baker (EPBB) Insurance in Portland, Ore., is always looking for something better. The recent spate of agency sales in Portland to national brokerages has given him an advantage, Baker believes, because working for his firm represents a chance for employees to become owners. "We're growing, and we're always looking for new people with character who want to grow a good book of business and care about the community," he says.

Baker is the product of perpetuation himself. His father Neil retired seven years ago. Baker and his partner, Wolter vanDoorninck, became full owners three years ago when they purchased Neil's remaining shares.

Marc Baker is not yet 50 years old, but with vanDoorninck, the agency has already tripled its book of business and raised the head count from less than 20 to about 40 employees. "We've done some internal restructuring. [And] we're working with a third-party consultant who has helped us offer value-added aspects to our relationships with insureds that other agencies haven't thought of," says Baker.

The agency specializes in insuring the energy industry and also partners with associations to insure their members. All the while, Baker and vanDoorninck keep an eye peeled for new talent. "We're always thinking about perpetuation," Baker admits. "That's why we want to meet good people and talk about our future and their future. For the people who get it, it's a great fit. And that's why we're a success." IA

Hodges (**hodgeswrites@aol.com**) is IA senior writer.