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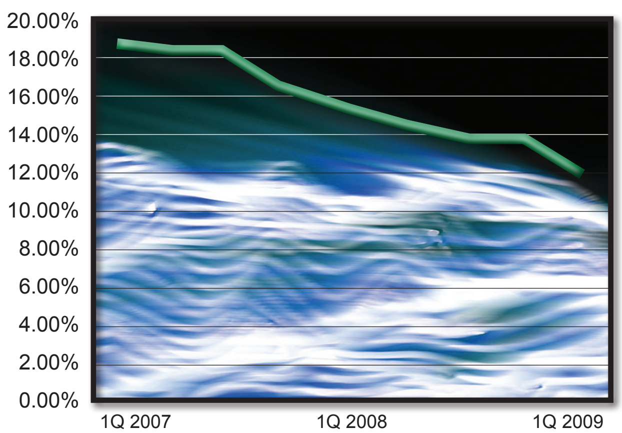
Building a Strong Balance Sheet

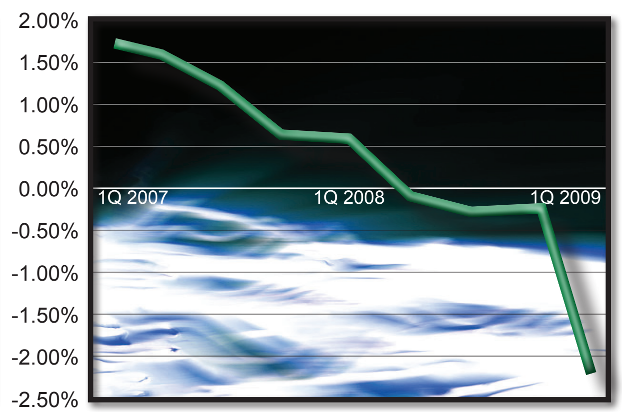
We discussed the importance of maintaining a strong balance sheet in the May issue of For the Record. Data extracted from our proprietary database shows the dramatic decline of agency revenue and pre-tax profit (see charts below), suggesting that many agencies have had (or will have) to dip into their retained earnings. Those funds need to be replenished.

We all know that every dollar of profit cannot be retained. As a result, building a balance sheet takes patience and discipline to allow the agency to have ample cash for funding operations, making building the balance sheet a long-term, ongoing commitment. Expect the process to take 3-5 years and spend the time necessary to plan and monitor. Set a timeline and tangible net worth ratio goal, estimate revenue growth and tax rates, and forecast how much capital must be retained each year to meet your objectives.

Average Agency Pre-Tax Profit as % of Total Commissions & Fees



Average Agency Net Revenue Growth



Source: Marsh, Berry & Company, Inc., 2009

Traditional ideas still apply when building a balance sheet. Revisit the basics, including: optimize workflow; invest in technology; optimize staff; enforce producer accountability; assign profit/loss responsibility to department heads; set goals to retain targeted amounts; mentor, educate and train; institutionalize the strategy; and incentivize staff behavior. Sometimes creativity is necessary. Nontraditional ideas include: move Agency Bill clients to ACH (automated clearing house) payment processing; educate your banker regarding direct bill commission receivables (often un-booked); sell a book of business; or infuse capital.

Prioritize the use of funds from the agency to ensure stakeholders are in agreement how funds are distributed. Legal obligations such as tax liabilities and debt service should be the highest priorities, followed by non-owner staff compensation merit raises and bonuses, working capital/retained earnings, profit sharing, and finally owner bonuses/distributions.

Rebuilding or strengthening a balance sheet does not happen overnight. Strike a balance between cutting too deeply too quickly or suspending investments that are critical for growth and retaining the funds necessary to keep your agency strong and flexible.

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