DELIVERING GROWTH AND PROFITABILITY

HOW TO BE SURE YOU INVEST TIME AND RESOURCES IN THE RIGHT AREAS

Introduction

As an MSP you must be constantly looking for new opportunities. Your clients' business and IT challenges are constantly changing so the managed services you offer must evolve accordingly to ensure they remain relevant.

But as you evaluate potential new services, you need to be sure that you are investing your time and resources in the right opportunities: those that will play to your strengths, not your weaknesses; those where you are well-placed to deliver the new service profitably and with high levels of customer service.

The more understanding you have of your current business performance, the better placed you will be to choose the right opportunities for future growth – and to cost and price them accurately and competitively.

How do you know which opportunities are right for you?

There are plenty of opportunities for MSPs, but which will bring the best growth prospects for your business?

Time to do your SWOT analysis?

A SWOT analysis helps you to identify internal strengths and weaknesses, in the context of external opportunities and threats. It can be an extremely useful exercise to go through when you are planning to move into a new service area.

Because you need to know which of the new opportunities will play to your strengths, which will require you to fill gaps or fix weaknesses in your current business - and which would best be avoided altogether because they are not a good fit for your company.

This kind of evaluation can't be found in an industry survey. It needs answers to questions such as:

- How profitable are each of the current services we currently offer?
- How satisfied are my clients with the level of service they are receiving now?
- What do our resource utilisation rates look like?
- Are we currently deploying our skilled technicians as profitably as they could be?
- Do we have technicians in-house who could be redeployed into the new, in-demand areas if their existing workload was removed?

And that means measuring your business against a range of key performance indicators (KPIs).

Identifying the success metrics that will help you most

A recent Autotask study[1] revealed some interesting findings here. When it comes to the metrics being used by MSPs to measure their current performance, responses showed an at best patchy approach to measuring KPIs, as shown in the chart below. Indeed, while almost 95% of MSPs measure at least one of the KPIs listed, only 6% measure them all – even though they are all likely to have an impact on future growth.

Key performance indicators (KPIs) rankings

1 Billable resource utilisation
2 Overall profits
3 SLAs
4 Profitability by customer
5 Customer satisfaction
6 Sales pipeline
7 Profitability by contract
8 Profitability by service
9 EBITDA
10 None of these

[1] Autotask's Metrics that Matter ITSP Benchmarking Study 2016

Unsurprisingly, perhaps, 'billable resource utilisation' is the top metric tracked, with 'overall profits' and 'SLAs' following close behind. Profitability by customer, by contract and by service appears much lower in the rankings – while 'customer satisfaction' only appears in 5th spot.

The top three metrics are certainly important in measuring your performance; but do they give you the full picture of where your success is coming from? That detail comes from the KPIs further down the list – and the results are not always as expected.

For example, your most profitable clients may not be those you send the biggest bills – or those who give you the highest satisfaction ratings; your most valuable technicians may not be those with the highest utilisation rates, but those who generate most new business; and the individual services you offer will have different levels of profitability – indeed some may actually be losing money.

When you are looking for hard evidence to help you to decide on which of the new opportunities you are best-positioned to grab, tracking your current performance using only one or two metrics is really not enough. After all, if you are not sure of the strengths and weaknesses in your current business – how can you build the foundation for a new service offering?

Getting from where you are now to where you want to be

You want to become a trusted partner to your clients in a new service area.

But before making any investment, you must be sure that you have a realistic chance of delivering on this new opportunity. And this means asking some very basic questions:

- How can you differentiate your new service from competitive offerings?
- How big is demand and how rapid is the take-up likely to be?
- How easy is it to sell as a concept?
- Is it a good fit for your current and target clients?
- How many existing clients are likely to buy the new service?
- Do you have the skills and experience in-house that you need?
- If you are redeploying existing resources to deliver the new services – what will be the impact on your current business?

And, of course, the most important question:

- Can you deliver the new service and make a profit?

Working out your true service delivery cost for profitable pricing

A simple delivery costing methodology

You need to know whether or not you will be able to deliver a new service profitably – a decision that depends on knowing your current service costs projected forward.

Because if you don't know what it's costing you to deliver your current services – how can you set prices and allocate resources for anything new?

Your service delivery cost will largely determine pricing levels. How aware are you of yours? Do you know which metrics you need to determine it?

This simple 3-step guide can help.

Step 1, Calculate the full hourly burden rate

This means calculating:

- The full **billable labour burden**, i.e. the total of all billable staff labour costs above and beyond gross compensation
- The **full overhead burden**, i.e. the sum of all company overhead costs, including non-billable staff and, for example, rent, rates, training and so on

The worked example below shows how to calculate the full hourly burden rate. You will need this to work out current service delivery costs and as a basis for calculating margins and setting prices.

$$\frac{\text{(Full billable labour burden + full overhead burden} \div \text{number of billable staff)}}{\div \text{ again by 2080 (working hours per year, assuming 8 hrs/dayworked)}}$$

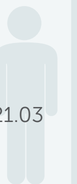
Note – this does not take account of extended hours support. If you are providing 24/7 coverage, this becomes a totally different calculation. So we will stick with 8 hours a day for now.

Worked example for 8 billable staff:

Full Labour Burden (£250K) + Full Overhead Burden (£100K) = £350,000

£350,000 ÷ 8 billable staff = £43,750

£43,750 ÷ 2080 paid work hours/year = £21.03 full hourly burden rate



Step 2, Take account of staff utilisation rates

A utilisation rate of 100% sounds like a wonderful goal – but it would mean no holidays, sick days, or training time for your staff. There is no hard and fast rule for utilisation rates and you may well have different utilisation goals across different teams. Many MSPs aim for around 75% utilisation; some lower, some higher. When you decide the most appropriate rate for your business, don't forget to allow ample capacity for surges and future growth.

Assuming the **full hourly burden rate of £21.03** taken from the worked example above, the sliding scale below shows how this rate increases as utilisation percentage decreases, so that at 75% utilisation the full hourly burden rate becomes £28.04, and at 65% - £32.35.

Cost of service delivery per hour £21.03

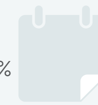
Utilisation rate	50%	60%	65%	75%	85%	100%
True cost per productive hour	£42.06	£35.05	£32.35	£28.04	£24.74	£21.03

Now that you have a good idea of your hourly cost of service delivery, you can begin to work out how much on average it costs to deliver each line of business, taking labour and other costs (such as third party products and services) into consideration.

Step 3, Calculate service margins

Once you know your hourly cost of service delivery, you can calculate service margins as shown in the continuing worked example for delivering service desk and NOC services below. This is an essential prerequisite for setting prices.

First work out monthly costs



- Cost of service delivery per hour at 75% utilisation = £28.04/hr
- Total hours of service delivered in month (service desk requests and NOC) = 150 hrs
- Cost: 150 hrs x £28.04/hr = £4,206

You can drill down further to calculate costs on a per client or per contract/service basis by looking at time spent per client and/or per contract/service.

Then calculate monthly margin

- Recurring revenue monthly billing: £25,000
- Service delivery cost: £4,206 (150 hrs x £28.04/hr)
- Profit: £20,794 (billing minus costs)
- Margin: profit ÷ billing x 100 = 83%

Add in other billable hours for projects, plus T&M to get a blended margin.

Armed with this information you can start to drill down into the profitability of your service delivery, T&M and other professional services work – as well as into staff profitability.

Don't forget to add in the anticipated cost of management time and the costs of any subscriptions such as RMM nodes, backup, AV and so on – and you will have all the information you need to review margins, mark-up and pricing – or project these onto new service areas.

Identifying lost billable time

The calculation above can also help you to understand how much billable time you may be losing each month.

A recent Autotask Study[2] gives an idea of just how many potentially billable hours are being lost each week – often on tasks that could be automated, eliminated or streamlined: 52% of respondents admitted to losing up to 5 hours per week in such tasks; while, worryingly, some 20% did not know how much time was being lost.

Of course if this non-billable time is being used to generate new business, it could ultimately be more profitable for the company than straight billable hours.

It's crucial to know the true cost of service delivery as this is a major determinant of pricing. And this brings us to the next challenge.

[2] Autotask's 'Metrics that Matter ITSP Benchmarking Study 2016

Resolving the Pricing Conundrum

A la carte versus flat fee? To bundle or not to bundle? Per user or per device? Cost-based or value-based?

One thing is sure, in the MSP guidebook there is no golden rule for pricing your services and nor should there be as the price you charge will depend very much on the type of services you offer, your target market and, as already noted, your service delivery costs.

Choosing the right pricing model

Choosing the right pricing model is easier said than done and a good number of MSPs admit to being dissatisfied with their current pricing.

There is quite a variation in pricing strategies across MSPs, as respondents to Kaseya's 2016 MSP Global Pricing Survey[3] highlighted: while value-based pricing remains dominant, there is a definite increase in price-matching – possibly as a result of today's highly competitive markets. Price matching may seem like a necessary evil to win a contract, but its ongoing use as a pricing model just fuels the commoditisation of IT services and inevitably results in a race to the bottom. Wise MSPs focus on delivering value to retain higher margin engagements, shifting from pure device management to delivering a great end-user experience or developing a specialist practice.

When did pricing become so difficult?

The growth of SaaS and cloud combined with new technologies that enable remote monitoring and support have totally changed the way IT services are delivered – and the costs associated with that delivery.

Add to this the impact of mobile technologies on the way that consumers expect their services to be delivered (anytime, anywhere, in-hours, out-of-hours and from multiple devices) and pricing has gained a whole new layer of complexity.

Then factor in the cost of acquiring and retaining specialist resources (people costs are likely to make up the bulk of your service delivery costs) – or the need to consider offshoring or outsourcing to a partner to reduce operational costs.

The fact that managed services is recognised as a growth area does not help. It means more suppliers are piling into your market – with an inevitable impact on prices.

Kaseya Survey Results for:	Cost Based	Value Based	Price Match
2014	25%	59%	16%
2015	28%	51%	21%

Why is it so important to get it right?

If you are not using the right pricing model for your business, you risk:

- Not being as profitable as you could be.
- Actually losing money because you are not charging enough to cover your fully burdened costs.
- Losing out to other MSPs who are positioning themselves more competitively – and still making a healthy profit.
- Not winning new business because of an inflexible or 'customer-unfriendly' approach to pricing.
- Losing money on some client contracts by applying the same pricing approach and margin across the board. This may include new clients who are still an unknown quantity, clients with more complex needs or those using older technology.

What are your options?

The different pricing models being used by MSPs all have their pros and cons. Some benefit the MSP more; some the customer. Also, the pricing model that works best when you begin your engagement with a customer may not be the most appropriate further down the line when you are managing more services on their behalf. And your pricing model may need to be varied across different service areas.

[3] MSP Global Pricing Survey, Kaseya 2016 Report

The main pricing models in use by MSPs today

Pricing model	What is it?	Impact on MSP	Benefits to customer
A la carte pricing	Customers select and pay for the specific service elements they need.	Allows a foot in the door when building recurring revenue from 'reactive' customers. BUT it can extend the sales cycle as the customer has to select from many choices – and it doesn't communicate value well.	The most flexible option for customers as they can build their own service agreement, completely tailored to their requirements – assuming they fully understand what these are. Customers know they are paying only for what they need.
Bundled (aka SLA-based, tiered pricing)	Different levels of support packages are offered at different price points and the customer selects the package that most closely reflects their needs.	MSPs can offer different package tiers and include a reasonable margin. Bundling some services can reduce the complexity of the offering. BUT the customer may just choose the cheapest option, so more effort may be needed to sell the value of the more expensive packages.	Customers have the option to choose a 'bundle' that most closely reflects their service requirements and budget. This approach can simplify the sales process from the customer's point of view.
Flat fee pricing for fully managed services	This is 'all you can eat' pricing – a value-based, standardised model, as opposed to the customer selecting individual items.	More effort is required to sell, but it can produce higher margins. On the flip side, it can also eat into margins if you underestimate usage or the cost of delivery.	Customers benefit from an all-encompassing managed services solution with a single cost. BUT it may be more difficult for them to justify internally, as opposed to the more transparent payment of individual service elements.
User-based pricing	A flat fee is charged per user, irrespective of the number of devices or services they use. Services such as BDR and security can be included in the seat cost and each user's multiple devices are covered.	Can be easier to sell and keeps things simple. Easier too for the MSP to ensure the consistent delivery of services across a business. BUT it can be risky as MSP margins can take a hit if the support/delivery costs for each device and service are not factored in correctly.	Because everything is handled within the one user seat charge, customers benefit from knowing that all aspects of their IT are accommodated within the cost. It is easy to administer as the number of users grow.
Device and end-user based pricing	A flat fee is paid for every device and end-user supported, with prices varying depending on the type of device (eg. server, mobile, desktop and so on).	Flexible and easy to administer and quote for services. BUT it does not communicate value as pricing is solely based on the number of devices/end-users managed. It can also make it difficult to upsell further services.	A flexible approach for customers as devices and end-users can be added as their business grows. BUT it can be difficult to see the value in the support offered as the price has become purely a numbers-based calculation.

Is there a 'most popular' pricing model?

The simple answer is 'no'. In fact, not only is there no consistent single model across MSPs – each MSP may adopt differing models or hybrids to come up with the right price for different customers and services.

It really does come down to what works best for your business.

Ten dos and don'ts for profitable pricing

Do

- Make sure you have a thorough understanding of your service delivery costs.
- Ensure the model will remain relevant as you grow: avoid having to totally change your core pricing structure as you take on more customers, with more complex needs.
- Keep pricing as simple as you can: transparency in pricing can eliminate confusion and reduce the need for extended negotiation in the sales process.
- Build in the value of any specialist industry sector or vertical market expertise you have: it will add to your value in customers' eyes.
- Be aware of what competitors are charging for comparable services: you are not operating in a vacuum and need to differentiate your services by delivering them to a high standard and as cost-effectively as possible.

Don't

- Follow an inflexible pricing strategy; this can turn potential customers away.
- Slavishly follow competitors' pricing.
- Forget to factor in the value you offer when you are comparing the prices you charge against those of your competitors.
- Reject bundling as an option; it can help you to better align your service offering to customer needs.
- Forget that increasing levels of automation and outsourcing can help to reduce your service delivery cost and so help you to keep any price increases to a minimum – or avoid an increase altogether.

Pricing for value

Don't undersell your services.

Price is not the only criterion on which you will be judged by prospective customers. In fact, it is not 'front-of-mind' for many customers according to the 2015 CompTIA 'Trends in Managed Services' Report[4], which also found customers prepared to pay a premium for MSPs who align most closely to their business needs.

Pricing for value is a major factor here.

The Kaseya 2016 MSP Global Pricing Survey[5] reports that:

> "high-growth MSPs share a determined, continuous focus on finding areas of growth and competitive value, and clearly articulating this value to their clients."

According to the Kaseya results, high-growth MSPs:

- charge more for their technicians.
- have a higher variance between what they charge for Level 1, 2 and 3 technicians.
- charge more on average for ongoing server support and maintenance per month.
- have a higher average size monthly managed services contract.

[4] CompTIA, 4th Annual Trends in Managed Services, May 2015
[5] MSP Global Pricing Survey, Kaseya 2016 Report

Partnering can help you achieve profitable growth

Working with a partner is a good way forward when looking to invest in new growth areas. It allows you to access additional expertise and, crucially, to ensure that high levels of service are maintained for your 'bread and butter' services such as Network Operations Centre (NOC) and Service Desk. It means you can redeploy your own technicians from routine monitoring, management and maintenance tasks to higher-value areas of client concern.

Partnering can also help to control the cost of service delivery as you can benefit from your partner's existing infrastructure and economies of scale – and scale for growth without capital investment.

A partner can even help with pricing.

For example, at Inbay we understand that every MSP is different and we take the time to understand the pricing models you use and then map our charges to your pricing model, so that you can clearly understand your cost of delivery for any services you use. Your new expense will align with your new revenue so every new client you take on using Inbay's services should be profitable – and you won't have had to make a huge payroll investment to achieve this.

Find out more

To find out how we can help you take your MSP to the next level just get in touch with one of our partner specialists today.

www.inbay.co.uk

ABOUT INBAY

Providing exceptional service to our partners' clients is our number one priority. Inbay has been providing specialist IT support since 2003, first as an MSP and now as a trusted partner to MSPs on an international basis.

We have built a reputation for helping our partners grow their managed services businesses by providing the highest quality service desk, NOC and project services at a fair price.

Operating from our headquarters in London, we offer MSPs 24/7 support to complement and extend their own resources, enabling them to scale cost effectively and drive profitable growth.

For more information, please visit:

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