The State of Partner Profitability: Managed Services Business Model
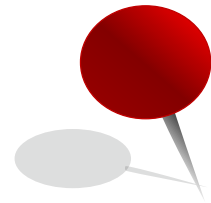
Continuing Education for IPED Channel Masters

IPED® Consulting

THECHANNELCO.™

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AGENDA

➢ **First, a little background**
  - When we talk MSP, what do we mean?

➢ **MSP Partner Profitability**
  - Revenue
  - Gross Margins
  - SG&A

➢ **And finally, Vendor Impacts**

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The Background

The 2017 State of Partner Profitability
Research Review and Discussion
Continuing Education for IPED Channel Masters

THE CHANNEL CO.

IPED Consulting

Beth Vanni
Sr. Consultant
and Research Manager

THE CHANNEL CO.

2017 State of Partner Profitability:
Driving the Growth and Evolution of the Channel
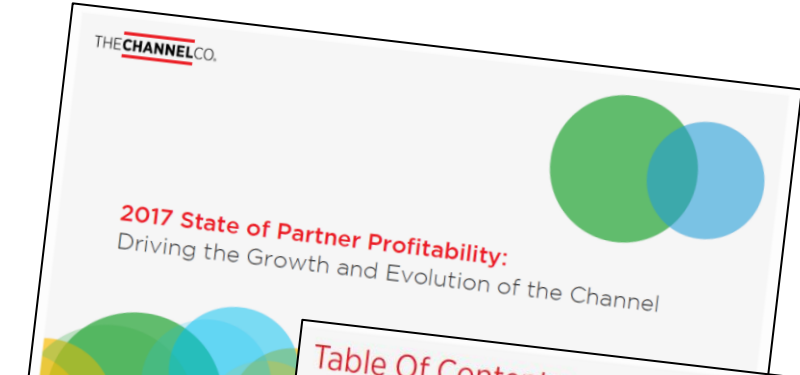
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Webinar Title: "The State of Partner Profitability - MSP Business Model" (part 2 of a 3 part series*)
*Part 1 of this series was delivered for another Channel Masters class in April. If you are interested in viewing Part 1 on demand for additional context before the July 28th session – following is the recording link: http://cc.readytalk.com/play?id=96tinu

✓ Online Survey with 318 solution provider respondents

✓ 23 in-depth partner interviews to deeply explore the quantitative elements of gross margin and SG&A cost structures

The Impact of Profitability: Then and Now

NOW – "Valuable"

- Intellectual property
- Monthly recurring revenues
- Customer retention & expansion rates
- Vertical insights & LOB relationships
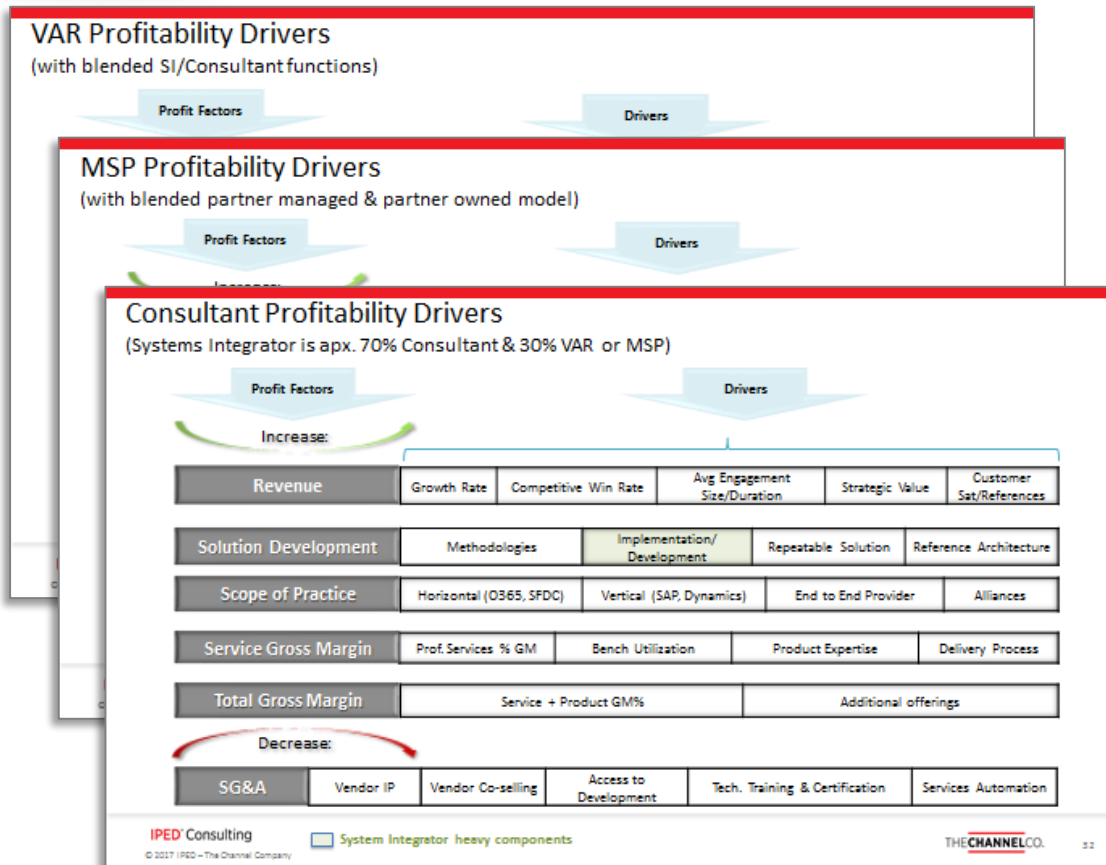- Services diversity

SUCCESS

THEN – "Profitable"

- Gross margins
- New customers
- Prof. Services growth
- Solvency

Three Pure-Play models from which you can have a granular view of profitability and benchmark your program

Partner Profitability

VAR Profitability Drivers
(with blended SI/Consultant functions)

Profit Factors → Drivers

MSP Profitability Drivers
(with blended partner managed & partner owned model)

Profit Factors → Drivers

Consultant Profitability Drivers
(Systems Integrator is apx. 70% Consultant & 30% VAR or MSP)

Profit Factors → Drivers

Increase:

Revenue	Growth Rate	Competitive Win Rate	Avg Engagement Size/Duration	Strategic Value	Customer Sat/References
Solution Development	Methodologies	Implementation/ Development	Repeatable Solution	Reference Architecture	
Scope of Practice	Horizontal (O365, SFDC)	Vertical (SAP, Dynamics)	End to End Provider	Alliances	
Service Gross Margin	Prof. Services % GM	Bench Utilization	Product Expertise	Delivery Process	
Total Gross Margin	Service + Product GM%		Additional offerings		

Decrease:

SG&A	Vendor IP	Vendor Co-selling	Access to Development	Tech. Training & Certification	Services Automation

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☐ System Integrator heavy components
THE CHANNEL CO.   52

Vendor Support Needs

Levers Of Partner Profitability: VAR

Partner P&L Levers	Type	Vendor Tools / Resources
	Increase Revenue	Stronger sales tools 23%

Levers Of Partner Profitability: MSP

Partner P&L Levers	Type	Vendor Tools / Resources
	Increase Revenue	Offer utility based or consumption based pricing 53%
MSP Sales	Decrease SG&A	More marketing visibility as part of vendors MSP partner ecosystem 38%

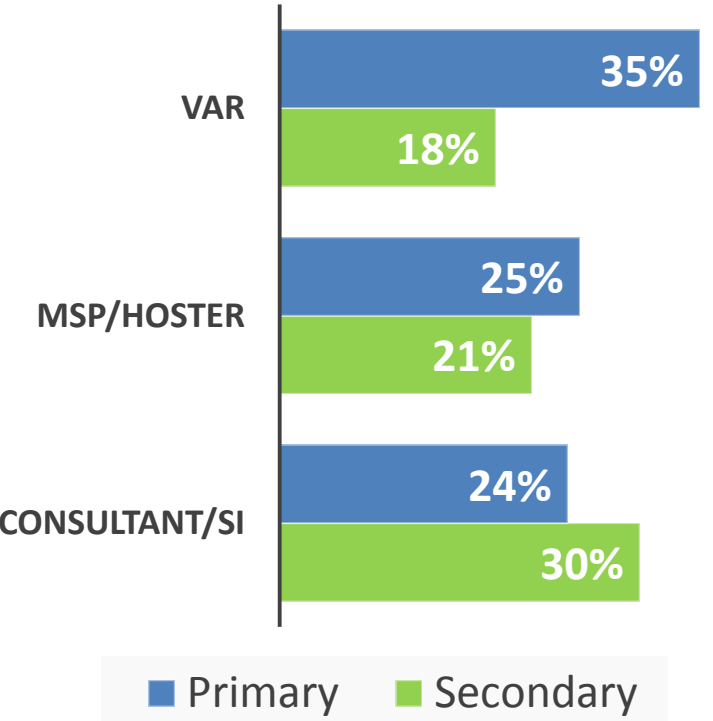### Levers Of Partner Profitability: Consultant/Systems Integrator

Partner P&L Levers	Type	Vendor Tools / Resources
SOLUTION DEVELOPMENT		
Intellectual Property	Increase REVENUE	More IP to help us Architect Next-Generation Services 34%
DELIVERY EFFICIENCY		
Service Delivery Tools	Decrease COGS	Better Access to Service Delivery Tools, Best Practices (Architectures, SOWs, Integration Guides) 30%
STAFFING		
Resources and Development	Decrease SG&A	Easier Access to Field SEs for Joint Engagement 43%
	Decrease COGS	Field Mentoring for Consultants 35%
	Increase REVENUE	Access to Field Salespeople for Joint Engagements 26%
	Decrease COGS	Help us Get Access to Certified Technical Talent to Expand our Bench 29% Better Access to Demo Gear 22%
COST OF SALES		
Sales Process	Decrease SG&A	Sales Influence Fees to Reward Co-selling 26%
Program	Decrease SG&A	Reduce/Eliminate Channel/Alliance Program Fees 47%

REVENUE · C.O.G.S. · SG&A

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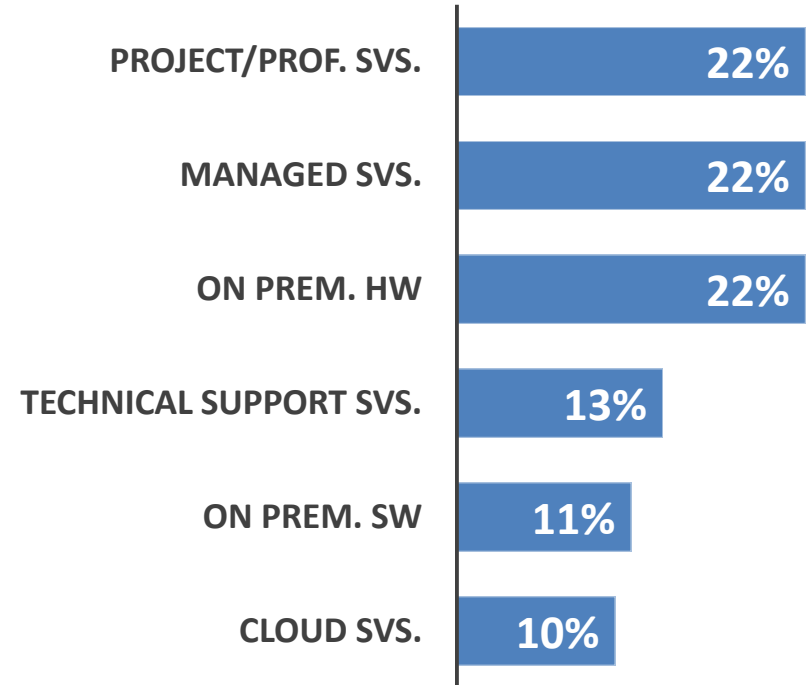THE CHANNEL CO.   50

Respondents are primarily hybrid VARs and MSP/Consultants selling to a diverse set of end-users, leading with professional and managed services and on-premise hardware
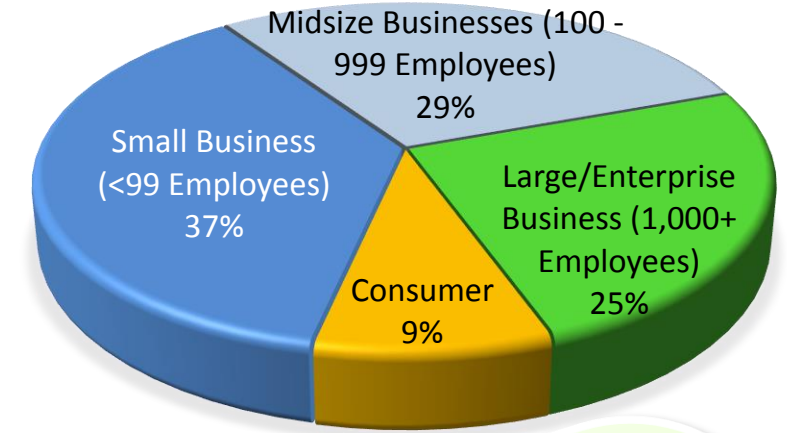
Top 3 Primary and Secondary Business Models

Business Model	Primary	Secondary
VAR	35%	18%
MSP/HOSTER	25%	21%
CONSULTANT/SI	24%	30%

■ Primary ■ Secondary

2016 Revenue Breakout By Category

Category	%
PROJECT/PROF. SVS.	22%
MANAGED SVS.	22%
ON PREM. HW	22%
TECHNICAL SUPPORT SVS.	13%
ON PREM. SW	11%
CLOUD SVS.	10%

Company's 2016 Revenue Median: $6.7M

Revenues by End-User Type

- Midsize Businesses (100 - 999 Employees) 29%
- Small Business (<99 Employees) 37%
- Large/Enterprise Business (1,000+ Employees) 25%
- Consumer 9%

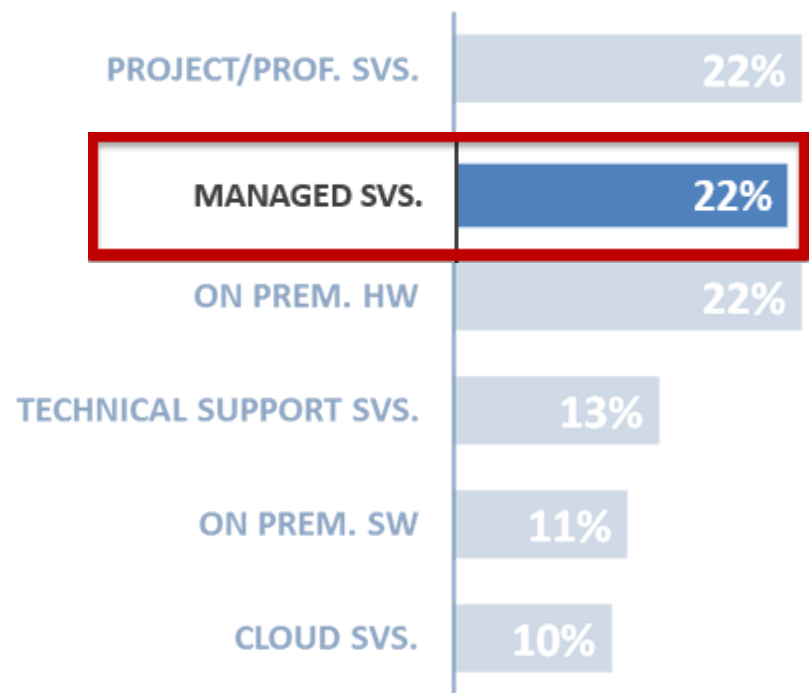**15% Growth** of Annual Revenues in 2016 Over 2015

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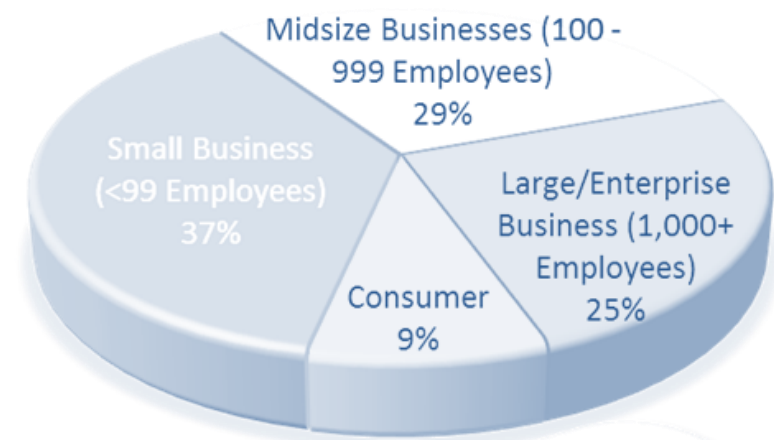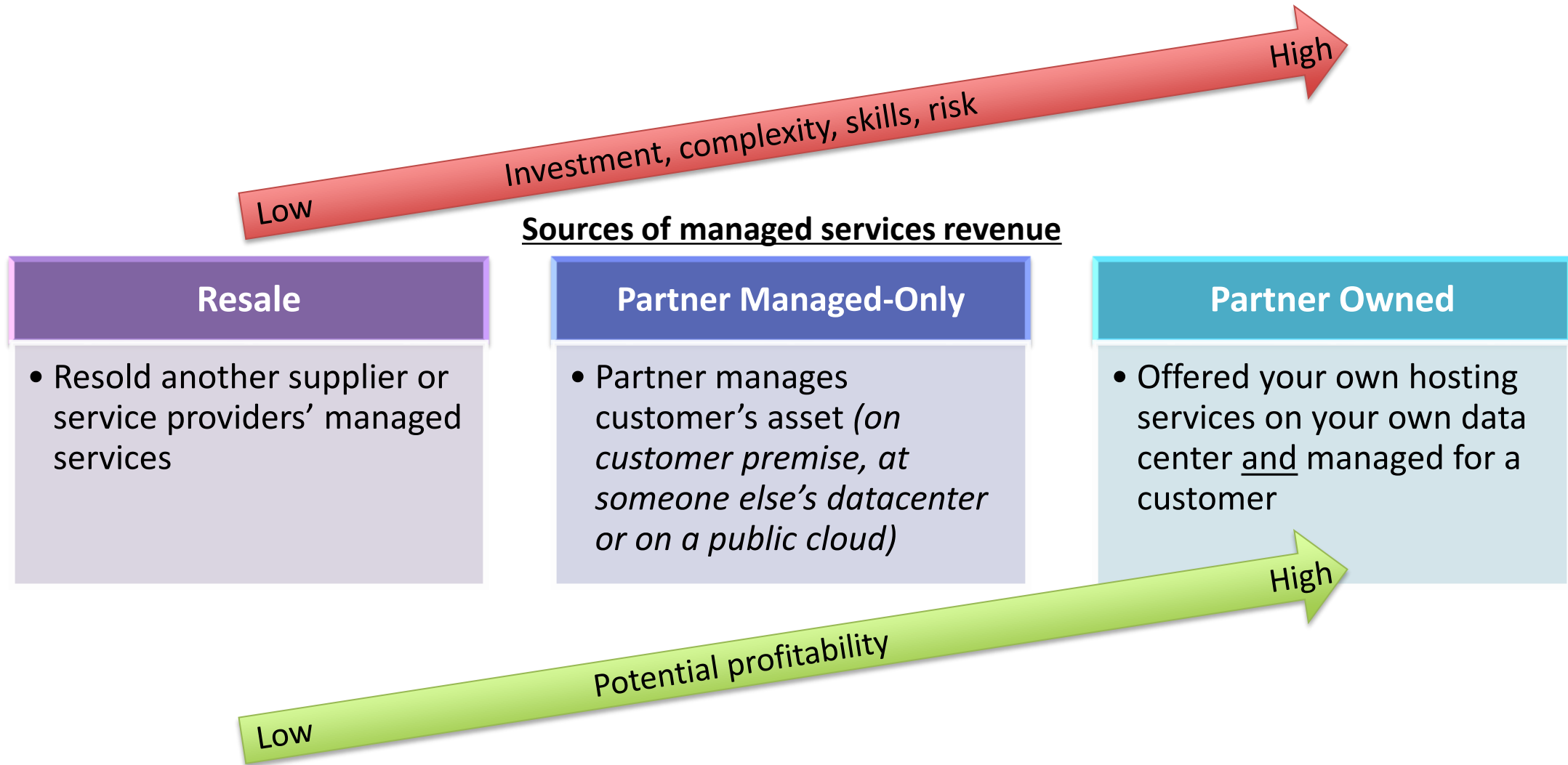
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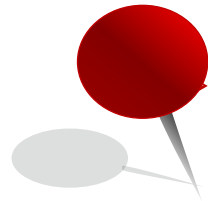- Consumer 9%

15% Growth
of Annual Revenues in 2016 Over 2015

MSP is a business model not just a partner type and the type of revenue they generate from their MSP business matters

Investment, complexity, skills, risk

Low → High

Sources of managed services revenue

Resale	Partner Managed-Only	Partner Owned
• Resold another supplier or service providers' managed services	• Partner manages customer's asset *(on customer premise, at someone else's datacenter or on a public cloud)*	• Offered your own hosting services on your own data center <u>and</u> managed for a customer

Potential profitability

Low → High

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AGENDA

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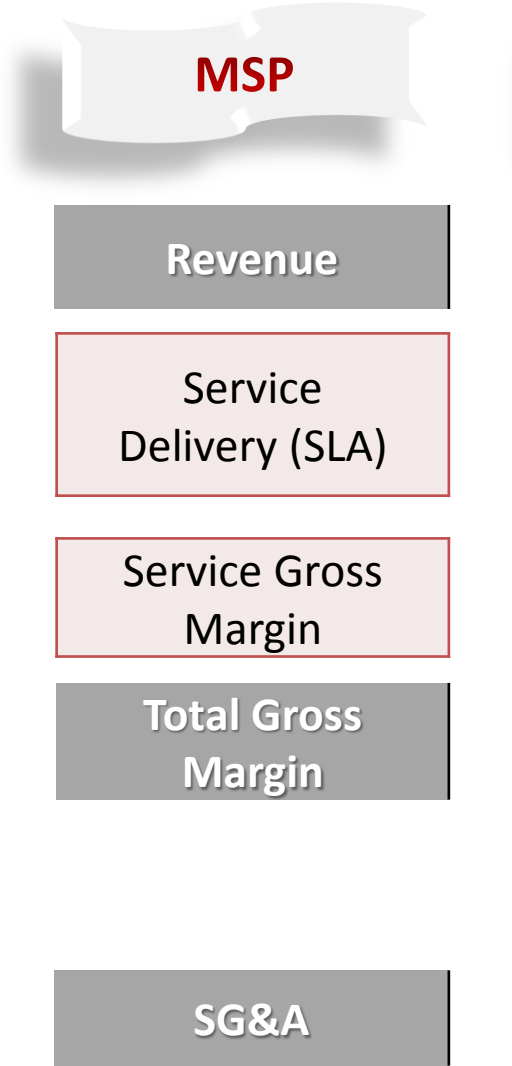
➢ **MSP Partner Profitability**
- Revenue
- Gross Margins
- SG&A

➢ **And finally, Vendor Impacts**

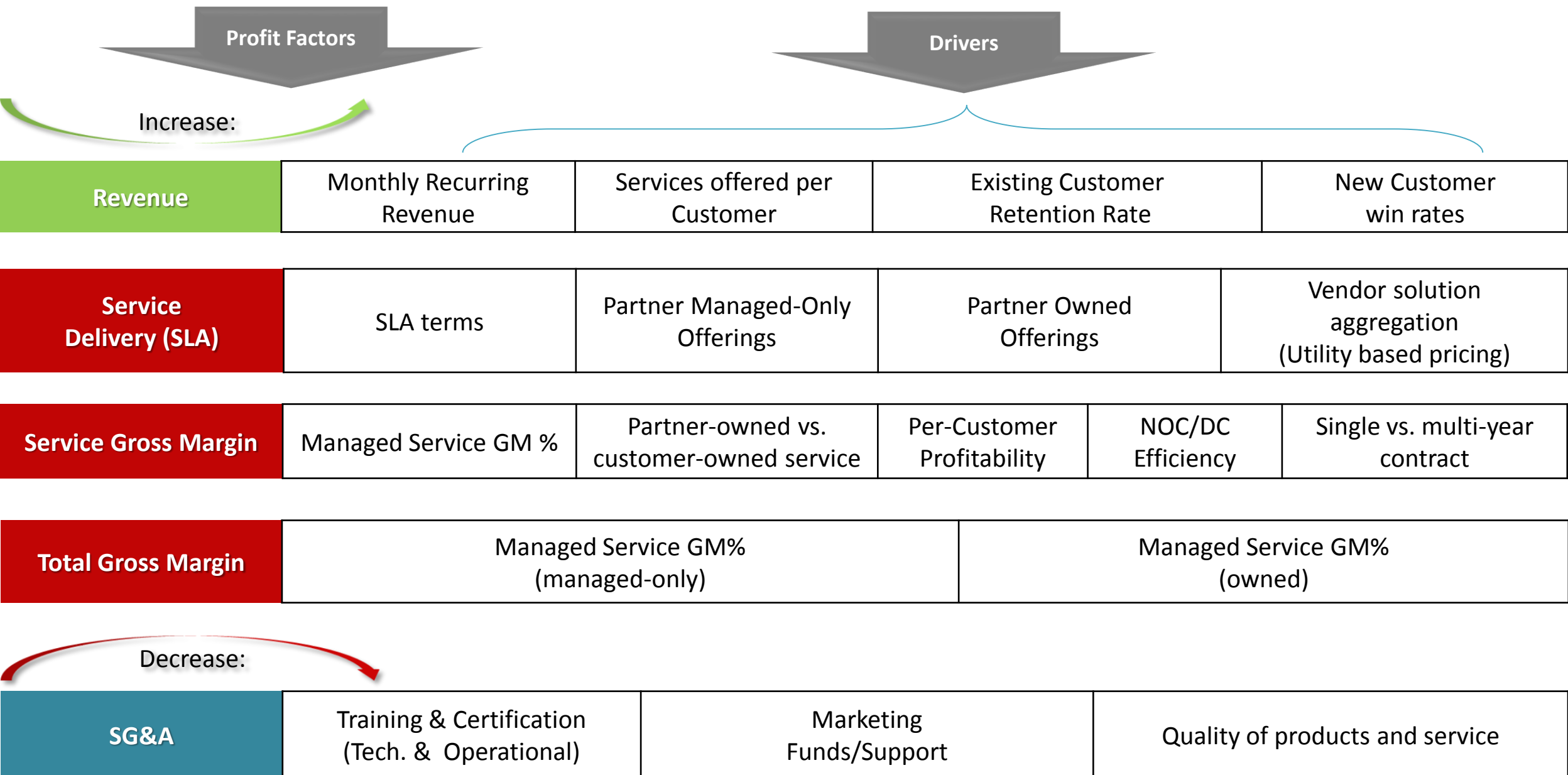# The Managed Services Business Model

2017 State of Partner Profitability

Profitability Factors Vary Distinctly by Business Model

Profit Factors

Maximize:

REVENUE

GP

Minimize:

SG&A

MSP

Revenue

Service Delivery (SLA)

Service Gross Margin

Total Gross Margin

SG&A

MSP Profitability Drivers
(with blended partner managed & partner owned model)

Profit Factors

Drivers

Increase:

Revenue	Monthly Recurring Revenue	Services offered per Customer	Existing Customer Retention Rate	New Customer win rates

Service Delivery (SLA)	SLA terms	Partner Managed-Only Offerings	Partner Owned Offerings	Vendor solution aggregation (Utility based pricing)

Service Gross Margin	Managed Service GM %	Partner-owned vs. customer-owned service	Per-Customer Profitability	NOC/DC Efficiency	Single vs. multi-year contract

Total Gross Margin	Managed Service GM% (managed-only)		Managed Service GM% (owned)	

Decrease:

SG&A	Training & Certification (Tech. & Operational)	Marketing Funds/Support	Quality of products and service

MSP Terminology: Profitability Drivers

Services offered per Customer – the quantity of managed services sold (by any measure -- user, device, server) sold to one customer across their infrastructure

SLA Terms - the MSP's ability to effectively manage the terms of their service-level agreement; includes staffing, help desk access, response times, etc.

Partner Managed-Only Offerings – the MSP's ability to meet SLA commitments and effectively deliver the service when the equipment is owned by the customer, either on their premise or in a colocation facility; the partner's role is that of management only

Partner Owned Offerings – the MSP's ability to meet SLA commitments and effectively delivery the service when the equipment is owned and managed by the MSP

Vendor Solution Aggregation - the extent to which the MSP bundles or incorporates a public MSP offering from another IT vendor or solution provider in their total service

MSP Terminology: Profitability Drivers Continued

Managed Services GM% - the ultimate measure of the MSP's staff and resource utilization, as applied across whatever unit of measure they use to measure profitability (device, user, customer, etc.)

NOC/DC Efficiency - for partners with their own hosting infrastructure, this is a measure of how scalable and efficiently the infrastructure performs, e.g., uptime, network latency, planned outages, etc.

Training and Certification - this is not just for the MSP's technical staff but for their NOC/DC and SLA management operational staff; training includes best practices in technical service administration, contract management and NOC/DC performance

Quality of Product or Service – for MSPs that bundle or integrate a 3rd party vendor or service provider's MSP offering within their overall managed service, this is a measure for how well architected that offering is and to what it requires bug fixes, patch management and other technical support services to keep it running smoothly

MSP Profitability Drivers: Key Trends

Increase:

Revenue

- Primary definition of success is % of MRR vs. topline sales
- For most, cloud services represents little revenue; some white label with wrap around managed services
- Primary focus (65% of revenue) from managing assets vs. owning them
- Retention is paramount to profitability

Service Delivery (SLA)

- Partners are expecting to buy solutions for their datacenters or customers on utility pricing from vendors
- Professional services critical to winning managed services – attach rate can be up to 60%
- Residency / staffing services common offering – can be upwards of 50% with the right long term project
- HaaS created with special financing and leasing; costs rolled into service contract

Service Gross Margin

- Margin stability continues due to quality and SLA improvements (vendor and partner)
- Mentoring relationships common with Service Leadership, True Methods, HTG, Taylor Business Group and Deloitte to benchmark effectiveness
- Targeting 30-40% for Professional services but will squeeze to get long-term managed services contract
- Higher gross margin services trending toward MDM and virtualized desktop; DR/BC remains a staple, but less profitable

Total Gross Margin

- Overall managed services gross margins remain relatively high and stable for those with critical mass
- Key to future profitability is ability to expand additional partner "owned" and partner "managed" services

# MSP Profitability Drivers: Key Trends Continued

Decrease:

SG&A

- Minimal investment in data centers – more often bank financed HaaS; high facility expense significant factor

- Low marketing investment across the board; dependent on vendor MDF

- Help desk staff primarily on payroll, not outsourced; bundled into most managed services

- Services automation significant investment; seek automation platform that can address multiservice offerings

Revenue Mix: MSPs
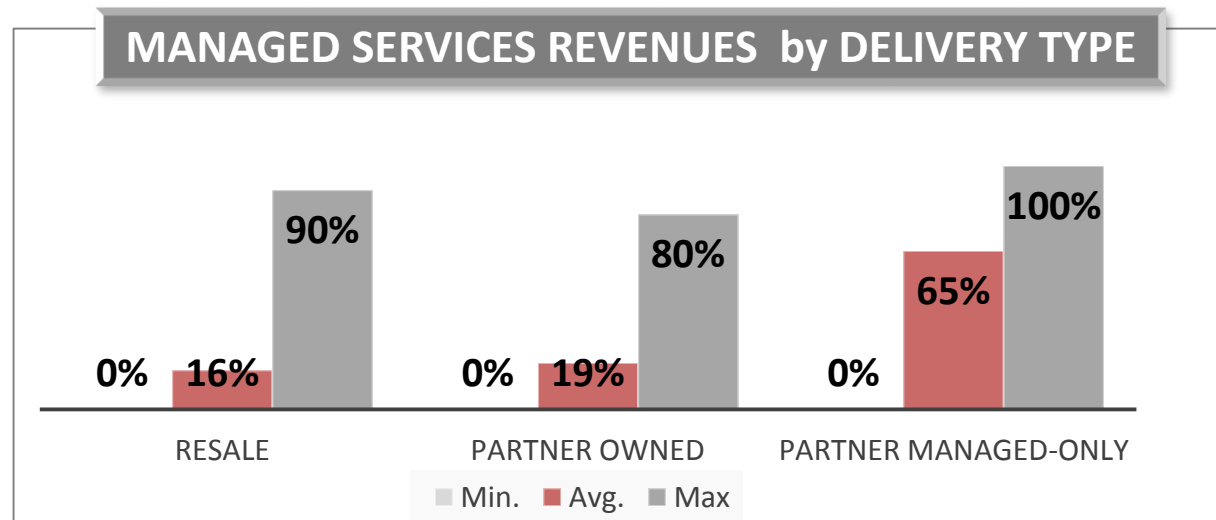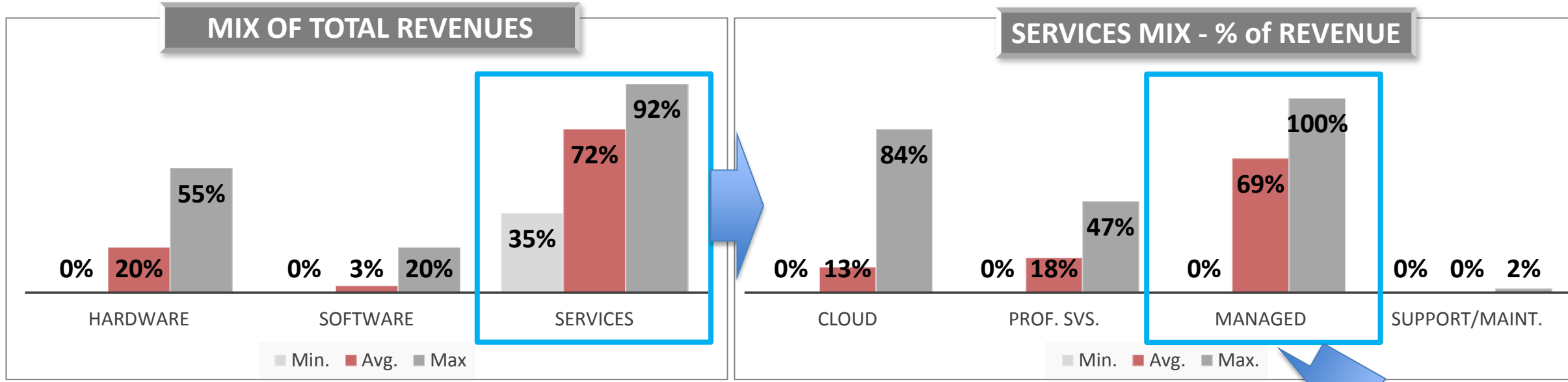
Best Selling Managed Services: 2016

Takeaways:

- Server, storage and network management top the charts of best selling managed services

- Application services (email, enterprise apps.) less than half of network management

- Security management services rank in the middle (19-32%); often highly specialized technical skill

Service	Rank
Network/Infrastructure Management Services	❶
Help Desk/Call Center Management	❷
Server Virtualization	❸
Storage Management: Backup, Archiving, Restoration	❹
E-mail Management and VPN access	❺
Storage Management: Business Continuity/Disaster Recovery	❻
Desktop Application Management Services	❼
Security Management Services: Monitoring/Response	❽

Majority of MSP revenue generated by partner-managed only

MSP

"Our revenue mix used to be 25% recurring and 75% project services mix; but it's got to be at least 30%+ recurring. This allows me to cover costs with recurring revenues."

% of MRR revenues

21%	61%	18%
Resale	**Partner Managed-Only**	**Partner Owned**
• Resold another supplier or service providers' managed services	• Partner manages customer's asset *(on customer premise, at someone else's datacenter or on a public cloud)*	• Offered your own hosting services on your own data center <u>and</u> managed for a customer

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Partners' Viewpoints on MSP **Revenue** Trends

MSP revenue success tied to MRR growth as the primary measure of revenue success

Professional services important, BUT many claim it's relevant only in the pursuit of a managed services contract

Critical mass of revenue of 30%+ required to truly achieve foundational success

Majority of revenue is partner-managed due to lack of ability to invest in partner-owned assets.

Vendor imperative:
Ability to seamlessly include offerings into managed service contract has become critical to vendor selection

Gross Margin Ranges: MSPs

Min. Avg. Max.

Product resale is necessary part of their model; gross margins declining except for legacy solutions

Gross margins on project-based professional services closely tied to MSP engagements. Cloud resale perceived as catalyst for additive services, not profit generator

Partner-owned assets drive greatest GM, but only at scale. MSP resale like product resell margins, EXCEPT in white label offerings
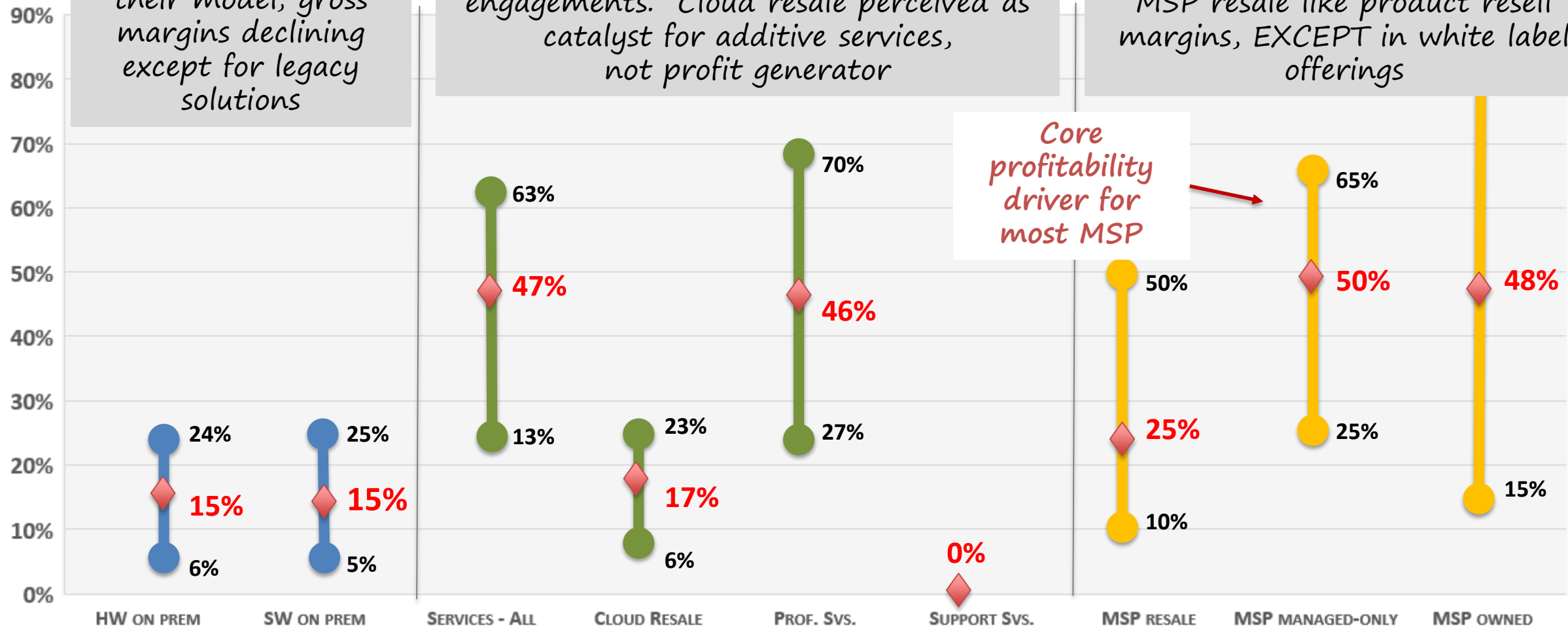
Core profitability driver for most MSP

HW ON PREM: 24%, 15%, 6%

SW ON PREM: 25%, 15%, 5%

SERVICES - ALL: 63%, 47%, 13%

CLOUD RESALE: 23%, 17%, 6%

PROF. SVS.: 70%, 46%, 27%

SUPPORT SVS.: 0%

MSP RESALE: 50%, 25%, 10%

MSP MANAGED-ONLY: 65%, 50%, 25%

MSP OWNED: 48%, 15%

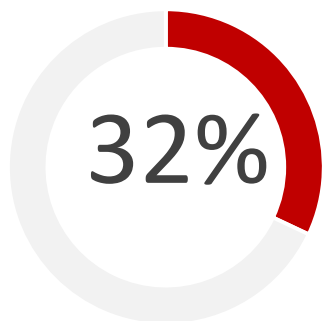# Partners' Viewpoints on MSP **Gross Margin** Trends

- MSP Resale often perceived like product resell with GM in the 10-20% range. Exception is white-label offerings and select VoIP/security offerings noted

- Partner-owned assets drives highest GM for MSP partners, but many unable to achieve scale and differentiation

- HaaS stated as viable option and provides profit opportunity via contract terms, financing, and packaging integrity

- Many MSPs incorporating cloud services and operational toolsets are allowing them ability to integrate into a customer offering

- Customer management continues to be significant driver of overall profitability (i.e. several "not good" customers can cause significant impacts to profitability)

SG&A Expense: Longer Sales Cycles

43%
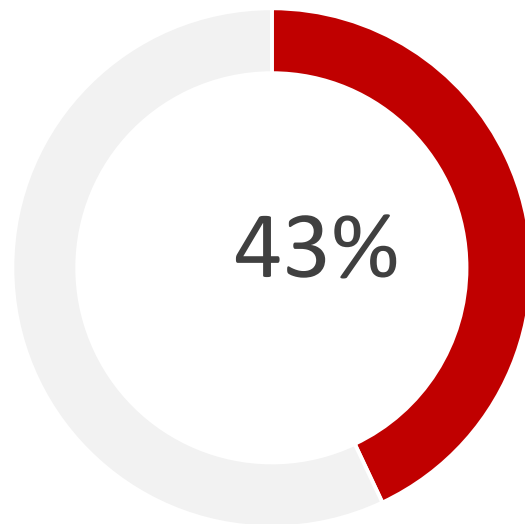
Say **longer selling cycles** have increased their selling costs most in 2016

32%

selling to **different decision makers**

22%
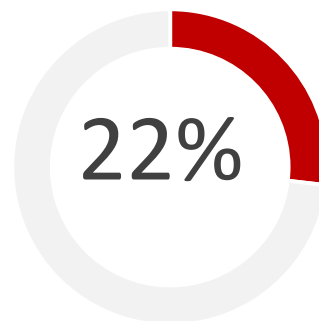
unpredictable customer demand challenging bench utilization

| Awareness | Needs assessment | POC /demo | Design / config. | Purchase | Upgrade / expand | Manage |

➢ **First, a little background**
- When we talk MSP, what do we mean?

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And finally, Vendor Impacts

Levers Of Partner Profitability: MSP

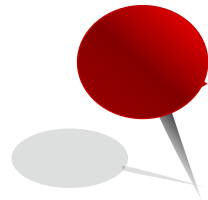| Partner P&L Levers	Type	Vendor Tools / Resources
MRR Sales Velocity	Increase Revenue	Offer utility based or consumption based pricing **53%**
	Decrease SG&A	More marketing visibility as part of vendors MSP partner ecosystem **38%**
	Increase Revenue	Share best practices among MSPs about pricing and packaging of services **23%**
	Increase Revenue	Benchmarking against other MSPs showing successful RR selling models **12%**
Service Delivery / SLA Management		
Operations Management		
Vendor Enablement and Transaction Support (Program)		

REVENUE

C.O.G.S.

SG&A

Q: What support do you need from your traditional IT vendors to increase your gross margins?
Please select three and rank in order of importance

Q: What support do you need from your traditional IT vendors to decrease your SG&A costs?
Please select three and rank in order of importance

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	Decrease COGS	Help us get access to certified technical talent for field or preventative maintenance work **16%**
	Decrease COGS	Help us get access to certified technical talent to outsource our help desk function **9%**
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Operations Management	Decrease SG&A	Create linkage to key PSA or recurring revenue automation tools **41%**
	Decrease COGS	Expanded financing to help us absorb the cost of building/expanding our data center **32%**
	Decrease COGS	Provide greater services automation tools that link to their systems **11%**
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	Decrease COGS	Provide greater services automation tools that link to their systems **11%**
Vendor Enablement and Transaction Support (Program)	Decrease SG&A	Make training and certification more affordable **64%**
	Decrease SG&A	Reduce/Eliminate Channel/Alliance Program Fees **33%**
	Decrease SG&A	Make marketing funds easier to get access to **28%**

REVENUE

C.O.G.S.

SG&A

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Cloud-Based Security Study Excerpt: Distribution Cloud Services Platforms provide a single platform for Solution Providers to manage cross vendor cloud environments
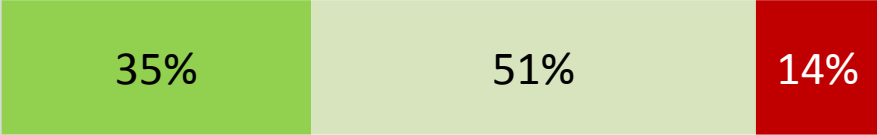
Key Takeaway:

Distributor marketplaces are becoming more important to partners with almost 1 in 3 partners declaring they are important in helping them determine endpoint security solutions

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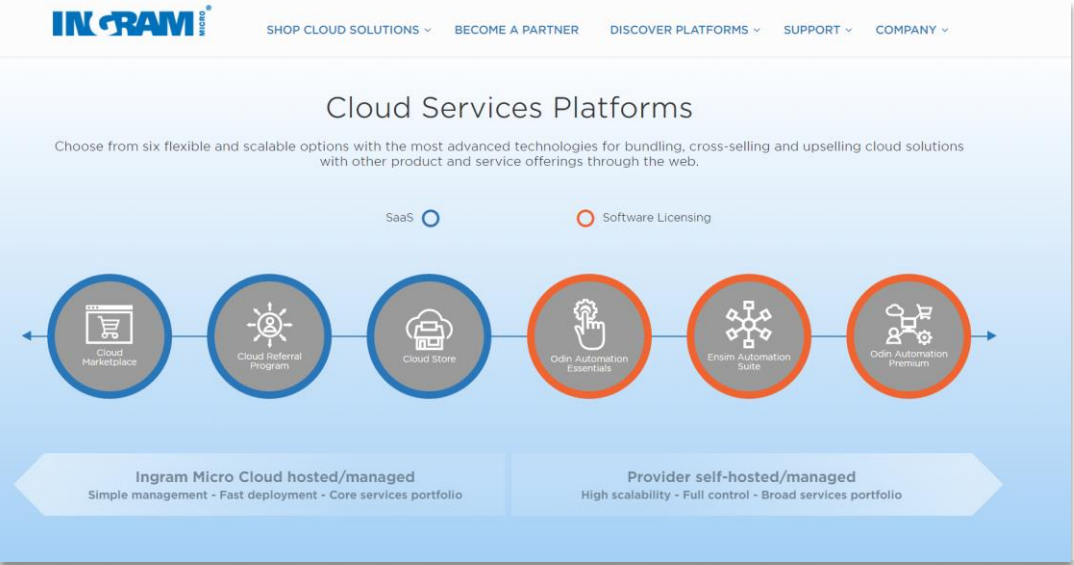
HOW IMPORTANT ARE DISTRIBUTOR MARKETPLACES IN:

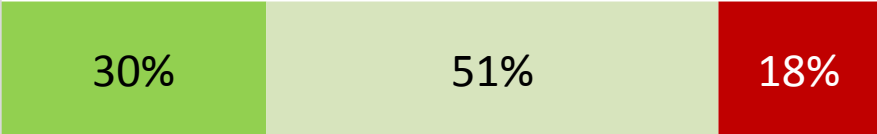■ Important (6,7) ■ Nuetral (3,4,5) ■ Not important (1,2)

	Important (6,7)	Nuetral (3,4,5)	Not important (1,2)
Making you aware of potential endpoint security solutions?	35%	51%	14%
Helping you determining which vendor to partner with for endpoint security solutions?	29%	54%	17%
Deciding which solution to recommend for a customer's endpoint security solutions?	30%	51%	18%

The Best and Brightest Aggressively Leverage Peer Groups and Mentors

"Service Leadership is about long term profit…True Methods is more marketing and sales. We don't pay for either but we read their writings."
$1.6M VAR/MSP

"Cisco and HPE helped us in terms of profit and volume."
$171M VAR

"My mentor is a retired CPA. I developed a board of advisors made up of customers and community business leaders to hold me accountable. I am the youngest in my mentor group (EMyth) by a decade."
$2M MSP

"With Deloitte we got a 1 hour biz review with their analysts. We got ripped. Second year we got ripped again. We were good but not great. We listened, changed and started asking business questions."
$17M MSP

"Below Average, Average, Best in Class, World Class" are concepts learned and applied. We designed processes to drive efficiencies, priced correctly and I made money."
$2M MSP

In summary……MSP Profitability:

Key Vendor Takeaways

Enabling a **utility based consumption model** is increasingly becoming table stakes to compete

The ability to integrate the vendor's offering into the **partners' choice of management tools** is becoming critical to vendor selection (RMM Tools, Distribution Marketplaces, Cloud Provider Marketplaces)

Vendors that can **outline a roadmap of additional managed services** have a decided advantage over their competition

Partner program evolution required to properly address MSP needs (architecture assistance, dedicated support, operational training, etc.)

IPED continues to advocate that vendors view the **MSP model not as a partner type, but as a business model** (most partners of all types are trying to offer some form of managed services)

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