

Brokerage profitability

improves in spite of recession



By Mike Berris, CA

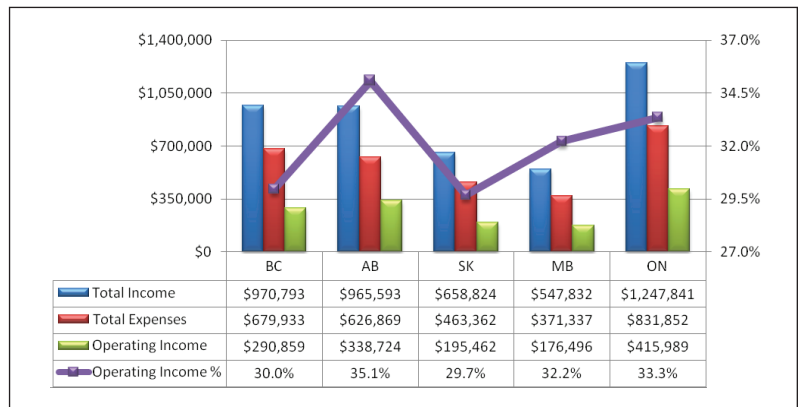
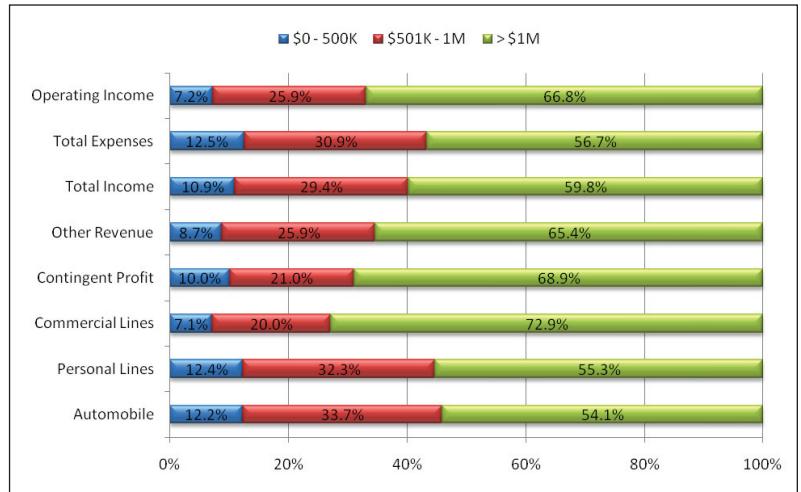
This year 285 insurance brokerages from the five western provinces participated in the biennial Berris Mangan Insurance Industry Profitability Study. Their commission revenue from automobile, personal and commercial lines (excluding contingent profits)

Highlights from the Berris Mangan Insurance Industry Profitability Study

totals \$244 million. The size of the Canadian property and casualty industry is about \$42 billion. Assuming standard commission rates were earned, this volume of revenue works out to net premiums written of \$1.8 billion. The study's 285 participants represent 4% of the P&C insurance industry in Canada, which is statistically significant.

Improvements in industry profitability may be attributed to:

- Consolidation in the industry. Large brokerage groups have acquired and integrated smaller brokerages into their business models.
- Cost control: The salaries and wages, premises, data-processing and admin expenses have decreased as a percentage of total revenue, while marketing expense has increased (see table).
- Improved employee productivity by 5% (for every dollar spent on salaries and benefits, brokerages earned \$2.06 as compared to \$1.96 two



	Total and Average Income and Expenses by Operating Profit Margin					
	Operating Profit less than 30.6%			Operating Profit greater than 30.6%		
Number of Brokerages	159			126		
	Total	Average	%	Total	Average	%
Automobile	47,642,751	299,640	40.1%	48,269,379	383,090	32.5%
Personal Lines	40,064,792	251,980	33.7%	49,096,936	389,658	33.1%
Commercial Lines	20,813,033	130,900	17.5%	38,340,184	304,287	25.8%
Contingent Profit	3,744,313	23,549	3.2%	5,973,999	47,413	4.0%
Other Revenue	6,517,038	40,988	5.5%	6,673,571	52,965	4.5%
Total Income	\$118,781,927	\$747,056	100.0%	\$148,354,069	\$1,177,413	100.0%
Personnel Expense	\$68,674,009	\$431,912	57.8%	\$60,747,058	\$482,120	40.9%
Premise Expense	\$9,842,380	\$61,902	8.3%	\$8,649,340	\$68,646	5.8%
Data Processing Expense	\$1,963,925	\$12,352	1.7%	\$1,372,762	\$10,895	0.9%
Marketing Expense	\$4,729,869	\$29,748	4.0%	\$3,265,867	\$25,920	2.2%
Administrative Expense	\$12,820,210	\$80,630	10.8%	\$13,345,133	\$105,914	9.0%
Total Expenses	\$98,030,393	\$616,543	82.5%	\$87,380,160	\$693,493	58.9%
Operating Income	\$20,751,533	\$130,513	17.5%	\$60,973,909	\$483,920	41.1%

Average Industry Profitability = 30.6%

Average Brokerage Income & Expenses in 2009 and 2007

Sample Size	2009		2007	
	\$	%	\$	%
Automobile	336,534	35.9%	195,591	32.4%
Personal Lines	312,848	33.4%	201,236	33.4%
Commercial Lines	207,555	22.1%	142,749	23.7%
Contingent Profit	34,099	3.6%	34,317	5.7%
Other Revenue	46,283	4.9%	28,962	4.8%
Total Income	\$937,319	100.0%	\$602,855	100.0%
Personnel Expense	\$454,109	48.4%	\$308,076	51.1%
Premises Expense	\$64,883	6.9%	\$46,397	7.7%
Data Processing Expense	\$11,708	1.2%	\$11,130	1.8%
Marketing Expense	\$28,055	3.0%	\$17,093	2.8%
Administrative Expense	\$91,808	9.8%	\$67,870	11.3%
Total Expenses	\$650,563	69.4%	\$450,566	74.7%
Operating Income	\$286,756	30.6%	\$152,289	25.3%

Average Property and Casualty Insurance Brokerage Income by Operating Profits

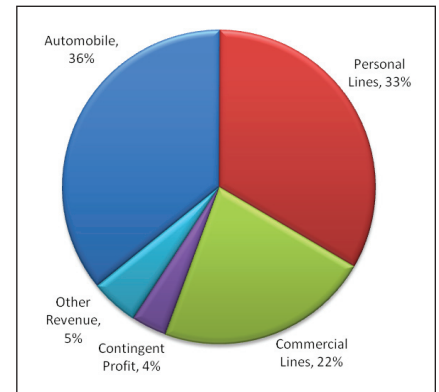
	Brokerages with Operating Loss	Operating Profits between 0% & 18.0%	Operating Profits between 18.0% & 31.0%	Operating Profits greater than 31.0%
Brokerages	25	46	88	126
Total revenue	\$300,325	\$806,095	\$843,107	\$1,177,413
Operating expenses	\$391,691	\$711,950	\$630,550	\$693,493
Operating income(loss)	(\$91,366)	\$94,145	\$212,557	\$483,920
Operating profit margin	-30.4%	11.7%	25.2%	41.1%

Source: 2010 Berris Mangan Insurance Brokerage Profitability Report

service representatives are more engaged in revenue-producing activities.

Location continues to play an important role in determining brokerage commission volume. There are larger brokerages that are doing a good job in centralizing operations with a view to improving efficiency. We believe that there will be a concentration of bricks and mortar locations in the coming years.

It is our view that there will be changes to the industry and brokerages are aware of this and are starting to



adjust to meet the challenges. Examples of possible changes include growth in direct sales channels, pressure to deliver adequate volumes and underwriting profit, and continued automation of processes.

Organizations that invest in employee engagement, systems, external and internal growth will ultimately be the winners.

The top 40% of the market earns 75% of the industry profits. This relates to economies of scale and management.

The market for profitable brokerages is still strong, but acquirers are tending to be more cautious and will base their offer price on the perceived prospective cash flow.

With the strong results seen over the last few years, this may be a good time for brokers to prepare their brokerages for sale.

There is still a strong demand for brokerages as consolidators continue to view acquisitions as the best method for meaningful growth. We have seen considerably more discipline in the acquisition process.

Premium prices are being paid for well managed brokerages with good underwriting results. Brokers can no longer expect high price multiples higher than 2.5 times commissions unless they can demonstrate superior performance. ★ ★ ★

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years ago). Although average personnel costs (salaries, commissions and benefits) went up by about 50%, the increase in overall operating expenses was limited to only 45%, resulting in higher average operating income.

While automobile and personal lines were the main business lines contributing to the revenues of small (revenues less than \$500,000) and medium (revenues between \$500,000 and \$1 million) brokerages, larger brokerages (revenues of more than \$1 million) earn 27% of their revenues through commercial lines.

Brokerages are doing a good job in working with insurance companies to improve customer service and develop

stronger relationships with customers. This is important to ensure that brokers remain relevant in an environment where low-cost manufacturers of insurance are able to cut prices by reducing coverage and selling direct to the public. Brokers need to stress the value they add to the value chain through sourcing the correct coverage at the best price, assisting customers with claims management, and providing expert advice on all aspects of risk management.

Brokerage results have improved despite depressed premium rates in both personal and commercial lines business. We attribute this to better management. For example, brokerages are focusing on developing systems where customer

