

Why do independents sell up? Do they think larger firms do a better job? **Insurance Times** wanted to know too, so we asked them. Read on for the answers

Mergers: what brokers really think

CONSOLIDATION HAS transformed the broking market over the past two years. Small, medium-sized and large brokers across the country have been swallowed up by hungry consolidators, larger regional firms and rattled insurers eager to secure revenues and maintain profits in a soft market. What's more, these players have been keen to position themselves for when the market turns, creating a dynamic competitive environment as recession approaches. So *Insurance Times* decided it was time to ask brokers for their views on how consolidation has affected the general insurance market and what will happen next. Of the 76 firms surveyed, more than half indicated that they had a gross written premium of less than £10m.

What our survey found

Most (just over 53%) of the brokers interviewed noted that merger activity has slowed down since the changes to the capital gains tax regime in April and the start of the economic slowdown.

"I would assume it is as finance is harder to obtain," said one. "The days of inflated prices for mediocre-to-average businesses has, I believe, come to an end."

Many believed this was a good thing because they felt clients had received poor service from larger businesses. "Customer service is paramount and indisputably linked to retention. Larger is not necessarily coupled with diminished service, but often it has transpired to be the case," said another broker. "Most consolidators would struggle to achieve the 95%+ retentions realised by smaller players such as ourselves over the past 20 years."

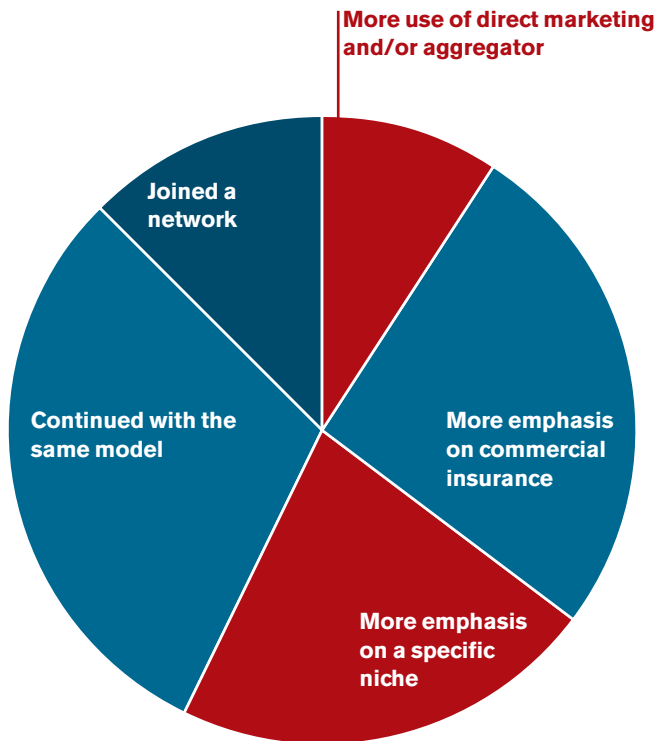
Just under a third of the respondents believed consolidation would continue at the same level and 16% of brokers thought merger activity would increase (see chart, below).

More than half the brokers surveyed said if they were to sell, it would be because of an increase in regulatory burden. Just under half pointed to declining margins.

Customer service and client management after a merger was another crucial factor. "As far as possible, it should be business as usual for the clients – there's a good reason they choose to deal with their broker," said one broker. "If better insurance facilities are available to clients following merger, all well and good. Items such as commission deals, IT integration and management information should not be allowed to affect client service."

There were plenty of warnings too from brokers concerned about the future management of their books. "If the business is split up and certain classes moved to different locations, some clients could walk." Or as another broker put it: "I strongly believe there should be a relatively long planning process if business retention is to be maximised by new owners."

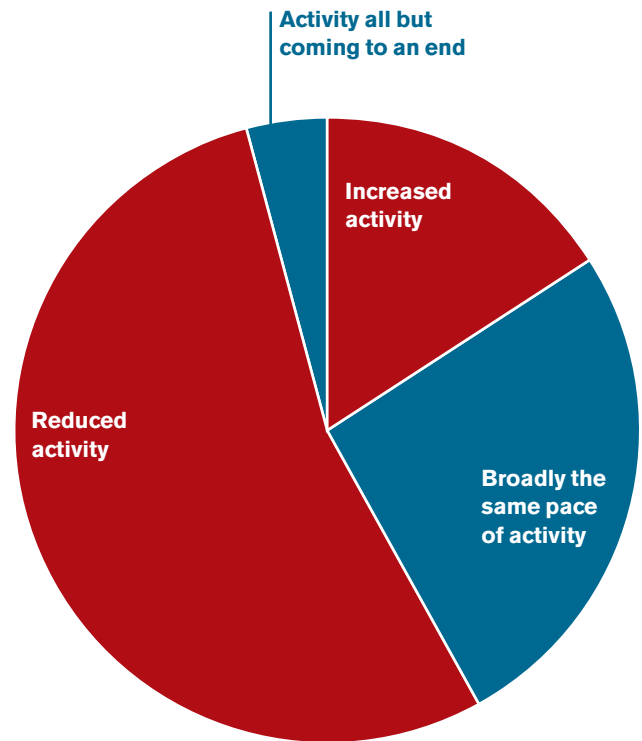
Most brokers deemed several other factors "very important" in deciding whether to sell their businesses or not. Almost 90% said a good financial offer was key to the decision; 55% cited



HAS YOUR BUSINESS MODEL CHANGED?

How have market trends affected your business model over the past couple of years?

Continued with the same model	42%
More emphasis on commercial insurance	36%
More emphasis on a specific niche	30%
Joined a network	17%
More use of direct marketing and/or aggregator	13%



WILL CONSOLIDATION CONTINUE?

How much consolidation activity do you anticipate among brokers over the next two years?

Reduced activity	54%
Broadly the same pace of activity	26%
Increased activity	16%
Activity all but coming to an end	4%

a suitor company's ability to integrate business processes; 78% pointed to a suitor company's customer service reputation and 65% said they wanted a commitment that their staff would be retained (see chart), below).

Other brokers reluctant to sell their businesses pointed to the value of providing independent advice. And it was noted that there is an opportunity for brokers to manage sophisticated clients looking for an enhanced service in this competitive climate.

Most of the respondents had been approached to be acquired recently. And many of those that declined the offer pointed to the economic climate and the suitability of the suitor company's business model as key to their decision. One broker said there would always be an opportunity for acquisitions and deals in the sector, but "far fewer opportunities for the less efficient or less profitable in the future". Other brokers saw an opportunity in the economic downturn to better manage existing clients and attack the renewals process with vigour. One said: "Now the financial crisis is firmly upon us, the consolidation we have seen in recent times will surely slow, if not cease, and hopefully we will see a period of stability." **IT**

THIS REPORT PRESENTED IN ASSOCIATION WITH



Over recent months the credit crunch certainly seems to have encouraged those brokers who aren't waiting to "see it out" to search out the best deals. However, when all the offers are on the table, it's still rarely a price-only decision.

Brokers who have spent many years building a business want to know that the business, its staff and customers will be looked after in the right way long after they have gone.

For Swinton, it's been business as usual. We have purchased two or three businesses each month in 2008, have a strong pipeline going into 2009 and continue to look for quality, well-run businesses.

BROKERS IN THEIR OWN WORDS

"Mergers and acquisitions reduced the quality of personal service to the client?"

"This is a great opportunity for the small broker to attract discerning clients."

"Provided that funds are available, mergers and acquisitions are relatively easy to achieve. Success or failure is then measured by how effectively the businesses are merged and function as one, while maintaining profitability and retaining both customers and key staff?"

"Consolidation was bound to happen as larger players have more flexibility in the market."

"The small will get smaller, both in number as well as their own businesses, and the big will get bigger. The client doesn't feature anywhere in the big boys' plans or the regulators'. Let's not forget that the big boys are not independent, there is virtually no independence left. Is the client really getting the best deal? Almost certainly not and no one seems bothered, certainly not the regulators. They are only interested in ticking boxes, making up new, ever more ridiculous rules, none of which will prevent the next Independent, Equitable

and so on, which we all know is just around the corner?"

"Bit of a bubble is it not? I would think a large percentage of merger and acquisition funding was provided based on ambitious growth and increased revenue (commission) plans. Not sure if some of the acquirers are now starting to regret borrowing so much."

"Some will go bust but there will be more true mergers instead of takeovers. If they haven't retired in the past few years - and made a packet through selling - then most owners of independent brokers will stick around until the good times return?"

"Some have bought in a scattergun/panic approach under the 'We must have more market share' banner. They are now starting to see that you cannot incorporate so many businesses so quickly."

"Often the clients are not considered, as they have many years with individuals and the takeover robs them of their trusted contacts?"

"Consolidation has been inevitable, although some of the prices that have been paid have been way over the top."

"Good businesses will survive and flourish. Those looking to sell will receive less as prices get back to more acceptable levels?"

"Brokers that are now owned by larger organisations will be sold on during this economic downturn to raise funds or satisfy shareholders. Compared to the UK economy, most brokers seem to be holding their own and this has to be a good thing. However, I fear companies will sell off brokers in order to make some quick returns."

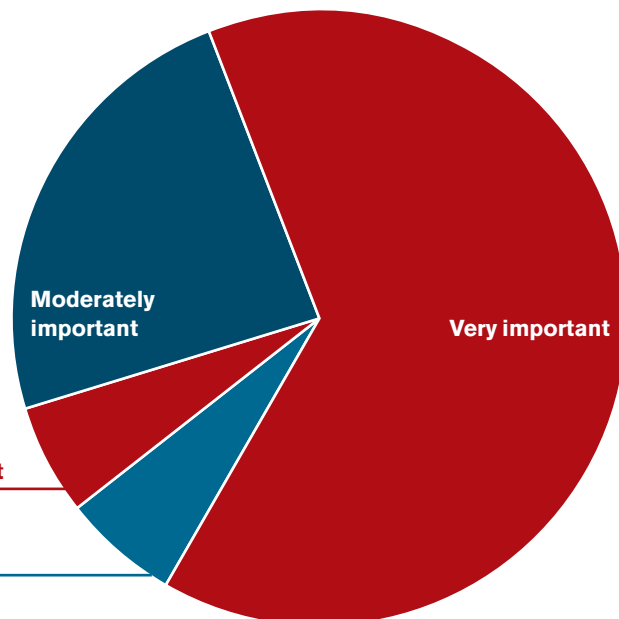
"Consolidation has slowed down after the capital gains tax panic and the current financial situation. From what I have seen - and I work with one of the companies that is buying up brokers - very little integration is actually taking place so the real reason for buying up brokers is to build size and maximise commission and fees. Virtually no time is spent on the client side at all?"

"Brokers have let their market share decline due to lack of finance to support their growth in the internet sales channel. So as the super-brokers grow, this should help the recovery of the broker and give the customer the correct advice and product, not just the cheapest."

WHAT DO YOU WANT FROM A BUYER?

In deciding whether to accept an offer to sell your broking business, which of the following factors would play a significant part in the decision?

	Very important	Moderately important	Marginally important	Not at all important
Suitor company's ability to integrate business processes	55%	27%	15%	3%
Opportunity for business to develop and expand	42%	33%	22%	3%
Possibility of fixed-term contract as a consultant	17%	38%	38%	8%
New management looking after existing clients	48%	25%	14%	12%
Suitor company's customer service reputation	78%	13%	7%	1%
Commitment to continue trading locally	55%	19%	16%	9%
Commitment to retain current staff (see chart)	65%	24%	6%	6%
Option to maintain a shareholding	15%	19%	34%	31%
Maintaining firm's existing name	21%	27%	33%	18%
A good financial offer	88%	9%	1%	1%
A fast, no-fuss deal	61%	25%	7%	6%



Marginally important

Not at all important