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Agency Subsidization at FinGain

You have recently been hired by FinGain, a financial services firm, as Senior Director of Operations. FinGain has a very distributed service model – that is, while there is some centralized oversight and management by the home office, each agent is responsible for building its own business and managing its own clients. One of your key responsibilities will be to manage the agent pipeline – that is, to recruit new agencies and to ensure strong performance of existing agencies. In addition, agencies are like any small business – some succeed, and some do not. Thus, you must also be highly mindful of how best to develop and implement policies that retire or transition agencies that are not meeting their financial performance goals.

FinGain has hired you because it believes in your ability to grow the pipeline strategically and with a long-term view of success. FinGain's executives all have significant experience in various financial services agency businesses, and they want to avoid two kinds of potential failures. First, they want to avoid over-recruiting new agents. The senior leadership team has first-hand experience with operations teams that are too aggressive with incentive mechanisms, lack strategies for long-term success, and thus over-recruit new agents, which eventually leads to a spike a new agency failure rate that significantly lowers the aggregate number of agencies and FinGain's overall financial performance.

On the other hand, FinGain's leadership team doesn't want an overly conservative recruiting effort. They (and you) fully recognize that you could increase new agency success rates to near 100%, but such results could only come at the imposition of unrealistically high demands on new agents – for instance, by requiring a very high level of liquid assets and many years of business leadership experience. Plus, such conservative recruiting measures lead to fewer total agencies, and less market share than the leadership team is willing to accept.

Now, FinGain is counting on you to develop and implement sound strategies to manage the agency pipeline.

Your boss and VP of Operations has asked you to tackle the thorny problem of whether FinGain's home office should be providing a direct monetary subsidy to young agencies to help them navigate the world of agency start-up.

In orienting you to the issue, your boss explains: “We’re trying to be more rigorous about these kinds of decisions. Some of our agencies get a $30,000 subsidy throughout the first year, which just means that we cover up to $30,000 of their first-year costs. I really like that we do this - too many first-year agencies fail, and that’s to the whole company’s detriment. We have the ability to improve their odds of survival, especially in those critical first handful of months. I think that’s exactly what we at the home office should strive to do – make the agencies more successful. On the other hand, we’ve never rigorously evaluated whether the subsidy makes sense. I need you to help us make a well-informed decision of what to do next.”

You eagerly take notes and ask one question before leaving your boss’ office: “What’s the criteria for getting the subsidy?”

Your boss replies, somewhat defensively: “We’re big into empowering our leaders to make their own decisions here at FinGain, so we tend to leave this decision up to the regional managers. Overall, about one-quarter of our first-year agencies get the $30k subsidy, and the rest don’t get anything. I imagine that the decision of who gets the subsidy is very manager-specific.”

Energized by this important new project, you believe that you can best answer this question by comparing the value of agencies that do and don’t receive the subsidy. You decide to calculate agency value over a 5-year period, using an 8% discount rate. Your research yields the following information about the subsidy at FinGain over the last handful of years:

- On average, agencies earn gross revenue of $1.2M in the first year, regardless of whether they receive the subsidy. It is reasonable to expect 5% average annual increase in agency revenue.
- The financial relationship between the home office and each agency is simple: each agency returns 20% of gross revenues back to the home office.
- As best you can tell, the only difference between agencies that do and don’t get the subsidy is in attrition rates (or, in the FinGain vernacular, “death rates.”) The average agency attrition rates are given below:

		Agencies without subsidy	**Agencies with subsidy**
Attrition rate throughout:	Y1	14.6%	9.9%
	Y2	11.3%	11.1%
	Y3	10.7%	10.6%
	Y4	8.4%	8.7%
	Y5	7.9%	8.0%

To tackle this problem, you decide to calculate agency value *to the home office*. This should make it easier to assess whether the home office should be providing a subsidy.

Please answer the following questions, making sure to explicitly describe how you are treating the subsidy for purposes of calculating value.

Q1. Agency Valuation Calculations:

a) **What is the 5-year value of an agency that does NOT receive a subsidy?**
b) **What is the 5-year value of an agency that does receive a subsidy?**

Q2. Managerial Implications:

a) **From an agency value perspective, is it a good idea to provide a $30k subsidy to an agency in its first year?**
b) **Please be sure to make clear all of the assumptions that are needed to answer part (a).**