PRIVATE EQUITY INVESTORS

Beyond the bad press

Private equity firms are similar to something P&C providers understand well — insurance distribution

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Private equity (PE) firms get a bad rap. They're frequently described as caring more about themselves and their investors than their entrepreneur partners. Or they're viewed as Excel whiz kids who don't fully understand the inner workings of the industries into which they insert themselves.

However, much like top-tier brokerages, the best PE firms have been in business for decades. And they know how to put the needs of entrepreneurs first. In many ways, PEs share the characteristics of brokerages and insurance companies.

Beating the rap

PE firms have been accused of negative behaviours, including going back

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on promises to leverage top-tier support staff to help businesses expand, and inadequately assessing or identifying key business risks. Too often, entrepreneurs find that when times get tough, PE firms fail to live up to partnership promises.

But although some individual PE firms may be guilty of such transgressions, they're not all the same. In many ways, PE firms have a lot in common with insurance brokerages or carriers.

How so? It's not a stretch to swap the words 'investors' with 'underwriters.' Or the word 'Excel' with 'insurance technology.' Furthermore, 'lack of business support' can be seen as functionally similar to 'poor claims handling.'

The best insurance brokerages know they won't succeed by placing commissions first, accepting low retention, and adopting a belief that finding the next customer is more important than serving existing ones.

It's the same for best-in-class PE firms, which have employee shareholders and engage in deliberate succession planning. They put the entrepreneur first and invest in mechanisms that maintain and improve service quality. When there are bumps in the road, they work through those issues as partners.

PE and insurance distribution

PE firms have partnered with Canadian insurance brokerages, MGAs, carriers and service providers for decades. Roughly 100 Canadian insurance M&A transactions were completed in 2022; many involved PE or PE-backed strategies, according to S&P data.

Although the current debt market and economic outlook may lead to slower M&A during 2023, good companies are always in demand.

A PE partner can help brokerages pursue growth initiatives like investments in new producers and acquisitions. Plus, it can strengthen the balance sheet for those taking risk; provide liquidity for those seeking to exit or diversify their net worth; and build an infrastructure to ensure multi-generational growth.

Businesses considering an equity partner should think of the process like placing a specialty product line — several markets may be available, but one option will be best.

Just as you would ensure an underwriter has assessed and has appetite for the risk, you should make sure the PE firm knows your business and can bring value to your organization.

PE partner support can include:

- *Strategic advice* — defining a 100-day plan and long-term strategic goals.
- *Revenue growth* — sourcing customers and channel partners, and instituting key performance indicators.
- *Margin improvement* — peer benchmarking and supporting investments, including technology and people, to improve operations.
- *Human resources* — recruiting C-level officers and structuring equity-driven incentive programs to align interests.
- *M&A* — sourcing, diligence and negotiating M&A opportunities to add geographies, talent and/or technology.
- *Capital structure* — providing access to banking relationships.
- *Exit* — assisting with future liquidity after growing the business.

So, how do you make your company attractive to PE investors?

PE firms want to see consistent, profitable growth. For brokers and MGAs, that means recurring revenue rather than one-time pops from Contingent Profit Commissions (CPCs). For carriers, underwriting profit is better than investment income.

Strong margins will also get PE attention. High earnings before interest, taxes, depreciation and amortization (EBITDA) margins, excluding CPCs, are a sign of a well-run brokerage business. That's important for MGAs, too, as is underwriting performance.

Investors also see expertise in certain industries, product lines or market segments as a sign that an investee firm has a competitive advantage, while diversification among producers or salespeople and trading partners mitigates risk.

What's more, appropriate processes and systems that facilitate retention, underwriting and the ability to monitor the business in real time are an asset. And although you do not need to be a fully digital brokerage, using technology to enable operations is valuable.

It's undeniable insurance distribution is changing, but firms making appropriate investments are well-positioned to take market share aggressively. The right capital partner can help expand geographic reach organically and, through M&A, make appropriate technology investments and enhance recruiting through equity-driven incentive plans. CU

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