The State of Partner Profitability:
Managed Services Business Model

Continuing Education for IPED Channel Masters

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

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

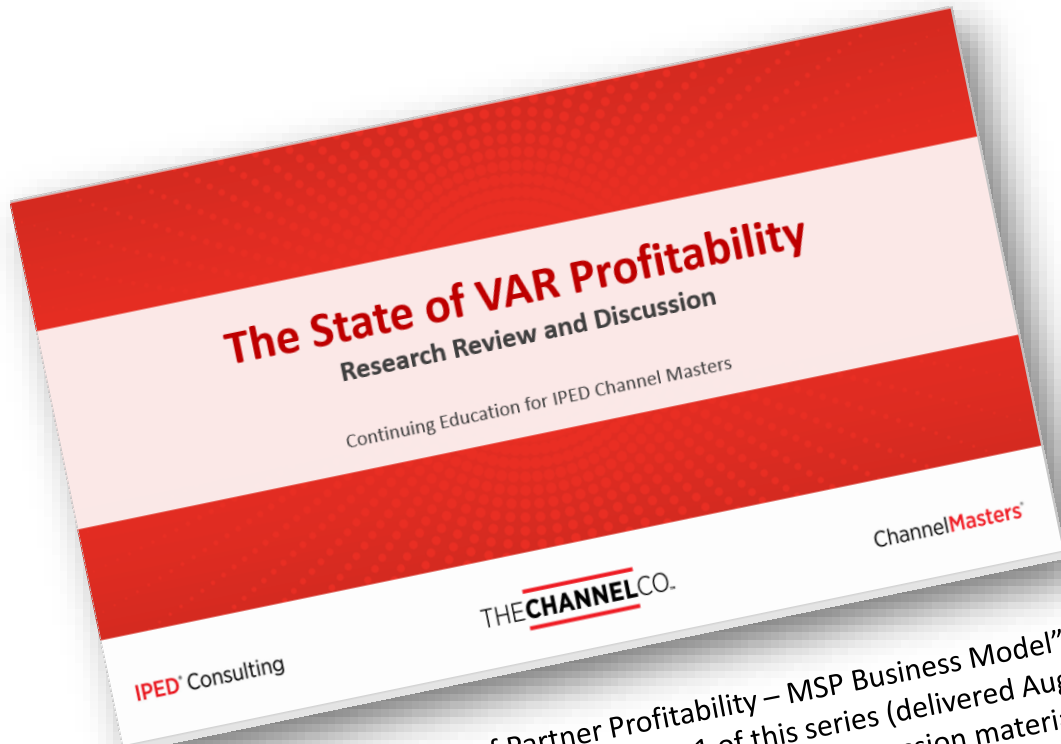➢ **And finally, Vendor Impacts**

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

> ## MSP Partner Profitability
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> ## And finally, Vendor Impacts

The Background

The State of VAR Profitability

Research Review and Discussion

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Webinar Title: "The State of Partner Profitability – MSP Business Model" (part 2 of 3 part series). If you missed Part 1 of this series (delivered August 3) please refer to your Channel Masters class portal for the session materials.

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State of Partner Profitability:
Driving the Growth and Evolution of the Channel

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		- Key Takeaways	
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✓ 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
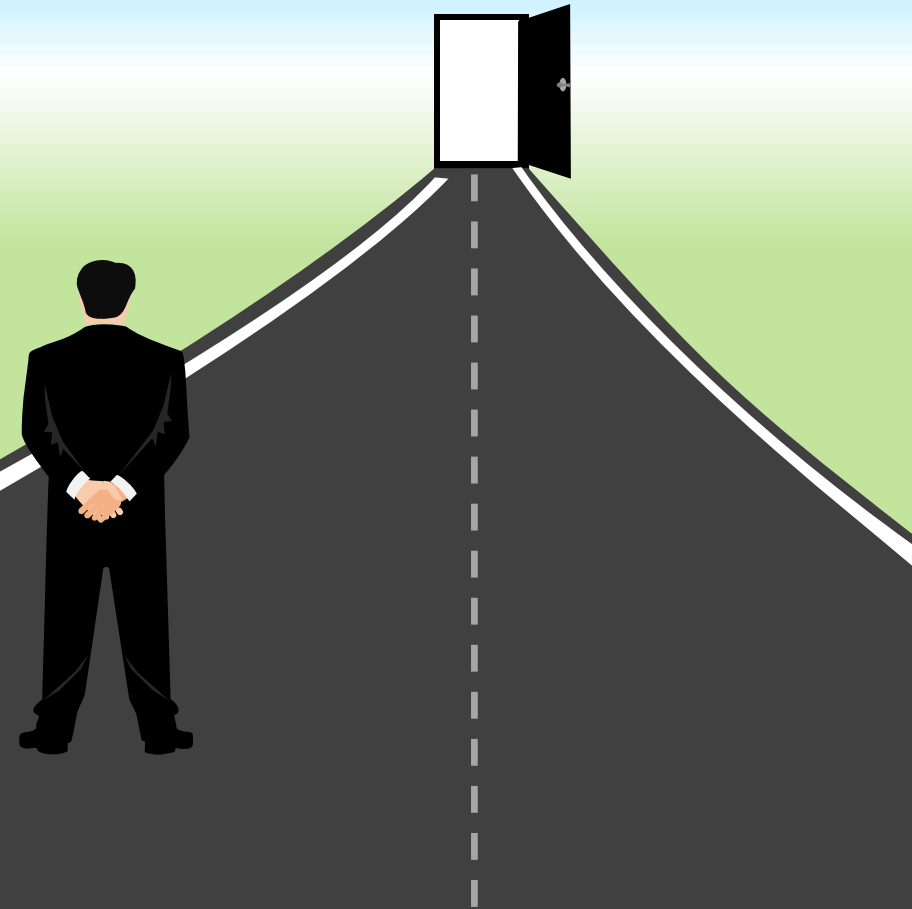
The Impact of Profitability: Then and Now

NOW – "Valuable"

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

S U C C E S S

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

Vendor Support Needs

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Why role-based programs matter: hybrid business models

How to Use These Models:

- Dissect your ideal partner profile

- VAR, MSP and Consultant models are the 3 pureplay roles

- Factor in the correct percentage of the 3 pure models to achieve the hybrid mix of your ideal partner profile

- Then benchmark partner needs to your program

70% VAR + **30% MSP** = **Hybrid VAR**

70% MSP + **30% VAR** = **MSP: Managed-Only**

70% Consultant + **30% MSP or VAR** = **SI**

- Illustrative -

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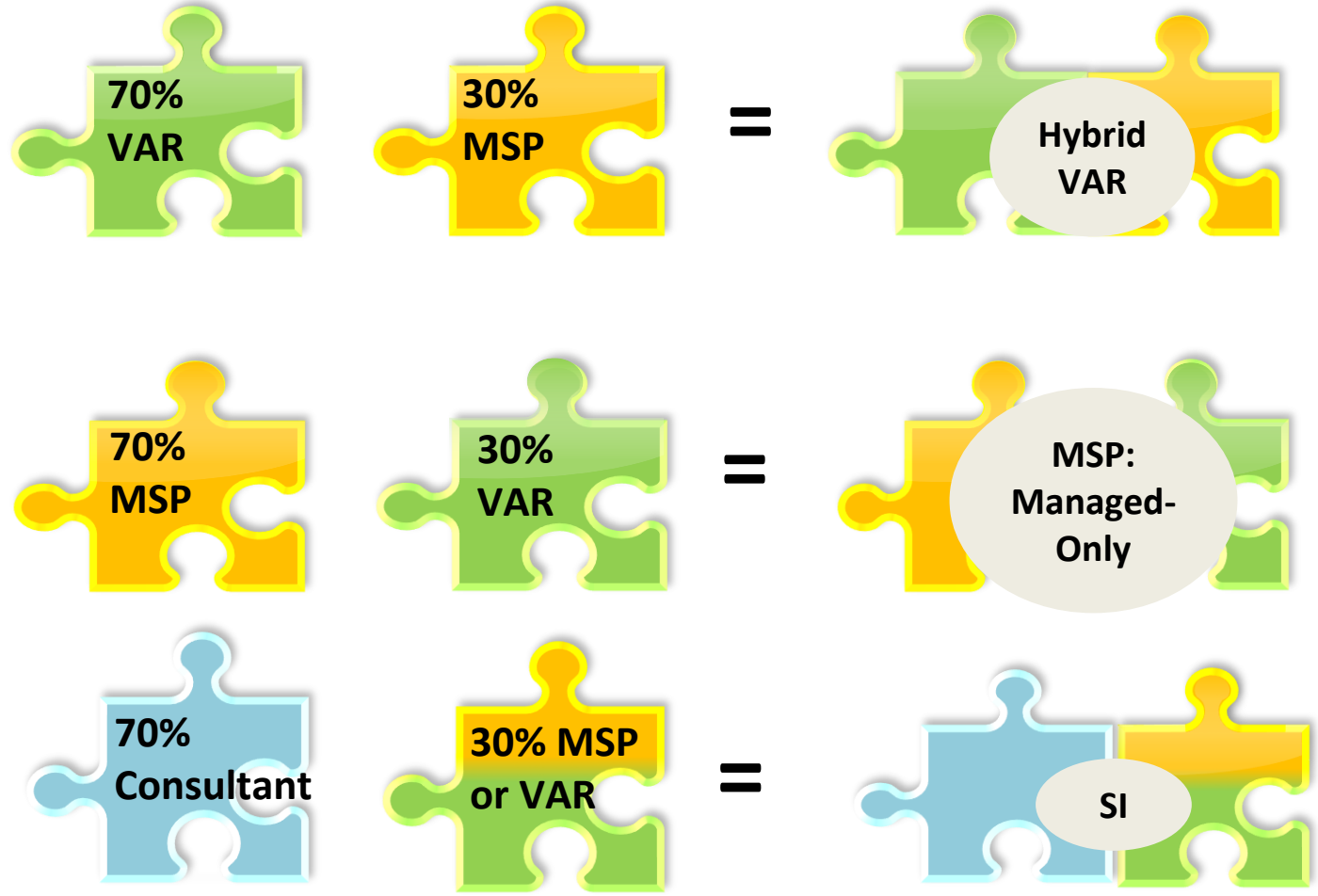
Respondents are primarily hybrid VARs and MSP/Consultants selling to a diverse set of end-users, leading with professional and managed services and on-premise hardware

Top 3 Primary and Secondary Business Models

- VAR: Primary 35%, Secondary 18%
- MSP/HOSTER: Primary 25%, Secondary 21%
- CONSULTANT/SI: Primary 24%, Secondary 30%

■ Primary   ■ Secondary
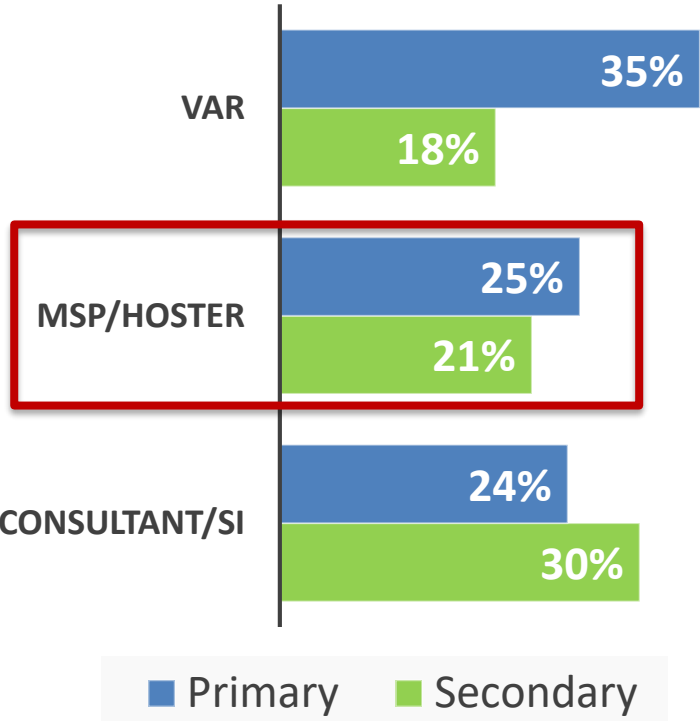
Revenue Breakout By Category

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

Company's Revenue Median: $6.7M
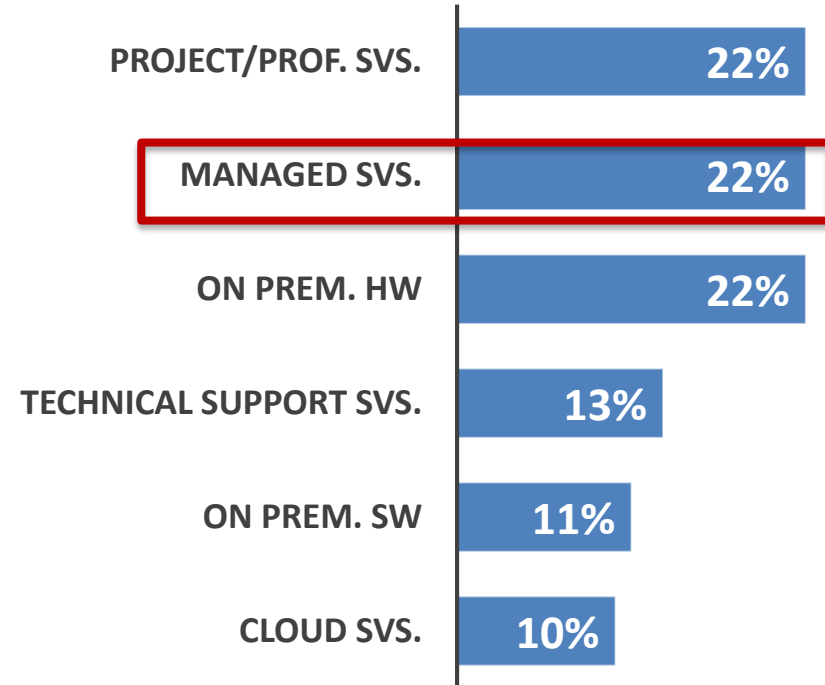
Revenues by End-User Type

- Small Business (<99 Employees) 37%
- Midsize Businesses (100 - 999 Employees) 29%
- Large/Enterprise Business (1,000+ Employees) 25%
- Consumer 9%
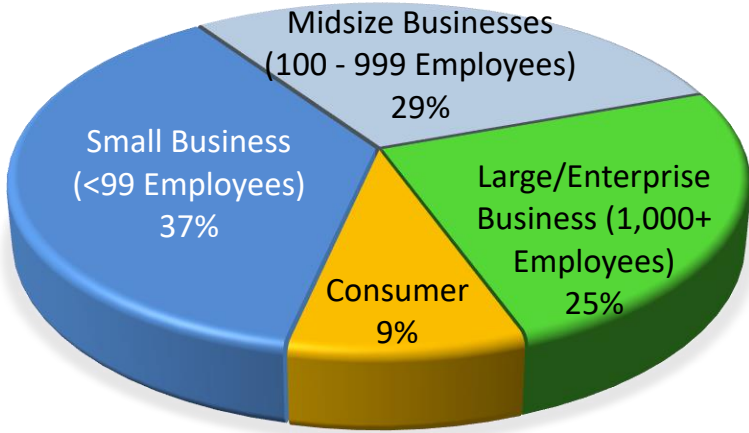
15% Growth of Annual Revenues

MSP is a business model not just a partner type and the type of revenue they generate from their MSP business matters
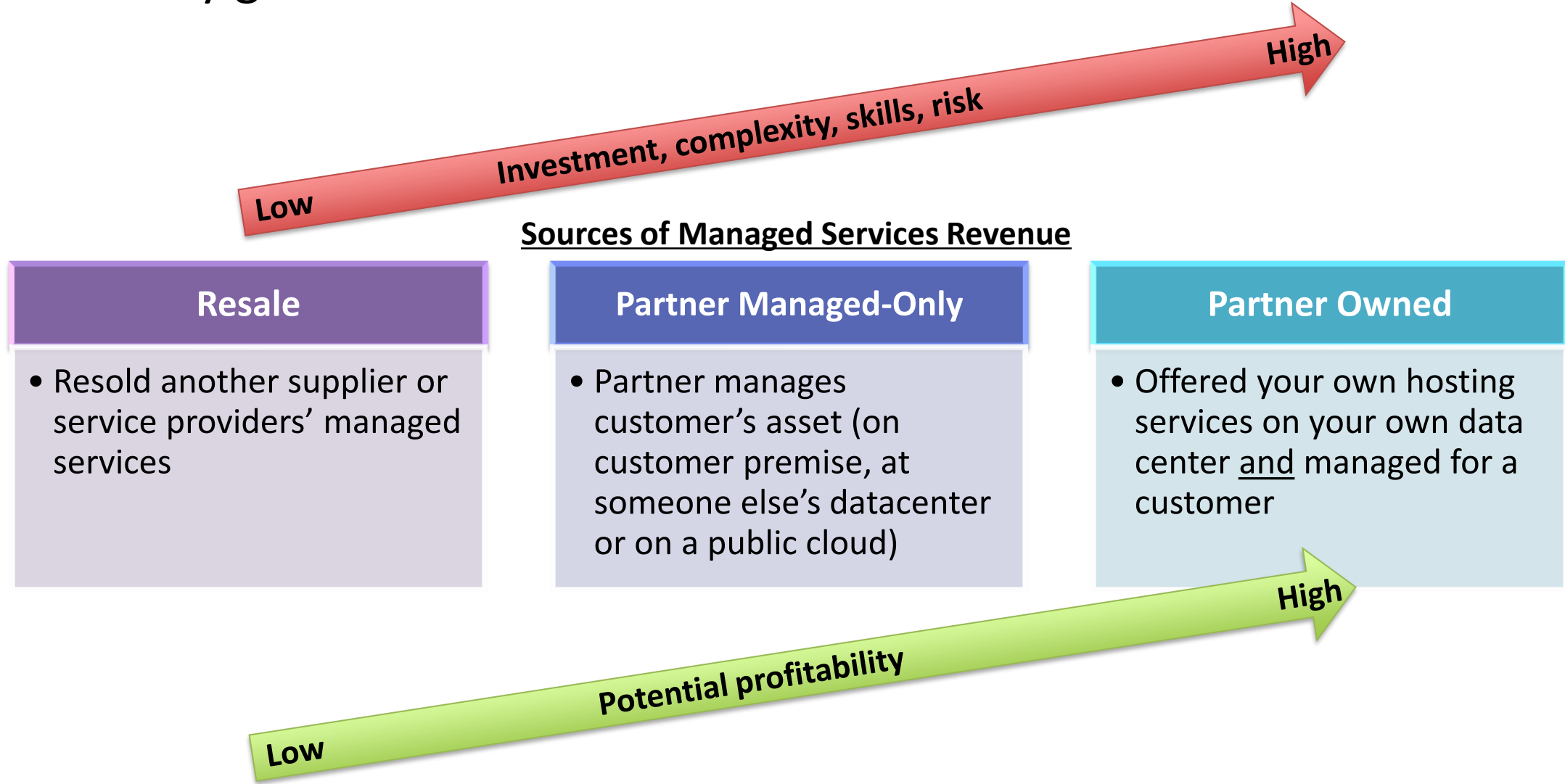
Investment, complexity, skills, risk
Low → High

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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> **And finally, Vendor Impacts**

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)

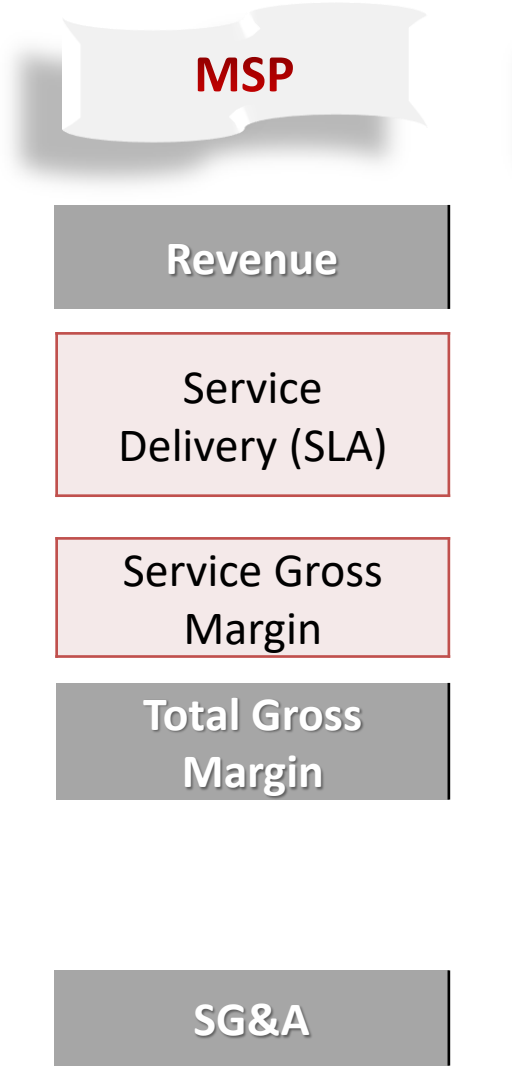**Profit Factors**

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

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
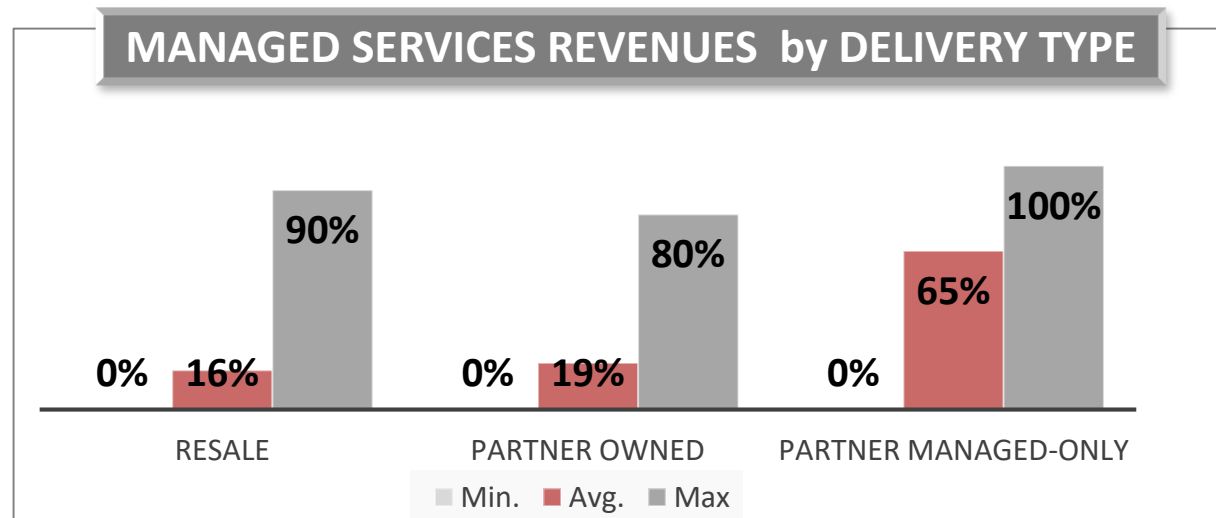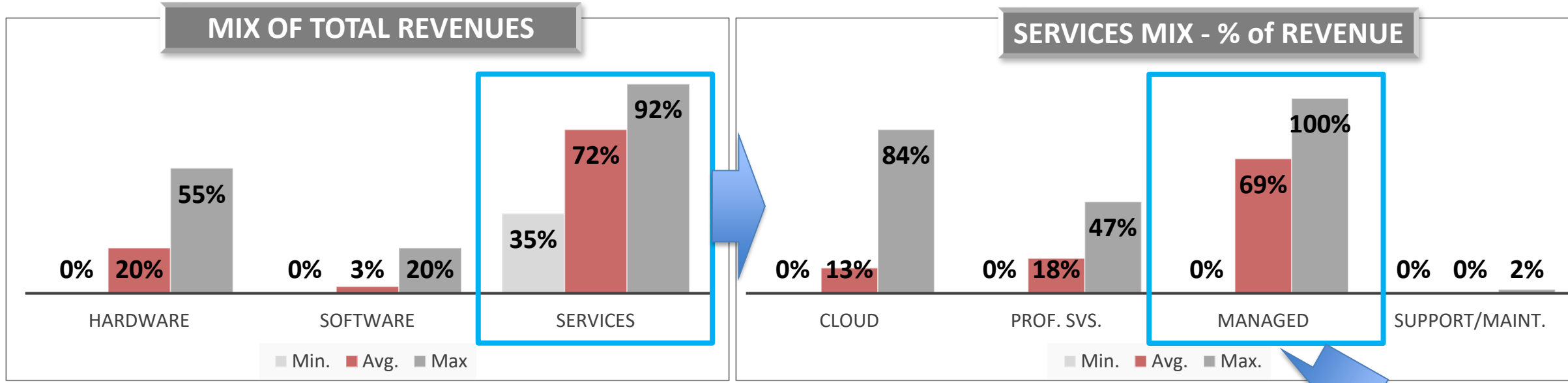
Majority of MSP revenue generated by partner-managed only

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

20%

Resale
• Resold another supplier or service providers' managed services

47%

Partner Managed-Only
• Partner manages customer's asset *(on customer premise, at someone else's datacenter or on a public cloud)*

33%

Partner Owned
• Offered your own hosting services on your own data center <u>and</u> managed for a customer

Q: Thinking specifically about your Managed Services business in 2015, what % of your total managed services revenue came from each of the following types of services? (n=207)

Source: 2017 Partner Profitability Study, IPED

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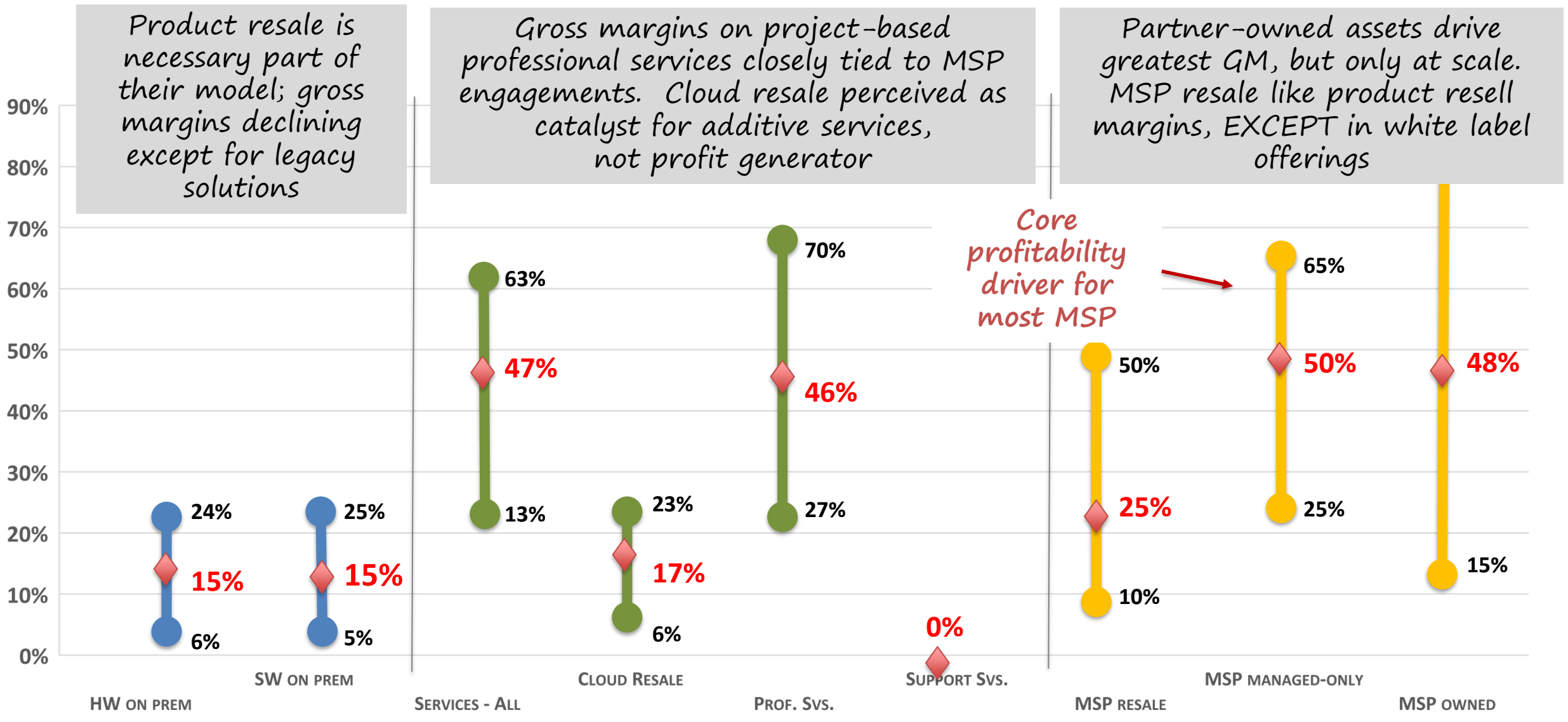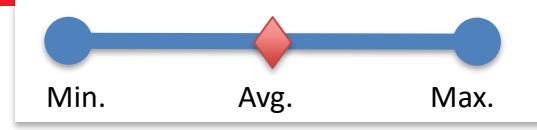
- Majority of revenue is partner-managed due to lack of ability to invest in partner-owned assets.

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

Gross Margin Ranges: MSPs

Legend: 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

Data points:

- **HW ON PREM**: Max 24%, Avg 15%, Min 6%
- **SW ON PREM**: Max 25%, Avg 15%, Min 5%
- **SERVICES - ALL**: Max 63%, Avg 47%, Min 13%
- **CLOUD RESALE**: Max 23%, Avg 17%, Min 6%
- **PROF. SVS.**: Max 70%, Avg 46%, Min 27%
- **SUPPORT SVS.**: 0%
- **MSP RESALE**: Max 50%, Avg 25%, Min 10%
- **MSP MANAGED-ONLY**: Max 65%, Avg 50%, Min 25%
- **MSP OWNED**: Avg 48%, Min 15%

Y-axis: 0%, 10%, 20%, 30%, 40%, 50%, 60%, 70%, 80%, 90%

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Source: Partner Interviews

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Today's most profitable services: primarily infrastructure focused with half of top 10 also under the most gross margin pressure

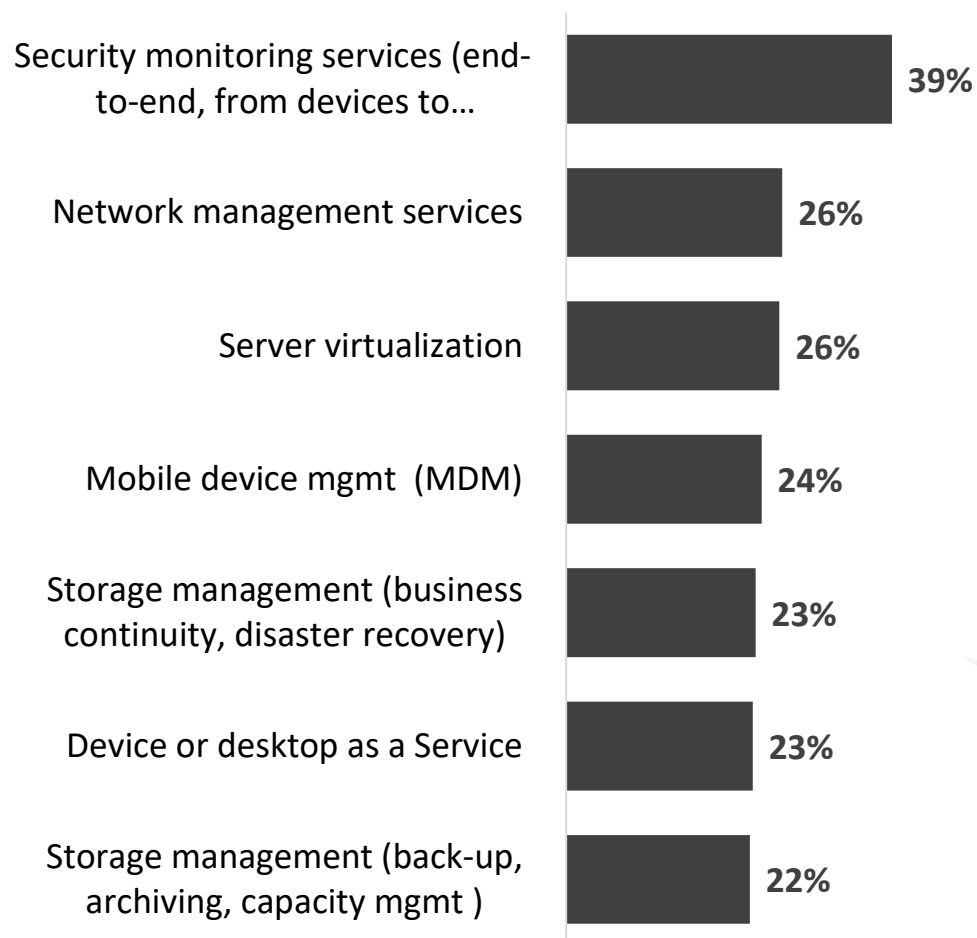## Most Profitable Managed Services Offerings (ranked 1 or 2)

Service	Percentage
Network Management Services ⚠️	67%
Enterprise application management	67%
Mobile device mgmt.	64%
Hardware Helpdesk ⚠️	64%
Desktop Application Management Services ⚠️	55%
Server virtualization ⚠️	52%
Device/desktop as a service	49%
Storage management (back-up, archiving) ⚠️	42%
Managed print services	40%
Storage management (business continuity, disaster recovery)	38%
Security monitoring services	34%

Most Profitable Managed Services: By Customer Focus

Rank	Small Business	Mid-Market	Enterprise
1	Network Mgmt. services	Network Mgmt. services	Enterprise Application Mgmt. (custom apps, ERP)
2	Mobile Device Mgmt.	Desktop/Device as a Service	Network Mgmt. services
3	Hardware Help Desk	Enterprise Application Mgmt.	Hardware helpdesk
4	Unified Commun.	Storage Mgmt. (DR/BC)	Security monitoring services

Q: Please rank your company's top 4 most profitable managed services offerings over the last 12 months.

Future services investment: security and network mgmt. top the list across MSP profiles; Mobile device mgmt. a priority for all MSP profiles, providing edge insights

Security monitoring services (end-to-end, from devices to...) — **39%**

Network management services — **26%**

Server virtualization — **26%**

Mobile device mgmt (MDM) — **24%**

Storage management (business continuity, disaster recovery) — **23%**

Device or desktop as a Service — **23%**

Storage management (back-up, archiving, capacity mgmt) — **22%**

Rank	Small Business	Mid-Market	Enterprise
1	Security monitoring svs.	Security monitoring	Server virtualization
2	Network mgmt. services	Server virtualization	Mobile device mgmt.
3	Mobile device mgmt.	Storage mgmt. (back-up, archiving)	Desktop/device as a service
4	Unified Communications	Mobile device mgmt.	Security monitoring svs.

*"Security has not made us rich, yet. My customers have a hard time trusting "the phone guy" to be their security specialist. We're still trying though – we're white-labeling Sophos now and looking at others."*

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Q: Which are the new managed offerings your company is planning to focus on (build, resell) in the coming 12-18 months? (n=279)

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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
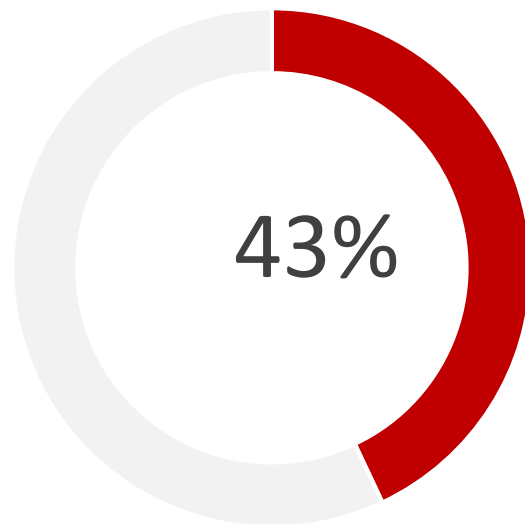
43% Say **longer selling cycles** have increased their selling costs most in 2016
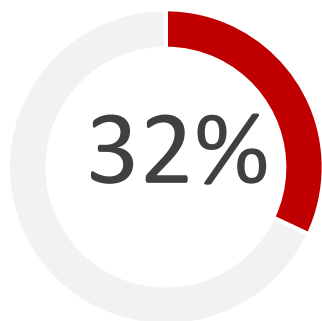
32% selling to **different decision makers**
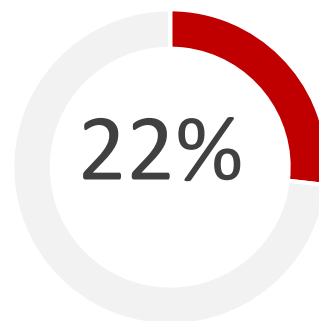
22% **unpredictable customer demand** challenging bench utilization

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

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  - SG&A

📍 **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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Service Delivery / SLA Management	Increase Revenue	More IP to help us architect next-generation services **13%**
	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%**
Operations Management		
Vendor Enablement and Transaction Support (Program)		

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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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REVENUE

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Levers Of Partner Profitability: MSP

REVENUE

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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%**

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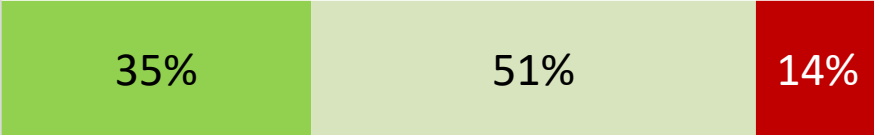
Key Takeaway:

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
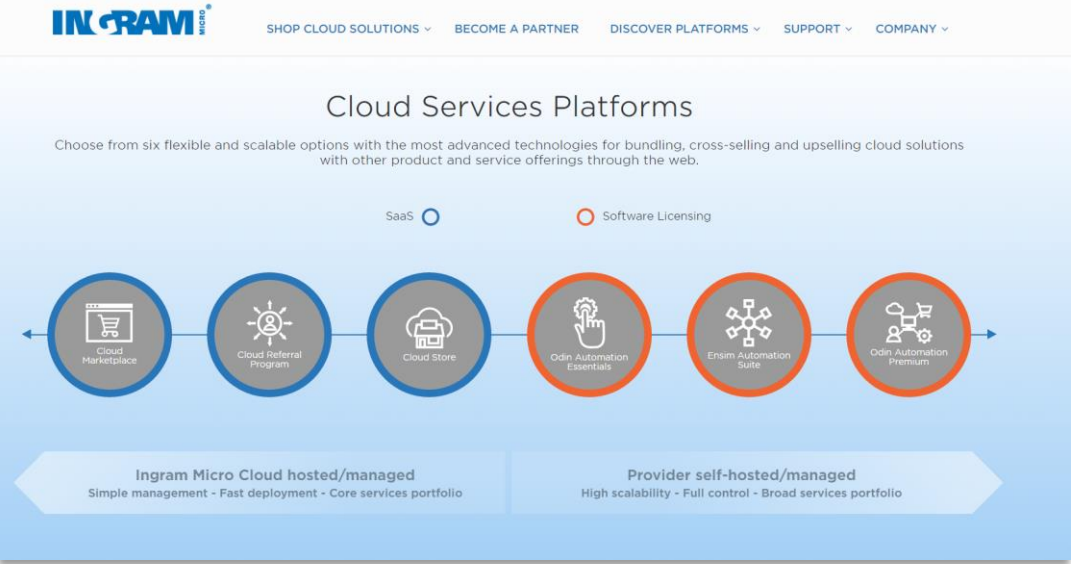
HOW IMPORTANT ARE DISTRIBUTOR MARKETPLACES IN:

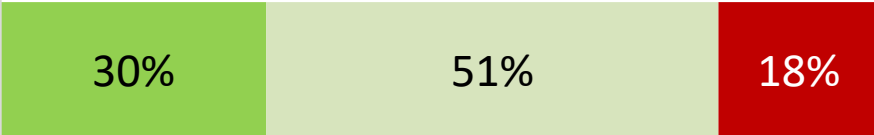■ Important (6,7)   ■ Nuetral (3,4,5)   ■ Not important (1,2)

Question	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 IPED perspective: Broaden your thinking to include other cross vendor scenarios

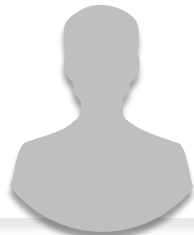# The Best and Brightest Aggressively Leverage Peer Groups and Mentors

"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)

For More Information Contact:

Lisa Sabourin
Director of Engagements
C 561.339.5517
lsabourin@thechannelco.com

The Channel Company
thechannelco.com