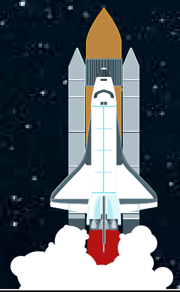
MACQUARIE

Pursuing sustainable growth

2016 Insurance Broking Benchmarking Results



Contents

How to get the most out of our benchmarking results

Click on a section to read more about the topics that interest you most, including best practice tips.

Ready to learn more?

Contact us today

Benchmarking your performance

About the research

Building on our previous surveys in 2011 and 2013, the 2016 report is an in-depth study of 200 insurance broking businesses of every size, from each state across Australia.

"In a challenging market, insurance brokers across Australia have proven both resilient and adept at creating efficiencies to maintain margins and drive profits higher. But alongside familiar market cycles, there are signs that a larger structural transformation is underway, with new platforms and technologies enhancing the customer experience. This will power evolving, alternative business models that are likely to change the industry landscape. That's why its critical to position your business now to ensure you can continue to thrive in a very different future."

Eoghan Trehy
Division Director
Macquarie Business Banking

Watch this video

Key characteristics

Who took part?

Participant profile

Average
16 staff
includes 2 business owners/principals

Median
10 staff
includes 1 business owners/principals

Age of business

70%
have been in business for over
10 years

50%
have been in business for over
20 years

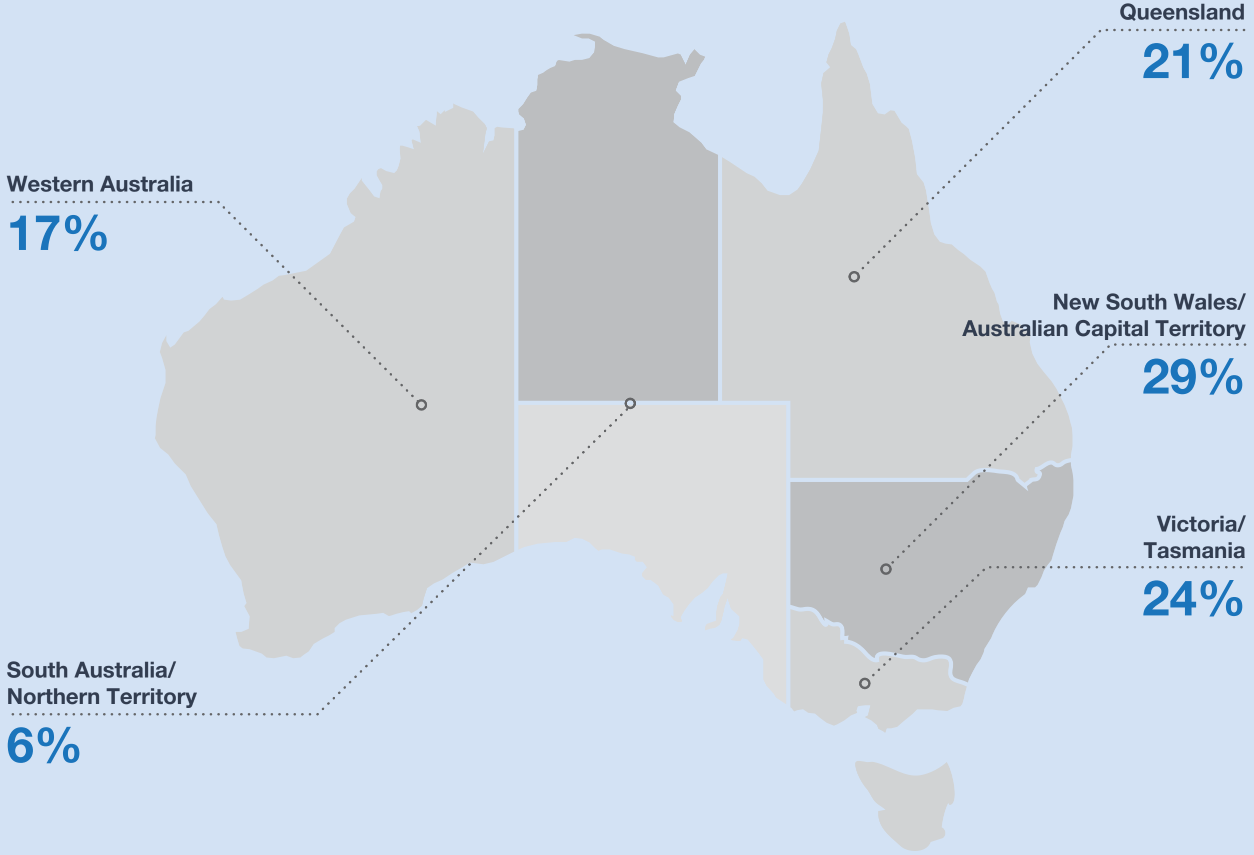
Business type (broker, AR or underwriter)

3 out of 4 are brokers

Who took part?

An Australia wide survey

Location



Participant characteristics

Measuring business size and performance

Despite challenging market conditions, 33% of firms achieved a profit of more than 30% in the 2016 financial year. While scale can help boost performance, these outperformers included businesses of every size in every state.

In this report, we describe businesses using these definitions:

Business performance

Lower profit
Firms with a profit margin equal to 10% or less of revenue
19%

Medium profit
Firms with a profit margin between 11% and 30%
48%

High profit
Firms with a profit margin higher than 30%
33%

Business size

Small
Revenue less than $1m
32%

Medium
Revenue $1m–$4m
47%

Large
Revenue above $4m
21%

Three trends shaping the industry's future

Capturing growth through specialisation

1. Is the cycle about to turn?

A sustained period of soft premiums has led many in the industry to speculate that we are nearing the bottom of the market cycle. But with APRA statistics showing gross written premiums (GWP) on commercial lines falling 7.2% in the June 2016 quarter while volumes jumped 10.9%, Macquarie Research analysts warn that green shoots are still thin on the ground.*

2. Seeking new efficiencies

Revenue pressure has seen firms focus relentlessly on efficiency, eliminating discretionary spending accumulated during the buoyant markets of previous years. But while brokers have been remarkably successful in remaining profitable despite difficult conditions, new efficiencies will become harder to find without genuinely transforming established broking business models.

3. Building the firm of the future

Meanwhile, insurtech startups and direct insurance providers are beginning to make their presence felt, hinting at the potential for technology to play a role in transforming the market in the years ahead. For today's high-performing brokers, that makes it essential to develop a strategy to future-proof your business and remain resilient in a rapidly changing market.

* Macquarie Research, Macquarie Securities Group and Fixed Income Currencies and Commodities Group, Australian General Insurance: Hard to turn the ship around, August 2016.

Performance

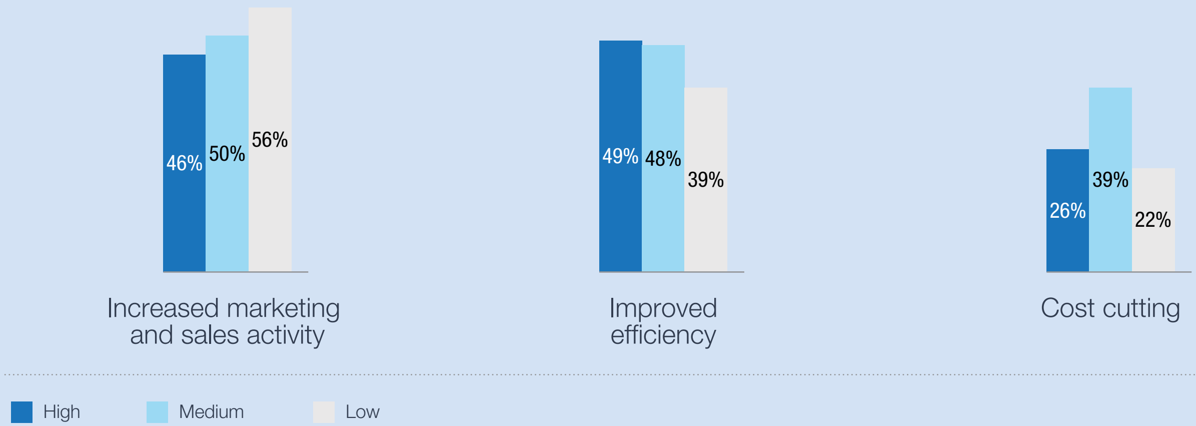
The outperformers

What makes a high performance insurance broker?

Efficiency was the key to outperformance in FY16. High profit businesses spent a lower proportion of revenue on operating costs across the board. And where lower profit businesses were more likely to focus on marketing or new products to improve profitability, half of all high profit firms said improved efficiency was one of the main reasons they grew their profits.

As a result, high profit businesses had considerably higher productivity than their lower performing peers, earning over $96,000 more per staff member per year.

Top three reasons for increased profits



Median revenue per staff member

Median revenue	$2.5m	$1.6m	$794,000
Median staff	15	18	12
Median revenue per staff member	$235,513	$177,653	$139,440

The outperformers

The benefits of scale

For an efficiently run business, the insurance broking business model can be highly scalable. Many high profit businesses outperformed by keeping fixed costs under control while building scale. As a result, they had median GWP almost triple that of their lower profit competitors, with a higher number of staff generating higher revenues per staff member.

	High profit	Medium profit	Low profit
Median GWP	$13.5m	$8m	$4.5m
Median revenue	$2.5m	$1.6m	$0.8m

Financial performance

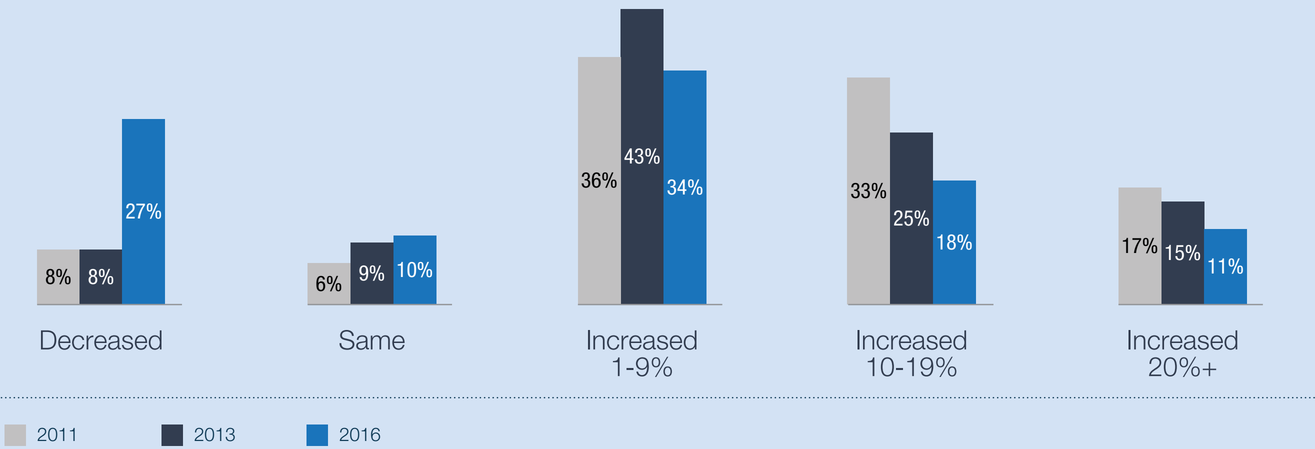
Revenue

Revenues under pressure

In a market some industry participants have described as the most challenging they've ever seen, one in four businesses saw revenue fall in FY16. As a result, both median GWP and median revenues were substantially lower than five years ago.

	2011	2013	2016
Median GWP	$10.3m	$10.8m	$7.9m
Median revenue	$1.7m	$1.7m	$1.5m

Change in revenue



Revenue

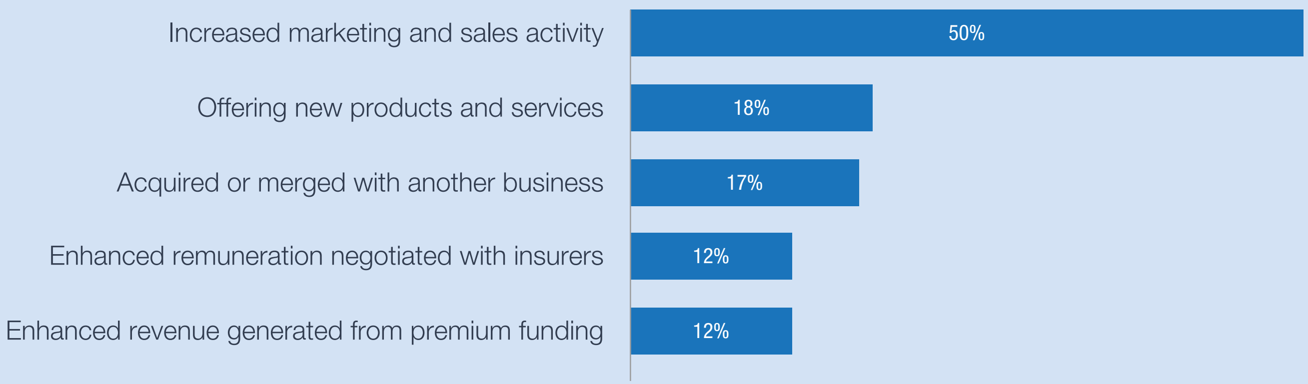
The benefits of diversification

An intensely competitive market was reflected in the declining proportion of revenue as a percentage of GWP, which fell to 2011 levels. Among the 63% who did increase revenues, half said higher sales and marketing activity was an important contributor. Meanwhile, a significant minority drove higher revenues by diversifying their income stream, either by adding new products or services (18%) or promoting premium funding (12%).

Revenue as a % of GWP

2011	2013	2016
19%	23%	19%

Top 5 reasons for increase in revenue

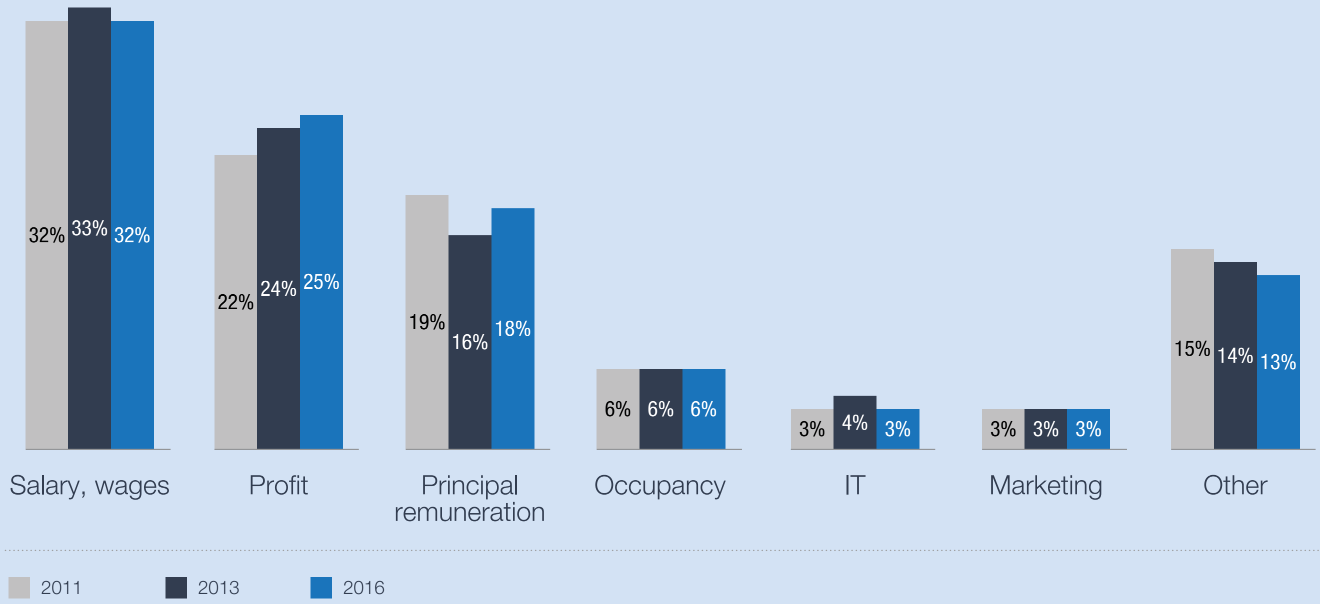


Expenses

Taking control of spending

Over the last five years, firms have consistently sought opportunities to reduce spending and increase the proportion of revenue flowing through to profits, which has risen from an average of 22% in 2011 to 25% in 2016. 37% of firms say they actively reduced costs in FY16.

Expense profile: total markets



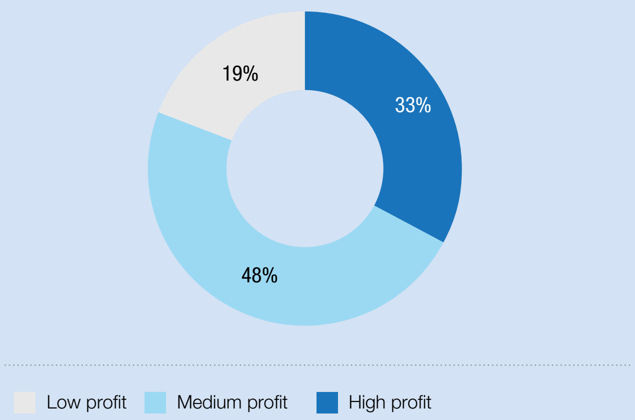
Profit

Staying profitable in a challenging market

Nine out of 10 firms reported a profit in FY16. Thanks to this persistent focus on controlling costs, the vast majority of firms have maintained or grown profits despite difficult conditions.

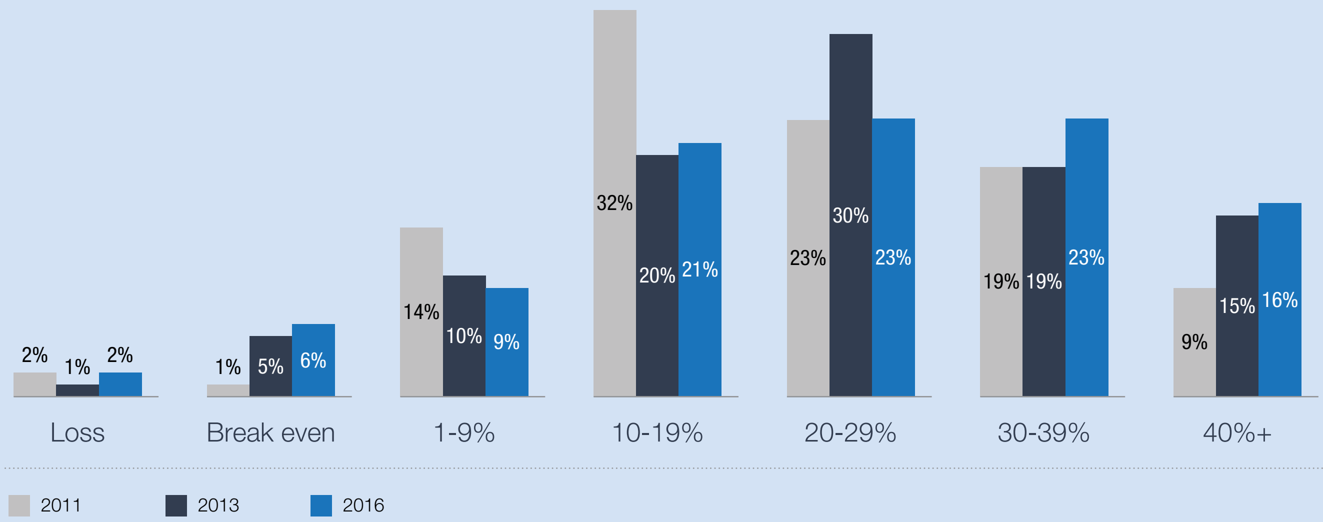
33% achieving margins of 30% or higher – a high performance target for all firms.

Distribution of firms



Median profit margins

2011	2013	2016
20%	25%	25%

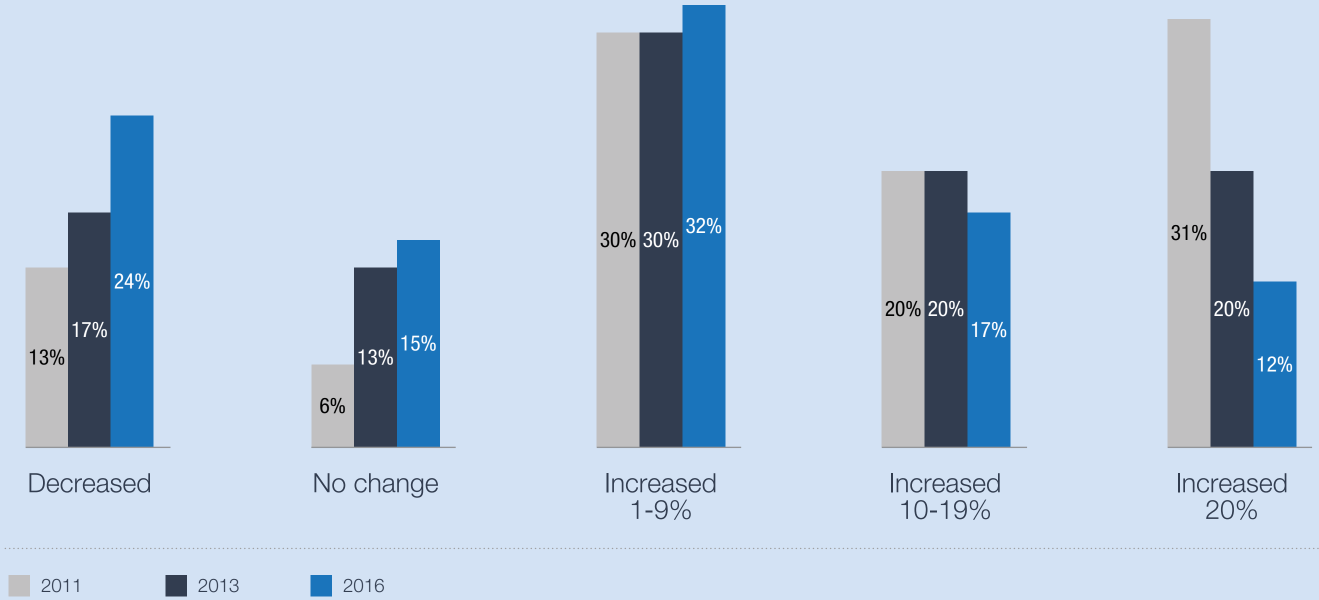


Profit

Pursuing growth

While most firms have remained profitable, profit growth has been harder to achieve. One in four firms saw profits decrease in FY16 compared to FY15, almost double the proportion of five years earlier. Across the market, 71% reported profit growth less than 10%. That underlines the fact that achieving efficiencies continues to be critical, as well as pursuing new growth opportunities.

Change in profit compared to last financial year



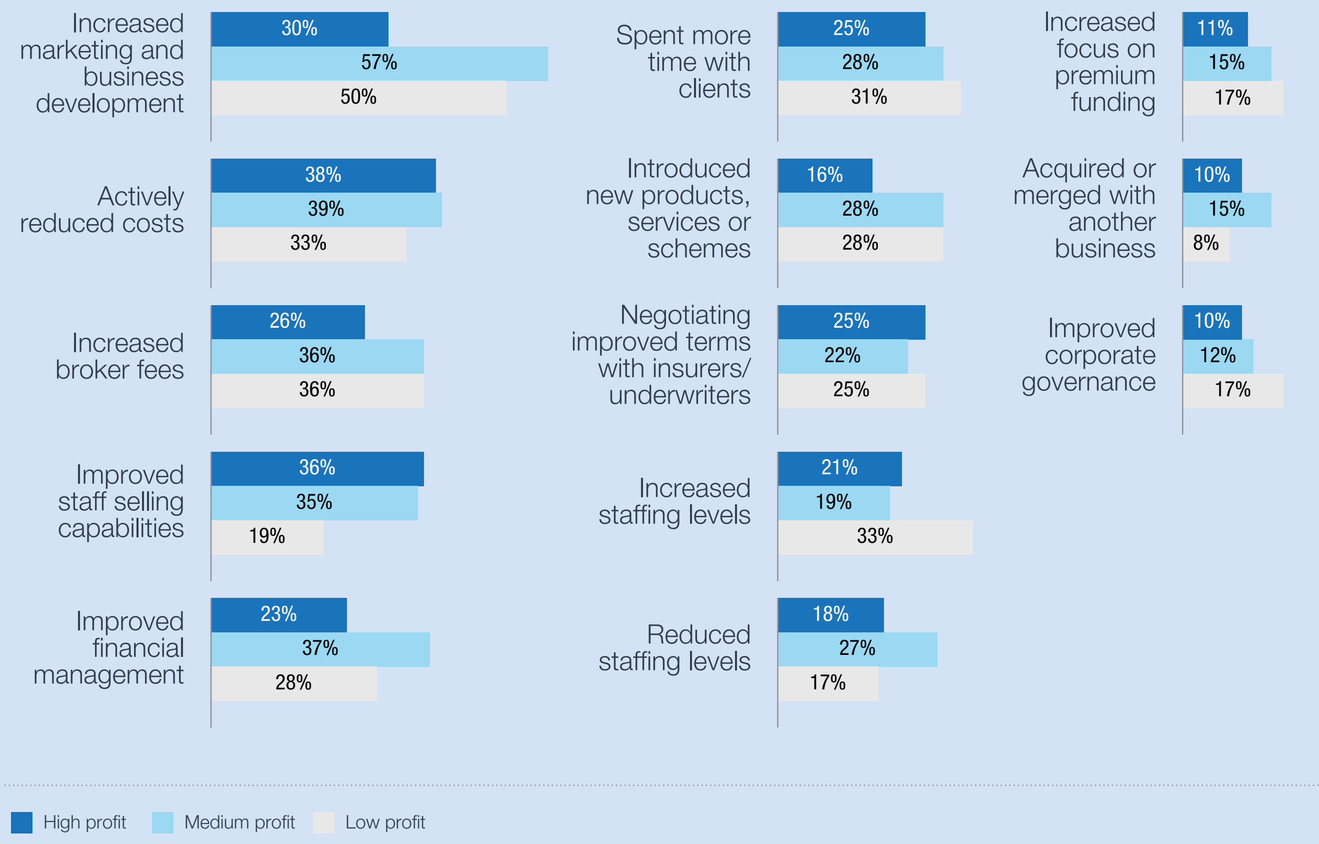
Profit

The outperformers

Even in a challenging market, some firms continued to outperform, achieving profit margins in excess of 30%. These outperformers included firms of every size, despite the advantages greater scale can bring.

High profit businesses typically focused on the basics of good financial management, skilled staff and strong client relationships, rather than simply relying on business development to drive revenues. Asked to name significant changes they had made to their business in FY16, high profit businesses were most likely to say they had actively reduced costs and improved staff capabilities. In contrast, their lower profit competitors were more likely to say they had focused on marketing and business development, hired staff or introduced new products.

Significant changes made in FY16



Best practice

Creating the foundations for sustainable performance

Efficiency is not only important in a tight market, it can be the key to sustainable success. Here are four ways a focus on efficiency can help you create the foundations for long-term outperformance.

1.

By investing in high quality systems — from customer relationship management (CRM) and workflow tools, to automated payment reconciliation — you can lift productivity and liberate your staff to focus on building strong client relationships and generating new business.

2.

Businesses with strong systems typically find it easier to attract higher quality and more experienced staff. That can create a virtuous cycle, where outperformance leads to improved service delivery, driving further outperformance.

3.

These businesses are also generally more scalable, enabling you to achieve consistent growth without re-engineering your operating model.

4.

The more efficient your business is today, the greater your ability to evolve in response to a changing market.

Technology and client service

Technology

Adapting to a changing market

Insurance brokers generally excel in the fundamentals of building strong client relationships and delivering high quality service. Yet our research suggests that many are less confident in making effective use of emerging technologies to reach new clients and service them more efficiently. More than half said they could do more to adapt to industry changes or are falling behind their competitors. And while most have made good use of technology to improve productivity and give staff flexibility, only a minority have harnessed online channels to interact with and service their clients.

Ability to adapt

6% We are falling behind our competitors

8% We are leading the way in innovation

41% We are keeping pace with industry innovations

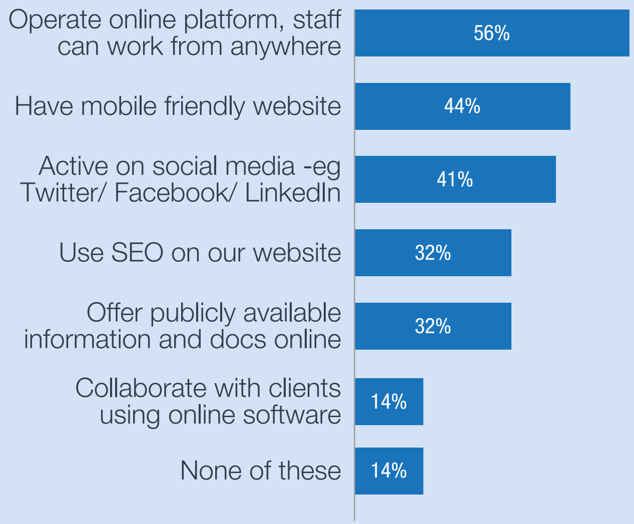
45% We have made some changes but could do more

Using technology to improve the client experience

Digital technologies can help you create a high quality and consistent client experience while efficiently serving a growing client base. Here are three ways you can use technology to improve the client experience:

1. **Provide value added content to attract existing and prospective clients to your website and establish your expertise.**
2. **Use social media to share your insights and interact directly with your target market.**
3. **Offer digital payments or full quote, bind and pay functionality to capture new business at lower cost per transaction.**

Current use of technology



Technology

Delivering services online

Many firms are only just beginning to realise the potential of digital technologies, including web-based service delivery. While three in four said they use their website for brand promotion and lead generation, only 5% of new business came via the web. Meanwhile, just one in 10 firms offered full quote, bind and pay capabilities online.

That potentially makes brokers vulnerable to emerging competitive threats, including the potential for disintermediated business models from new and established providers selling direct to business clients. While around half of firms saw direct sales by insurers as a key threat in the year ahead, only 15% saw insurtech startups as an issue, despite signs of increasing activity.

Competitive threats in FY17:

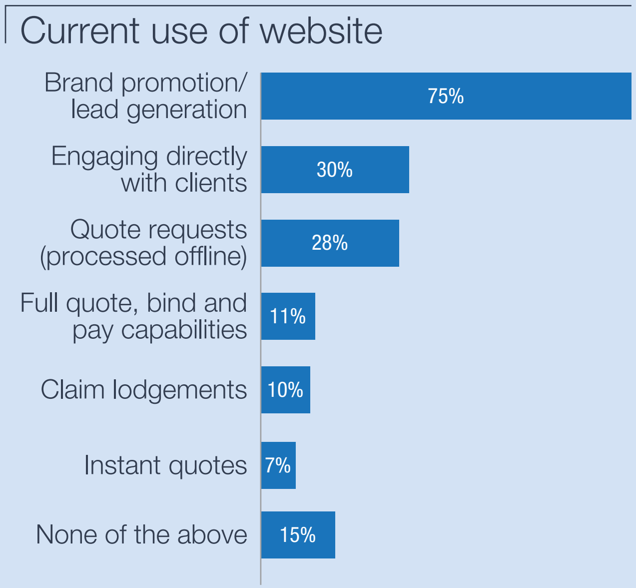
Direct online sales from insurance companies:

49%

Insurtech start-ups (eg peer to peer insurance):

15%

In an industry where simpler product lines are increasingly commoditised, technology can help you streamline and automate lower value transactions and client on-boarding, liberating staff to focus on real value-added activities and create truly personalised client interactions.



Technology

Insurance broking platforms

Ebix continued to dominate the insurance broking software market, with 80% of firms using at least one Ebix product, and six in 10 firms using WinBEAT. Yet brokers also continued to look for improvements from their platform providers, and three in 10 planned to replace their platform in the next 12 months.

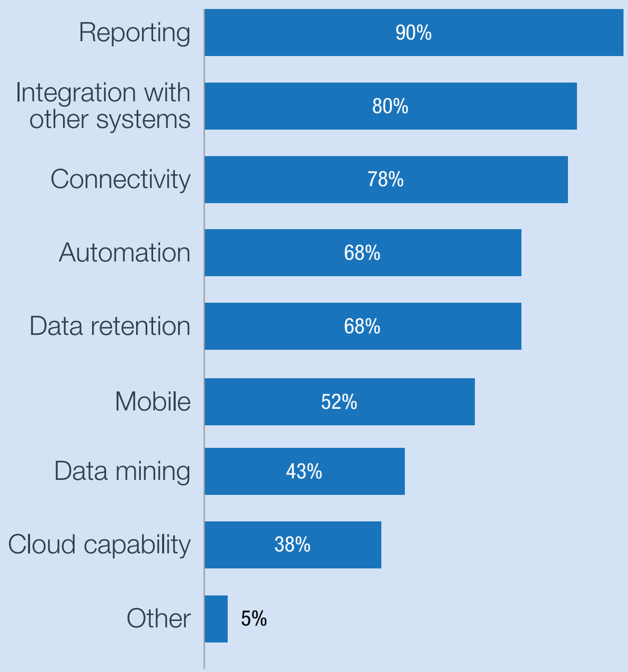
Asked about their platform requirements, firms were most likely to mention reporting, integration, connectivity and automation, reflecting a drive towards greater productivity and control through efficient systems.

WinBEAT is clearly the leading platform, used by 60% of firms.

3 in 10

planned to replace their platform in the next 12 months.

Platform/system requirements

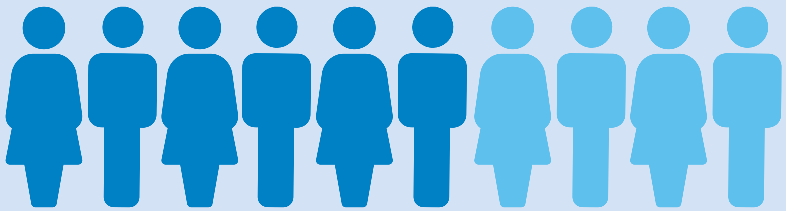


Client service

Realising the potential of premium funding

Firms were also convinced of the potential for premium funding to become a key element of their service offering, with three in four saying it is either essential or valuable for most clients. Nonetheless, only 28% of the average book was premium funded, suggesting that many brokers could do more to harness its potential.

57% claim premium funding is an essential service offering or is valuable for most clients.



Best practice

Harnessing the power of social - six ways to get more out of social media

Social media is not only a valuable channel for communicating directly with existing clients and reaching new prospects. It also provides an opportunity to engage new clients without the hard-sell, building trust and credibility before the sales process has begun.

Learn more on the Macquarie website: Embracing the power of digital disruption

1. **Share your knowledge.** Use LinkedIn or Facebook to share insights, post best practice tips and showcase your expertise, then promote them to a wider audience through Twitter.

2. **Personalise your content.** Social media provides a unique opportunity to reach out directly to clients with targeted content that speaks directly to their needs.

3. **Build an online community.** Unlike traditional, one-way marketing communications, social media provides an opportunity to interact directly with your clients and create a community of interest.

4. **Attract prospects to your site.** By promoting your business on the platforms where existing and potential clients already live online, then linking back to your core site, you can attract new prospects to your website and increase conversions.

5. **Cross-sell additional services.** Use your social media presence to grow your share of wallet and promote a wider range of services to your existing clientele, supported by case studies and testimonials to demonstrate value.

6. **Connect and generate referrals.** Build an expert network online by connecting with likeminded people and businesses and sharing content with their clients.

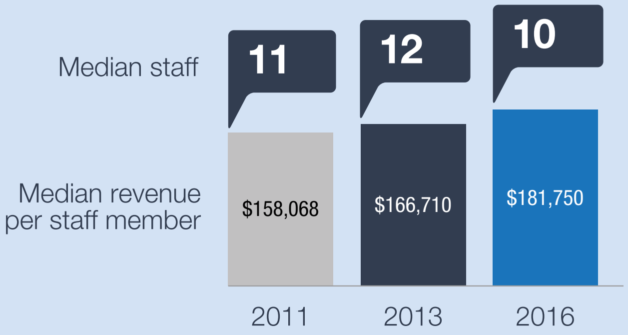
People

Staff numbers

Supporting strong performers

In their drive for efficiency, firms have trimmed staff numbers since 2013, with the median number of staff per firm falling from 12 to 10. But high profit businesses not only continued to employ more staff overall, they also typically focused more heavily on client-servicing brokers and administrators, along with specialist claims managers.

Median staff numbers



Average number of staff in role	High profit	Medium profit	Low profit
Business owners/principals	2.1	2.2	1.8
Client servicing brokers	4.1	6.2	2.9
Broker support staff	3.2	3.8	3.2
Authorised reps	0.6	1.0	1.2
Business development staff	0.7	1.2	0.4
Claims staff	1.1	0.8	0.6
Administration	0.8	0.8	0.5
Finance/accounts staff	0.7	0.8	0.5
General managers/directors (non owners)	0.7	0.6	0.8
Compliance staff	0.1	0.2	0.1
Marketing	0.1	0.2	0.0
Other staff not included above	0.7	0.6	0.1

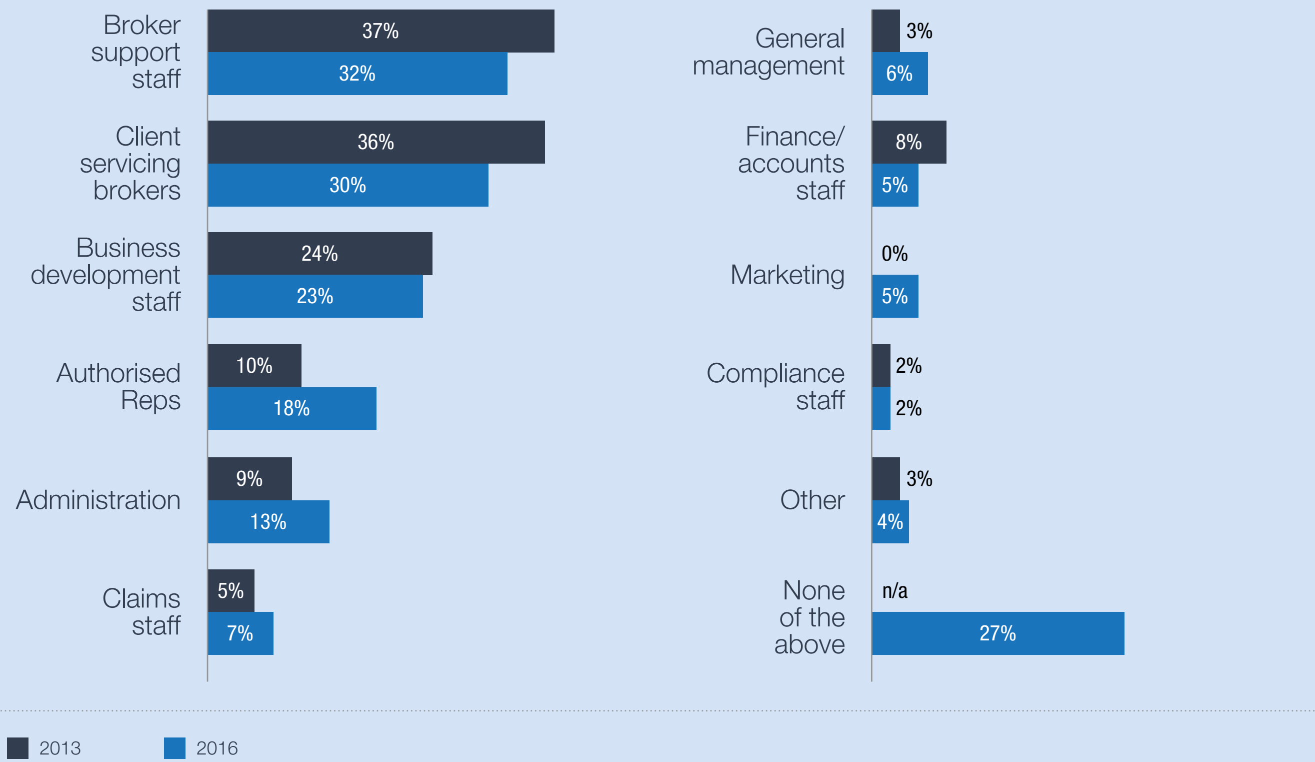
Hiring intentions

Fewer intend to hire

Significantly fewer firms intended to grow staff numbers than in previous surveys, with more than one in four saying they had no plans to hire new people in FY17. Among those intending to hire, broker support staff and client-facing brokers were the most popular roles, although authorised representatives and specialist administrators were also in greater demand than they were three years ago.

In 2016, fewer firms intend to hire brokers and broker support staff, whilst shifting focus to authorised reps and admin staff.

Hiring intentions

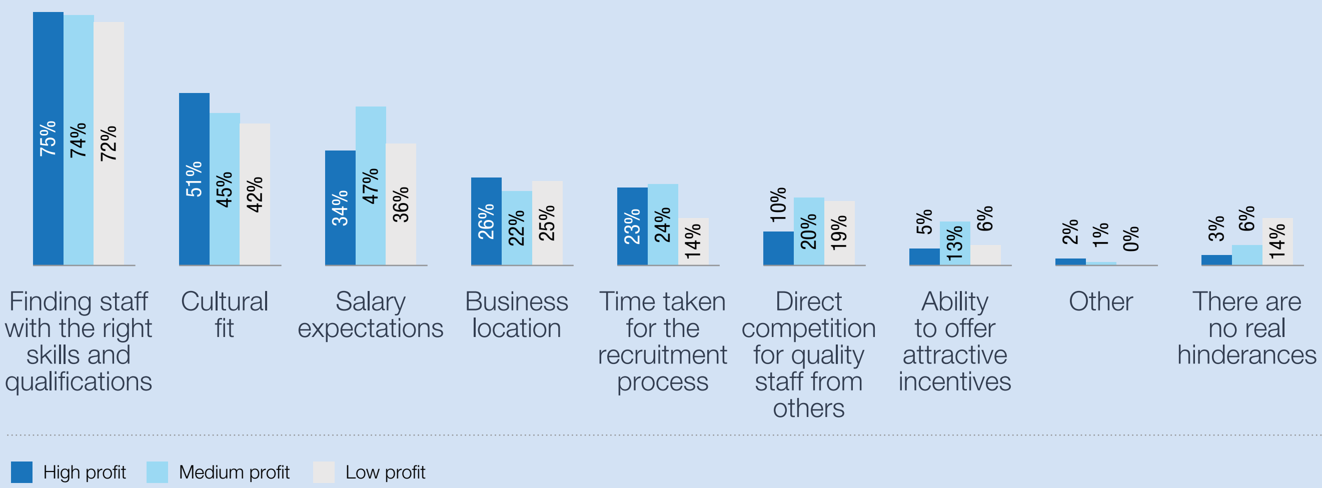


Hiring challenges

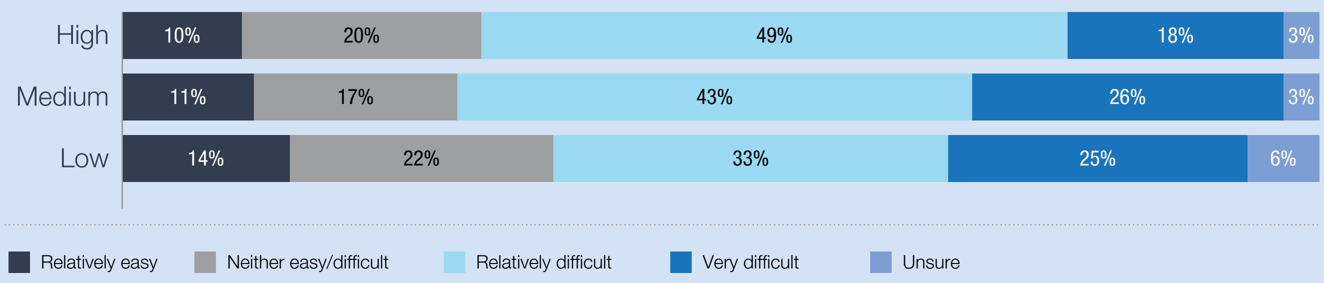
Difficulty with finding the right people

Despite a reduced appetite for new staff across the industry, there can be no doubt that experienced people are still in demand, with two in three businesses saying it's difficult to find staff with the skills they want. Interestingly, high profit businesses were somewhat more likely to say finding skilled staff is difficult than their lower profit peers. While these firms were less likely than others to have difficulties meeting salary expectations or competing for quality staff, they still found it challenging to achieve the right cultural fit or the right combination of skills and qualifications.

Hiring challenges



Difficulty in finding and employing new staff



Remuneration

Rewarding performance

High profit businesses used a combination of base salaries and incentives to keep salary costs under control, while still rewarding performance. And they were especially likely to retain talented staff by offering them training and development opportunities, combined with targeted bonuses to reward strong performance.

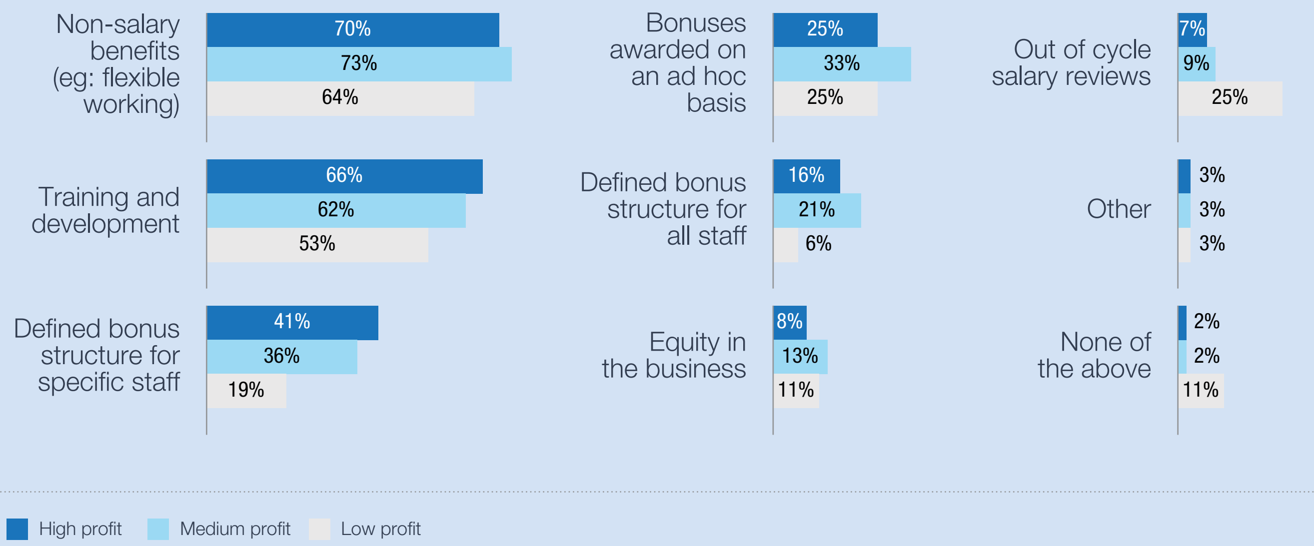
70%

firms apply non-salary benefits such as flexible working arrangements to help retain quality staff

60%

also use training and development as a retention strategy

Remuneration and incentives



Mergers and acquisitions

Willingness to buy or sell

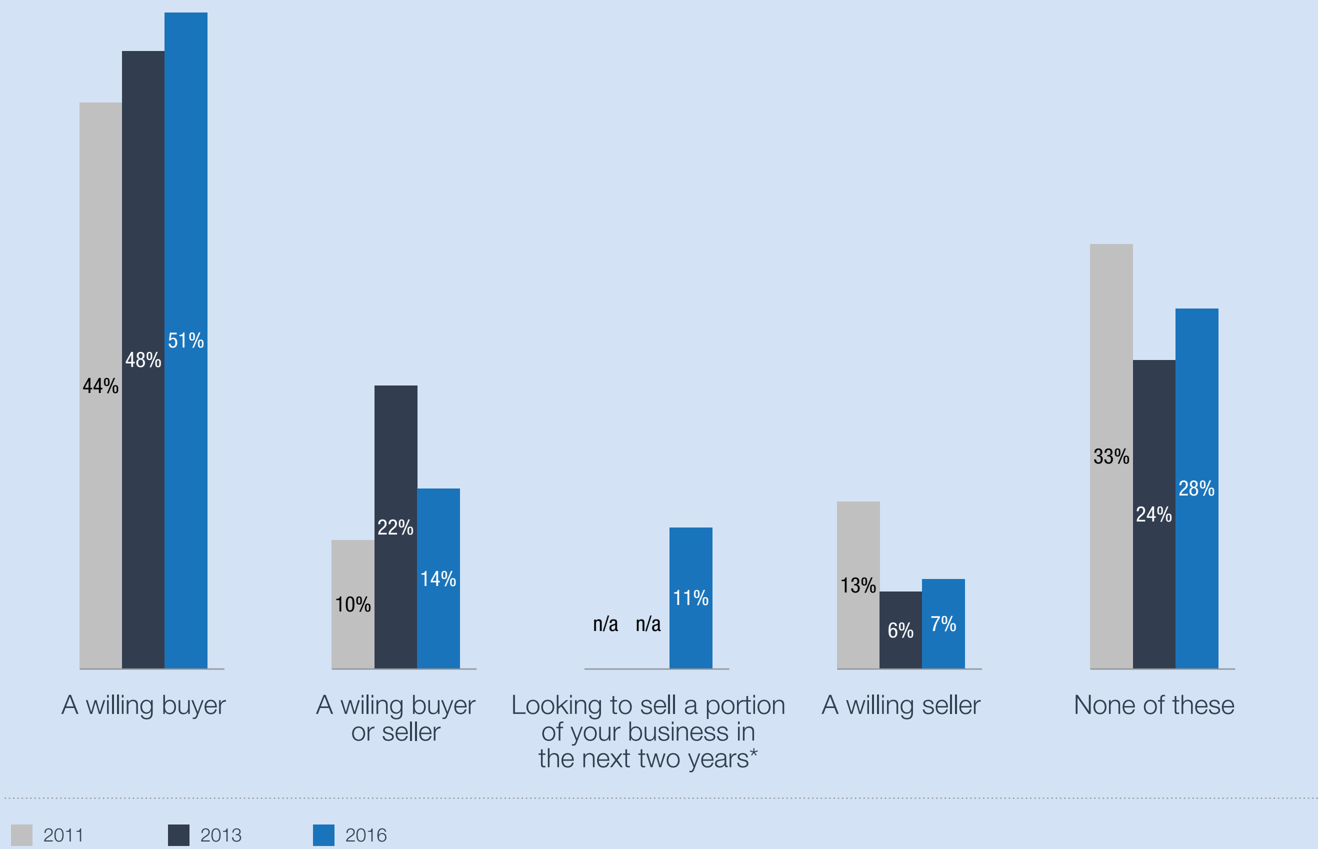
A seller's market

Even after the substantial industry consolidation of the last few years, the appetite for further acquisitions has only grown stronger, with more than half of all insurance brokers saying they were willing buyers, up from 44% five years ago. The result is very much a seller's market, with only one in five principals willing to even consider selling.

11%

looking to buy or sell a portion of their business in the next two years.

Willingness to buy or sell



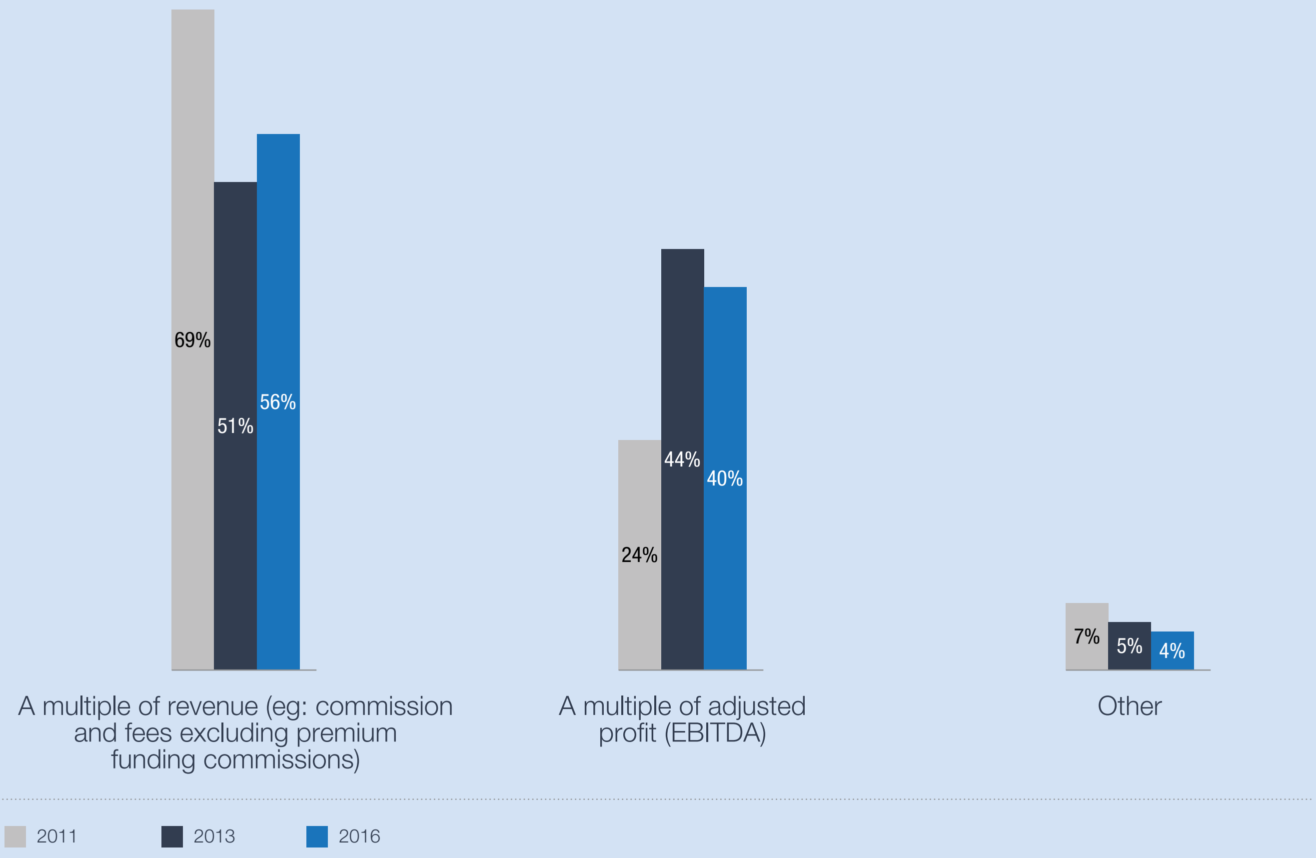
*New option added in 2016 Insurance Broking Benchmarking survey

Valuation methods

Revenue versus profits

Firms remained divided over their preferred valuation method. After falling out of fashion in 2013, revenue multiples were back in favour with 56% of businesses, in an environment when revenue growth has proved increasingly difficult to achieve. Unsurprisingly, high profit businesses continued to prefer profit multiples as the best metric for determining a business' true value.

Valuing the business



Valuation multiples

Profit multiples remain consistent

Firms were largely in agreement over the most appropriate multiples for future acquisitions, with both high and lower profit businesses nominating similar multiples for both revenue and profit. Their nominated revenue multiple was also very close to the median revenue multiple actually paid over the last 24 months by the 18% of firms that have acquired a business. Yet their preferred profit multiple represented a significant increase on the median multiple of 4.25 achieved in practice over the last two years.

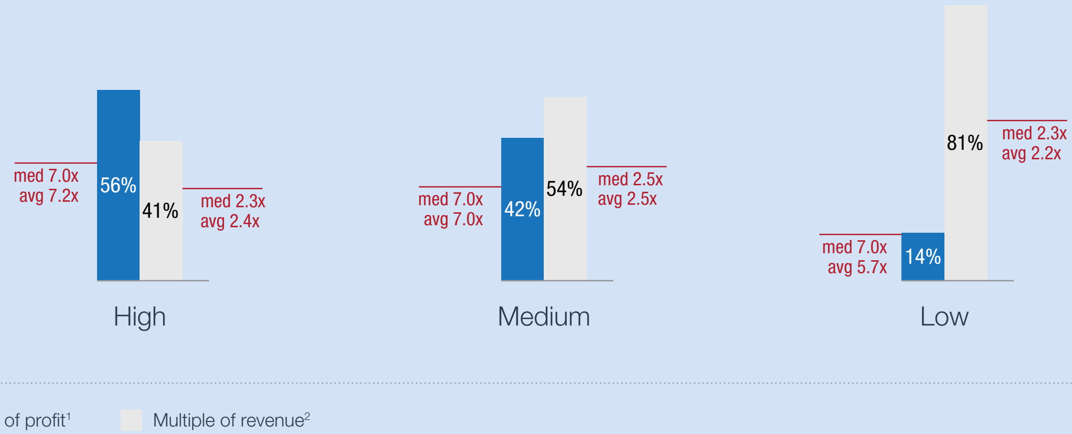
% of firms that acquired a business in the past 12 months

2016 18%

2013 18%

2011 19%

How should your business be valued?



[1] A multiple of adjusted profit (EBITDA).
[2] A multiple of revenue (i.e. commission and fees excluding premium funding commissions).

Succession planning

Realising value for the future

Two in three firms had succession plans in place, with a sale to key staff (31%) marginally outranking selling to another firm (28%) as the most popular option. Among the third of businesses without a success plan, most said they had no plans to exit in the near future, although a high one in five said it was simply because they had no obvious successors.

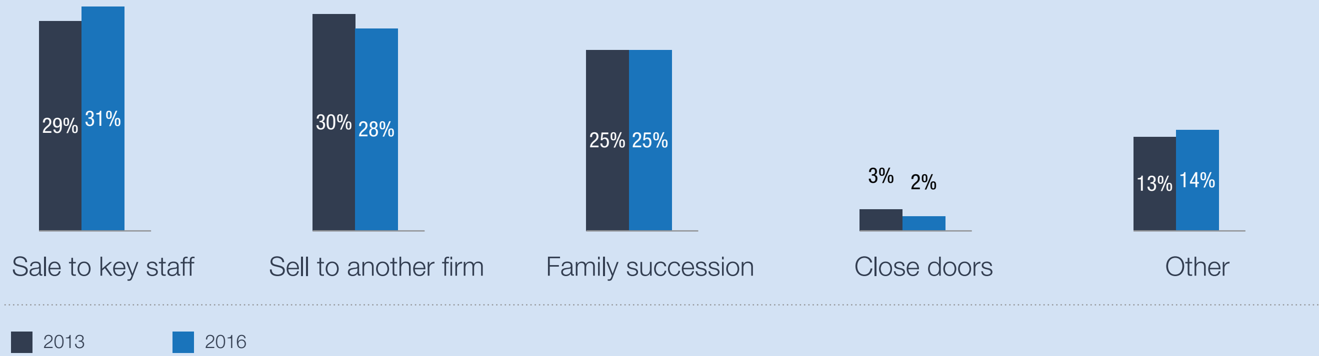
% with a succession plan

Not sure 4%

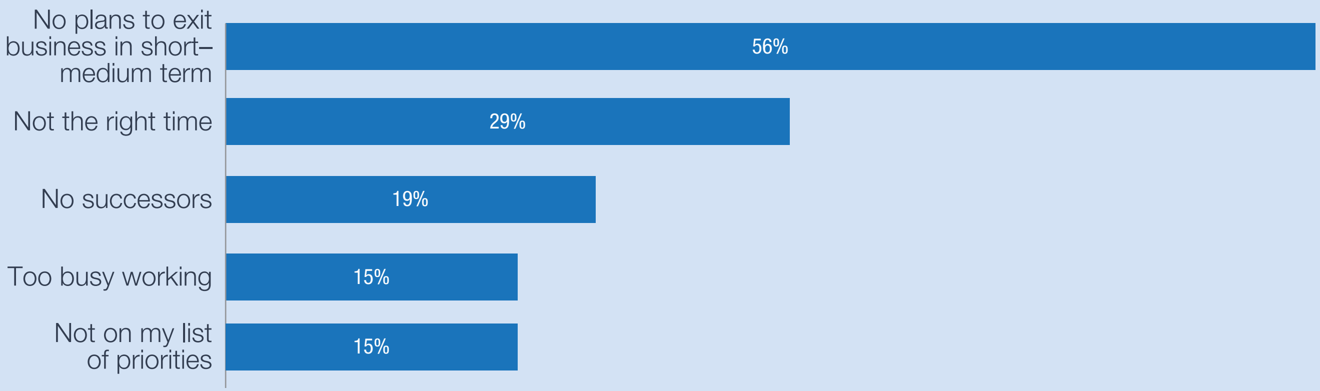
No 31%

Yes 65%

Succession plan details



Top 5 reasons for no succession plan



Read our quick guide to developing an effective succession plan.

Is this the right time to buy or sell?

Achieving critical mass in a world of digital revolution

As new technologies move towards critical mass, risk will shift from physical assets to intangible assets. For example, the arrival of driverless cars could significantly reduce the claim pool for commercial motor, domestic motor and CTP.

At the same time, new risks will arise, focused on technical failure rather than human error. As a result, both insurers and brokers need to start thinking about what the insurance solutions of the future will look like.

Those with the financial strength to invest in new solutions will be better positioned to respond to a changing market — another reason why building scale now can make sense. But a viable alternative is to stay small and nimble by creating a well-honed specialist offering.

> "The key to success is to create a value proposition based on trust, expertise and outstanding service, no-one can completely automate great customer service.

David Hosking, Chief General Manager, Broker and Agency at Allianz Australia, believes the next five years will see continued industry consolidation, as a soft-rate cycle makes organic growth harder to achieve.

At the same time, digital innovation will begin to change the nature of risk.

Outlook and future growth

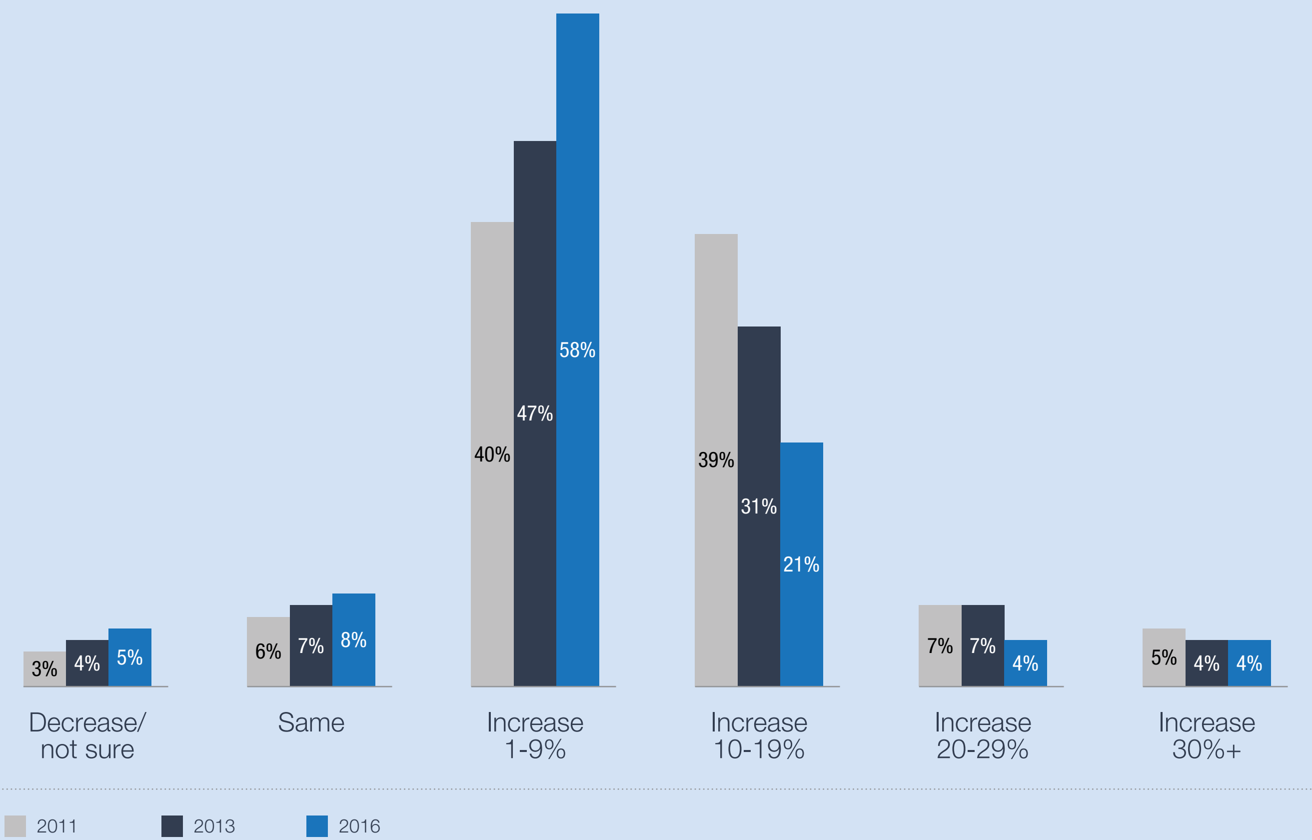
Revenue outlook

Cautiously confident

The vast majority of businesses were optimistic about the year ahead, with 87% forecasting higher revenues in FY17. However, growth expectations were still more muted than in previous benchmarking studies, with 58% expecting increases of less than 10%.

87%
forecasting higher revenues in FY17.

Expected change in revenue



Profit outlook

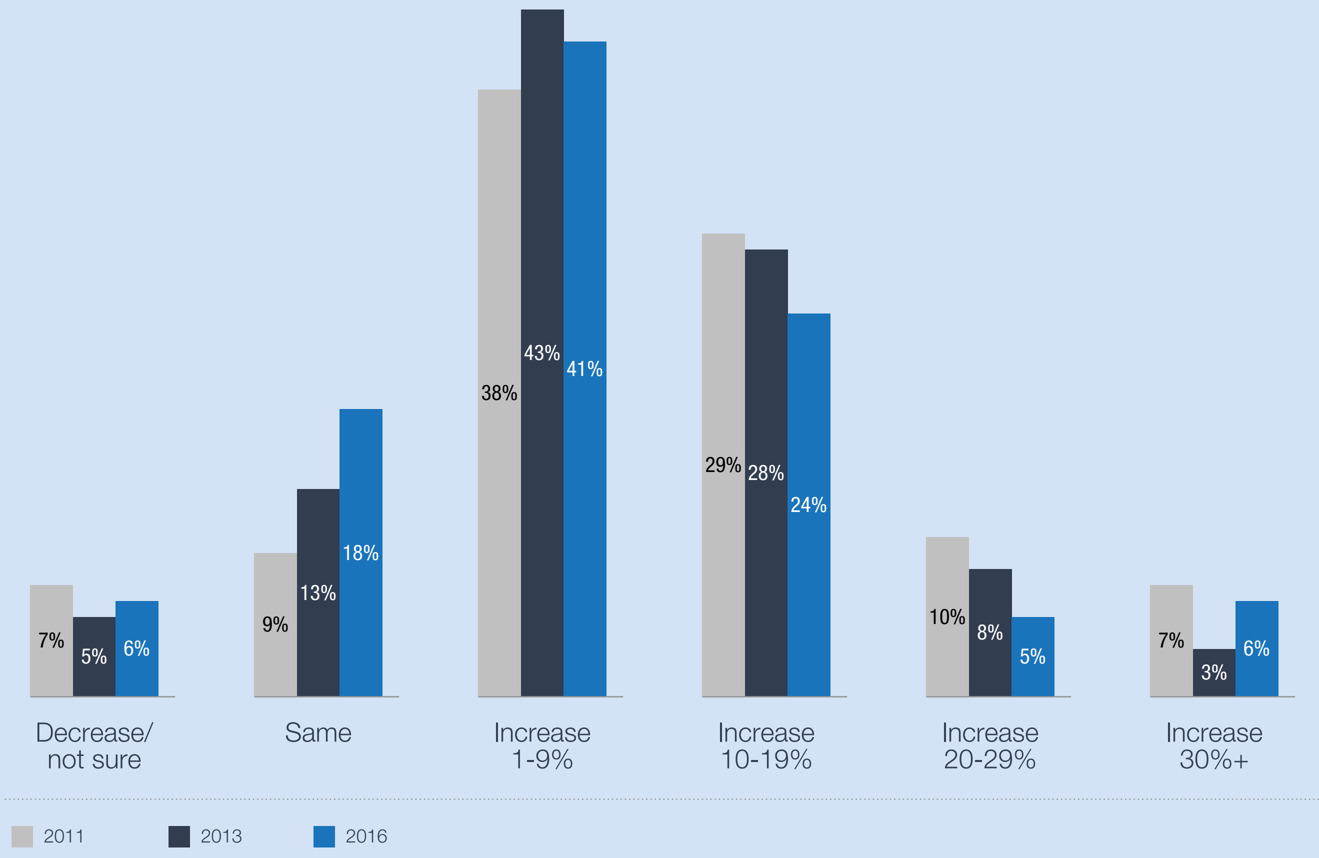
A polarised market

While still positive, overall profit forecasts were more subdued than the revenue outlook. Three in four businesses anticipated higher profits in FY17, with almost one in five expecting growth to remain flat and another 41% forecasting growth of less than 10%. However, 6% still said they could achieve growth of 30% or more, suggesting that a small group of businesses believe they have the right operational settings to continue outperforming.

3 in 4

anticipate higher profits in FY17.

Expected change in profit

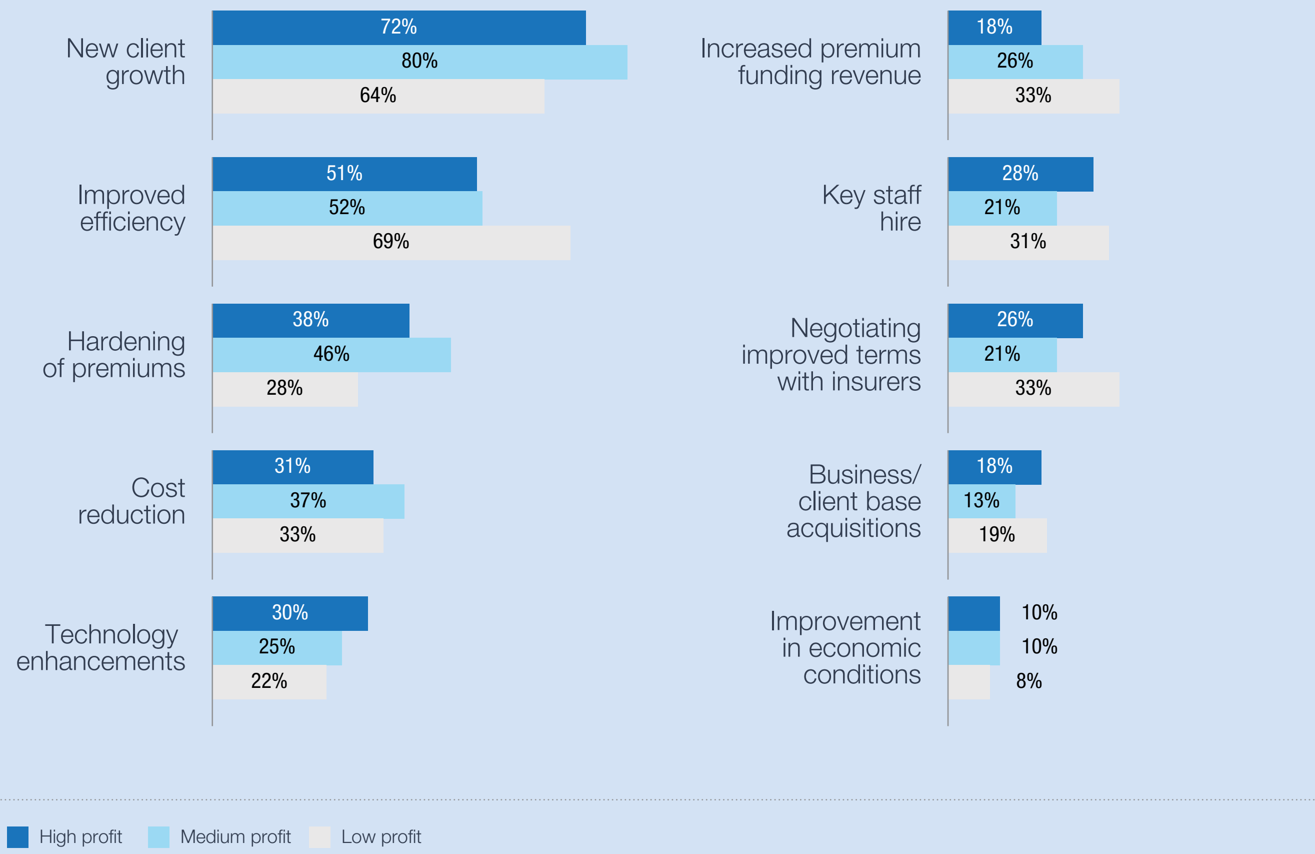


Profit drivers

Underpinning future growth

Asked which aspects of their business they expected to have the largest impact on future profits, high profit businesses tended to focus primarily on new client growth. Lower profit competitors were comparatively likely to seek higher profits through back office efficiencies – an area where high profit businesses already excel – although many will also seek to grow their premium funding revenue. Notably, hardening premiums were among the most commonly nominated factors for both groups.

Areas expected to positively impact profitability in FY17

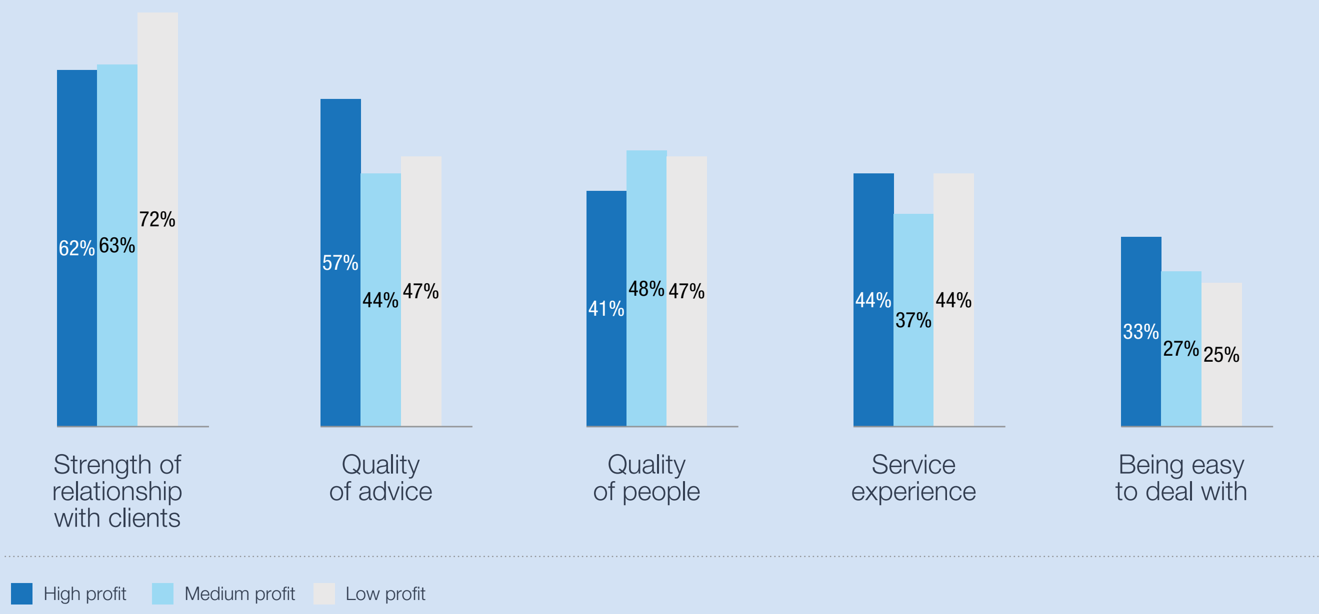


Winning new business

Differentiating yourself in a competitive market

In a highly competitive market, successful firms were increasingly seeking to create a distinctive value proposition to differentiate them from their peers. While most agreed that strong relationships are fundamental, high profit firms were more likely to emphasise the quality of their advice, while many lower profit firms relied on a strong brand or reputation to distinguish them in the marketplace.

Top five ways to differentiate business



Achieving best practice

Three habits of high performing businesses

1. Maximise productivity

High profit businesses invest in productivity, including staff training, technology and systems to support client service.

2. Retain talented staff

High profit businesses see skilled staff as a key driver of profit growth. By focusing on training and retention, then sharing equity when appropriate, you can secure the outstanding people you need to build high quality relationships and the sustainable growth of the business into the future.

3. Build a strategy for long-term success

In a market set to be increasingly impacted by technology, it's essential to think carefully about the future of the industry and your place in it, then build a strategy to take your firm where it needs to be.

State performance

State performance

The new two speed economy

While business conditions across the country remain difficult, firms in the resource-rich states of Queensland and Western Australia have been impacted by weak economic activity in the wake of the downturn in mining investment. In contrast, Victorian businesses have benefitted from a resurgent economy.

State outlook: Victoria

Riding high

Key insights

With average GWP of $18.7m and revenues of $3.98m, Victorian firms led the country on earnings. They were also among Australia's most diversified broking businesses, earning an average 27% of GWP from domestic lines.

Average GWP
$18.7m

Average revenues
$4m

Proportion of firms expecting an increase in revenue growth
85%

Proportion of firms who reported a profit in FY16
93%

Proportion of firms expecting an increase in profit growth
73%

State outlook: New South Wales

Feeling the pressure

Key insights

New South Wales firms had the most productive staff in the country, with median revenues per staff member of $181,395. But they also had fewer client-facing staff than their peers in other states, bringing overall revenue numbers down.

Average GWP

$13m

Average revenues

$2.7m

Proportion of firms expecting an increase in revenue growth

96%

Proportion of firms who reported a profit in FY16

91%

Proportion of firms expecting an increase in profit growth

75%

State outlook: Western Australia

Suffering from the mining downturn

Key insights

Western Australian firms were feeling the effects of the mining downturn, with 44% reporting zero revenue growth or declining earnings in FY16. However, they outperformed on premium funding, with around a third of the average Western Australian firm's book now funded.

Average GWP

$14.7m

Average revenues

$2.9m

Proportion of firms expecting an increase in revenue growth

82%

Proportion of firms who reported a profit in FY16

97%

Proportion of firms expecting an increase in profit growth

82%

State outlook: Queensland

Some gloom in the sunshine state

Key insights

Queensland firms were most likely to report falling margins in FY16, with 39% saying their profits had decreased. Asked why they had fallen, 44% cited softening premiums, while 38% said their clients were undergoing economic hardship.

Average GWP

$12.9m

Average revenues

$2.4m

Proportion of firms expecting an increase in revenue growth

83%

Proportion of firms who reported a profit in FY16

100%

Proportion of firms expecting an increase in profit growth

80%

State outlook: South Australia

Outstandingly resilient

Key insights

South Australian firms were among the country's most resilient, with every participant in our research reporting that they had achieved a profit during FY16. However, they have also been less effective than their peers in keeping costs under control, with the highest proportional spending on staff remuneration nationwide.

Average GWP

$13.4m

Average revenues

$2.5m

Proportion of firms expecting an increase in revenue growth

75%

Proportion of firms who reported a profit in FY16

100%

Proportion of firms expecting an increase in profit growth

58%

Ready to learn more?

Contact

If you'd like to learn more about putting our best practice insights to work in your business, contact me or your Insurance Broking Relationship Manager.

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