

The MSP Guide to Higher Growth

Part II: Pricing for Profitability

A successful managed services business is reliant on a solid business strategy and service delivery model, as well as finding the right technology for its needs.



Part II: Pricing for Profitability

This is the second part of a three part series of white papers collectively titled **The MSP Guide to Higher Growth.**

The other parts of the guide are:

Part I: Market Evolution and What It Means for MSPs

Part III: Efficiency, Tools and Best Practices

Determining Service Offerings

MSPs around the globe offer a wide variety of services to their clients. For those operating primarily in a confined location, e.g., a city, county or region, much will depend on the needs of clients and the level of competition. Some MSPs find that they can do well by delivering only minimal managed service capabilities, such as remote monitoring and patching, while the bulk of their revenues come from time and materials contracts. Others, probably in larger cities and more competitive environments, find that clients are looking for MSPs to not only smooth their IT spending by offering consistent or fixed monthly rates but also to take on more of the risk of IT service delivery by offering service level guarantees.

Wherever you are, you are likely to find that clients look to trusted MSPs to offer more and more capabilities. As the pace of technology innovation continues to expand, it becomes harder for existing IT personnel within SMB organizations to keep up. Not because they aren't capable, but simply because they don't have time or opportunity to learn about new capabilities to the level required for adoption. For example, many SMBs are not able to optimize their virtualized environments, preferring to err on the side of caution versus efficiency. Similarly, many have little knowledge of cloud services beyond the SaaS offerings their business colleagues use. MSPs have a great opportunity to bridge this knowledge and resource gap and to provide cost-effective solutions to SMBs while increasing their own efficiency levels and offering profitable and valuable services.

Managed Services, as delivered by today's MSPs, fall broadly into four distinct categories:

1. General Support Services

These include remote Helpdesk support for technology issues and user support issues, as well as break-fix services where staff are deployed to client locations from a centralized pool of technicians to perform remedial actions.

2. Technical Managed Services

(e.g., centralized remote monitoring, management and online remediation services)

This category includes a wide range of online service elements including:

- Desktop support
- Server support
- Network management, configuration and connectivity support
- Mobile device and Bring Your Own Device (BYOD) services



- Email/Exchange service
- Audit and discovery
- Compliance monitoring
- Remote monitoring
- Backup
- Disaster recovery
- Desktop security
- Identity and Access Management (IAM) security
- Patching and update
- Print services
- IT service level management
- Guaranteed client IT service levels
- Cloud monitoring
- Cloud application user/access/content management
- Hosting services (customer owned equipment)
- Cloud services (IaaS, PaaS, SaaS)
- Unified communications (a.k.a. VOIP)

3. Administration Services

These services include:

- Technology requirements management
- End-user training
- User administration (e.g., access management), device configuration and onboarding

4. Strategic Planning and Support

This category relates to virtual CIO activities such as strategy consulting, business management liaison, budgeting and management (board) level reporting.

Each of these categories requires different sets of skills and investments. Typically, MSPs start out offering general support services such as break-fix capabilities that support equipment and software they have sold as resellers. As the number of contracts grows and the number and skill set of the support staff increases, additional services can be added. Familiarity with each specific customer's business and an increasing level of client trust and satisfaction are vital. Eventually, the most trusted MSPs may be asked to play the role of virtual CIO, helping the business to achieve its goals by intelligently leveraging appropriate information technologies, i.e., becoming an IT services broker rather than a reseller.

The services you offer must match the technical capabilities of your organization, your ability to make datacenter investments, the abilities of the IT management solutions that you use, and of course, the needs of your target customers. While some service elements may have become commoditized, e.g., remote monitoring, remember that SMB clients will most likely have a preference for bundled services. Bundle the commodity services with other elements and differentiate your offerings based on the bundle composition, how you will be able to reliably and uniquely provide the advanced service elements, and how you will deliver the outcomes that your clients seek.

When choosing which specific new services or service bundle components to add, consider the following:

- Do you need to add new service components to be competitive? How will you differentiate your version of the new services? Hint: Clients are interested in results. How can you better guarantee the results, even if the nature of the service is similar to competitive offerings? A great B2C example here is Enterprise Rent-A-Car®. They beat out all other car rental companies over the past decade to become #1 in a very competitive business by lowering costs (renting offices outside business centers) and delivering better service (i.e., they pick you up).
- How large will the demand be for your new service? When will the demand arrive? Currently there's a lot of hype around new technology trends such as big data and mobile device management. The chances are that generalized demand for big data services will take quite a while to develop. If you have skills in this area, consider taking a vertical approach to customer acquisition, focusing on those segments where demand is likely to takeoff first. Mobile device or Bring Your Own Device (BYOD) management demand will develop more quickly with larger businesses than in small companies. Security services are another growth opportunity worth exploring: multi-factor authentication, single sign-on, and password management can all be managed centrally on behalf of your clients. Make sure your new services match the needs of your target customers.
- What will the adoption of the new service do for your business valuation? As an MSP, your business valuation is dependent on your monthly recurring revenue stream and your profitability. Some services may add more to revenue but less to profitability. Some may be more easily differentiated and sustainable than others. Typically, those requiring a higher level of investment and commitment, such as hosting services, will add more to your valuation than reselling other vendor's services, even though these can be lucrative in the short term.
- Strategize on how to replace clients' on premise investments with cloud or hosted solutions that make it easier for you to add new and advanced service capabilities such as unified communications. This is important for two reasons: 1) the closer the service delivery point, the easier the service is to maintain, i.e., on your premises versus your clients', and the more efficient you can be; 2) hosted services are likely to prove far stickier - which is one reason they can improve your business valuation.
- How many of your existing clients will buy or use the new offering? If only one or two, is it worth the investment in time to develop the service? Remember it's easier to sell to existing customers first but only if they have or will have a need. The cost of attracting new customers can be five or six times the cost of selling to existing ones.

Your goal should be to steadily increase sales to existing customers while increasing the size of new contracts because of your growing services portfolio, while at the same time becoming ever more efficient and differentiated in your sales and marketing approach.



Pricing for Profitable Growth

The pricing of managed services, like the pricing of any complex solution, is a topic to which we could devote an entire book. Our goal in this guide is to provide some general guidelines and to identify key areas for consideration. As with most pricing decisions, there is no single correct answer or approach. Much depends on the nature of the services in question, your reputation within your target marketplace and customer set, and the level of competition you face.

The key to success

An important success factor for growing a profitable managed services business is managing and controlling unplanned and unexpected workloads. What this means, in reality, is being confident that the resources allocated to manage the services contracted by each client will be totally adequate to meet their needs. Knowing what resources will be needed, together with the cost of those resources, means that you can price your services profitably. Also, understanding how much technical and engineering staff time will be needed leads to optimized utilization, enabling your staff to reliably service multiple customers per time period. Finally, by constantly working on staff productivity, you'll be able to support new service offerings and generate more revenues, from both new and existing customers, without big increases in your workforce.

Eliminating unplanned and non-paid work

Numerous steps can be taken to minimize unplanned work. Some of the most frequently cited include:

- Take a proactive stance to end-user training particularly with respect to security and new application deployments. Consider producing simple written guidelines to address common issues, such as password management, that can be easily accessed and readily understood. A large portion of helpdesk calls relate to lost or forgotten passwords.
- Insist on standardized device configurations (including the actual devices) and software sets. These are much easier to manage, troubleshoot and rebuild when issues do occur.
- Mandate standardized policies and processes for software updates and downloads – restrict end-user administrative rights. By strictly controlling end-user actions and the applications that can run on their devices through policy management and governance, you can avoid a significant number of security and other issues.

- Test all major patches before deployment and roll them out under central management. Testing eliminates problems caused by obvious issues before they infect the entire infrastructure. Central management ensures that any issues that do occur can easily be correlated to the time/nature of the update.
- Review trouble ticket logs on a regular basis to identify any systematic issues that can be dealt with proactively.
- Secure system/device access with multi-factor authentication to make knowledge of passwords alone inadequate; secure sensitive information using encryption and containerization; implement a robust system for single sign-on and one-time-use-only passwords.
- Automate as many tasks as possible to reduce the possibility of human errors and to speed change processes. Systematic tasks, such as back up, should absolutely be automated but also consider implementing automated responses and user self-service actions to deal with frequently occurring issues and requirements. For example, can users order a replacement smartphone themselves and receive the replacement already preconfigured with their recovered content and contact information?

Value-based pricing

Knowing how to optimize your service delivery to maximize both staff productivity and client satisfaction is important to understanding and managing your service delivery costs but there are a few more factors to be considered before you can successfully price your services. For example, who are your customers? What are their expectations of your services and pricing? What outcomes are they seeking to achieve?

An oft quoted analogy is that no one really wants to acquire drill bits. They buy drill bits to create holes! (In reality the problem is more complex – the desired outcome is more likely related to assembling or building something. How much you are willing to spend on the drill bit might depend on the number of items being built or the material to be drilled). In the case of managed services, potential clients may be seeking a variety of possible outcomes: access to expert resources, support for tasks that they do not have the skills to address, efficiency of operation, freeing up time to address more strategic issues such as helping with business innovation, organizational change, achieving agreed to service availability and performance levels, etc.

The value of these outcomes will likely differ depending on the prospect's business and also on the size of the company. Think back to the drill bits; do consumers buy the same bits as construction companies? Do they pay the same prices? Before pricing any service it's important to determine the needs of your target market. Smaller companies have lower revenues in general and are constrained in their ability to fund expensive services. They look for low priced offerings providing basic levels of support. Nevertheless, all businesses are interested in getting the best value for their

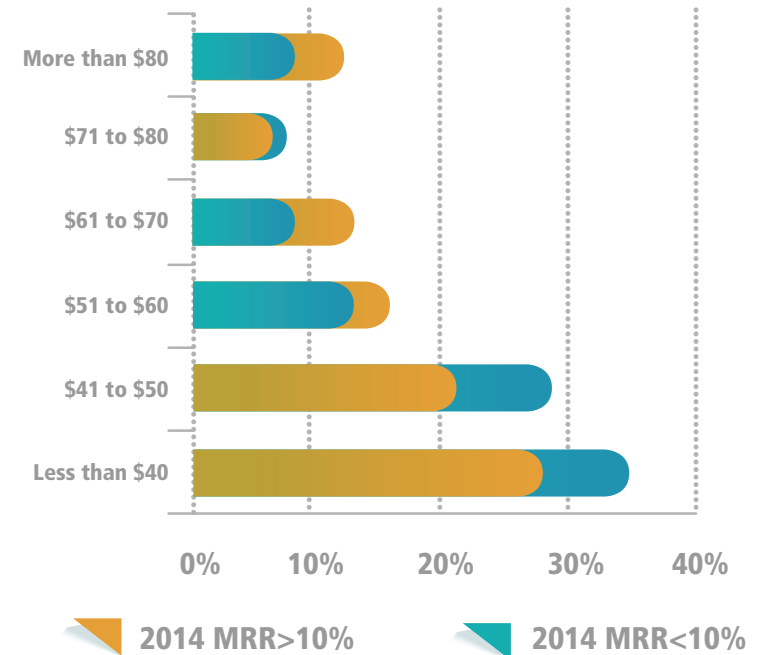


investments (read largest ROI) and most will favor higher value, versus a lower price, if the value price fits within their budgetary constraints.

If every client wanted the same outcome you'd expect price ranges for more popular managed services to be fairly narrow, but in reality, they're not. Consider the prices charged by respondents to the 2014 Kaseya MSP Pricing Survey for desktop support. The chart shows the average desktop device support and maintenance charge per month achieved by the survey respondents. The results shown compare responses from MSPs whose monthly recurring revenue (MRR) had grown at greater than 10% per annum to those who grew their MRRs at less than 10%. As you can see the range of prices is quite wide, reflecting the different value perceived by different customer segments in different locations.

The biggest value of a managed service to a small company may be doing things they do not have the skills or resources to do themselves. In this case, your differentiation must focus on how effectively you will provide the service and why you are so much better than your rivals. Do your skill levels provide a more certain outcome? Will you be quicker or just more effective than your competition? Will you pass on knowledge or help train internal personnel? Buying an ongoing service requires a level of trust; customers will pay more for providers they trust to provide good service. Pay attention to competitive price ranges but don't be fooled into thinking that the lowest price always wins. It doesn't. Faster growing MSPs will tell you that the best value service usually wins. This is also reflected in the above chart.

In comparison, mid-sized companies will likely pay more for their managed services. However, they also have more complex needs. As companies grow, their risks increase and they develop requirements that small service providers find harder to satisfy. They may need proof of regulatory compliance or training, liability insurance coverage for service provider staff visiting their locations, guaranteed service levels and any number of other items. If mid-sized companies are your target market, understand what these needs are and don't be phased by low-priced bids from much smaller (low overhead) companies. In general, there is a significant correlation between the (employee) size of clients and the size of their service providers. Bigger companies just find it easier to trust larger service providers because they see the increased maturity and professionalism that develops with growth and size. Understand the value of your service to your target audience and price accordingly.



Average Desktop Device Support and Maintenance Charges per Month

(weighted by response)

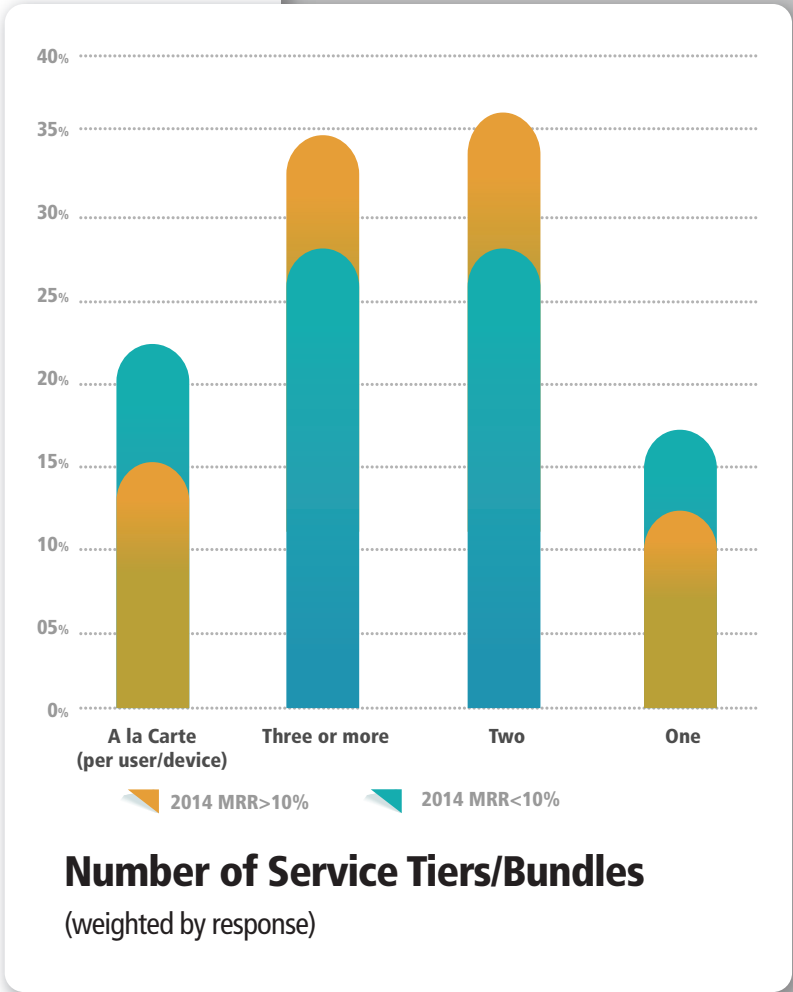
Tiered services

The results of the recent Kaseya Pricing Survey clearly show that MSPs experiencing faster growth in their monthly recurring revenues more frequently adopt value-based pricing and limit their offerings to a small number of bundled tiers (service bundles). The strategy that seems to work best is to offer just two or three service bundles and to price each bundle so that the more comprehensive the bundle, the higher the value. The rationale is twofold. Firstly, as indicated above, most businesses prefer to buy higher value services versus simply cheaper ones, especially when it comes to managing critical IT infrastructure. A great deal of trust is required to outsource to a third party.

Low price can signify low quality and that is definitely not a requirement when buying managed IT services. Consequently, there will be a tendency to favor the better value service bundle. Secondly, these MSPs position the more comprehensive service bundle as the least risky/most reliable. If elements of the infrastructure are managed by other providers or by internal resources, time and efficiency may be lost. Looming issues may be missed. Inevitably there will be some form of finger pointing when issues do occur, but more importantly, it will be harder to automate tasks and troubleshoot issues, which will lead to more trouble tickets and lower levels of client satisfaction. In general, the argument is that MSPs deliver better quality services when they manage more of the clients' IT capabilities.

Contract size and complexity

The outlined pricing guidelines are necessarily general in nature. Despite the need to standardize service elements in order to minimize unplanned work and maximize professional staff productivity, each client environment will employ a different mix of technologies, include a different number of devices and, represent a different level of complexity. And each client will insist that their needs are unique. Take advantage of this in your pricing strategy. Provide each customer with a value-based, customized price (monthly or annual service contract) for the service tier they want, based on the unique value you will deliver. The price should be derived from standard bundled tier pricing and your average cost per seat or device, but modified to meet each prospects' particular needs. Consider also how you might offer a fixed-price contract for the duration of the contract term. This is often very much appreciated by clients who do not have to find additional, often unbudgeted, funds when changes occur, such as needing to add devices or users during the contract period. If you do accommodate changes without increasing your fees, you'll likely benefit from a considerable amount of goodwill at contract renewal time.



Our most successful MSP customers suggest being flexible yet consistent with pricing. Review the price ranges for individual service elements described in the Kaseya Pricing Survey and determine where your pricing levels should fall. If your service capabilities are average compared to other MSPs, then price near the median. If you offer significant value-add, you will be able to price successfully at higher pricing levels.

Using value-based pricing will ensure that you are maximizing profits...but you must know the cost of your service delivery efforts first.

Calculating existing service delivery costs and gross margins

The cost of service delivery is the sum of the (monthly) cost of your billable employees plus the monthly (amortized) cost of your infrastructure and other expenses. These two costs then can be summed and divided to determine an average cost per user or per device per month. For ease of description we'll refer to this as "cost per seat per month" and leave you to decide if that means per user or per device.

It's important to have a full understanding of your service delivery costs so that you can pick a pricing approach that maximizes your profit. It's useful to first allocate your services to categories, as described in section three, as each category requires different skill levels, tools and other expenses:

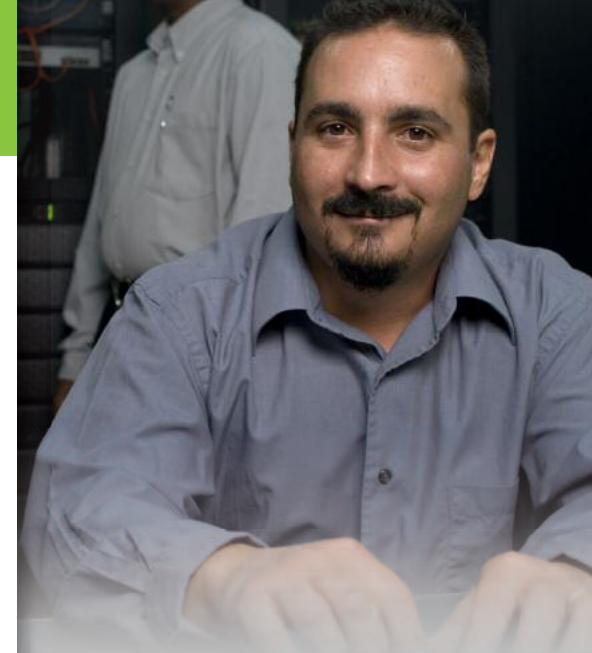
1. General support
2. Centralized monitoring, management and remediation
3. Administrative
4. Strategy and planning

Sum up the total of all appropriate costs per category on a monthly basis and divide by the total number of seats to determine your average total service cost per seat per month. While you may price based on your per device costs today, consider developing a per-user approach for the future. Increasingly employees have multiple devices that will need to be managed but the costs of supporting additional devices are marginal versus the cost of supporting additional users.

Next calculate your current average monthly revenue per seat by category. In an ideal world this would be your current price but if you have multiple service elements within a category or you allow discounting, the average revenue may differ from your standard price. Your gross profit margin is the difference between the revenue and cost, divided by the revenue:

$$\text{(Revenue - Cost) / Revenue} = \text{gross profit margin}$$

It's also helpful to know what your overall average cost and revenue per employee is and how additional services will



affect those averages. Your average cost per employee is generally the total cost of running your business – payroll and expenses – divided by the number of employees, including yourself. Your average revenue per employee is your total revenue from services and service-related activities divided by your total number of employees. That's all employees, not just your technical team. Include all sales, marketing, finance, admin and management staff, etc.

New services should add to your average revenue per employee as quickly as possible but without adding significantly to your average cost per employee. That way you know you will be increasing your gross margins. If you are investing in new skills to expand your services, how quickly will the average new services revenue per employee add to the overall average? Any plan to add new employees that only increase service revenues from new customers, or only a portion of existing customers, needs to be carefully considered. Ideally, new services will quickly be taken up by both existing and new customers and will raise the overall average revenue per employee.

Pricing managed services for profit

Now that you know your average profit margins for services that fall into the four categories, you are ready to work on pricing your new service. With add-on services it's hard to determine actual costs as this often involves a financial reallocation of already deployed personnel and equipment. Rather than estimating what portion of costs are applicable to a new service it's easier just to focus on the gross profit percentage and leverage the Kaseya Pricing Survey Results to determine where your pricing should fall. Using these numbers, you can calculate the allowable service cost/seat/month which can then be compared to your expected incremental cost/seat/month for the category to determine reasonableness.

For example:

- Assume a current average cost/seat per month for centralized monitoring, management and remediation services of \$50 and an average gross profit of 50% (i.e., the average per seat price per month is \$100).
- To price a new Enterprise Mobility Management service you would first look at the Kaseya Pricing Survey and see that per device/per month prices for mobile services (MDM and BYOD) range from \$0 to over \$15, but the mean for those who do charge for the service falls within the \$5 to \$10 range.
- Based on your value pricing strategy you decide to start with \$10/device/month.
- To earn a 50% gross margin means your incremental costs cannot exceed \$5/seat/month.
- If you are able to add the new service without increasing your staffing levels or your expenses then this service and pricing makes total sense.

- If you do have to add additional human resources and equipment or tools, estimate the expected sales growth of the service over three years and then calculate the average/seat/month incremental cost. Is it more than \$5 or less?

Your goal should be to add new services and generate new revenues without substantially increasing costs.

For the most part, new services will be bundled with the other services in each category - perhaps creating two tiers – and your bundle pricing will be determined by your overall cost/seat/month for the bundle and by the gross profit you want to achieve.

The example above uses a 50% gross profit margin to simplify the math. Typical gross margins range from 25% to 75% - see table below.

Metric	Calculation Note	Typical	Best in Class
Gross Profit Margin	$(\text{Revenue} - \text{Cost}) / \text{Revenue} \times 100$	25% to 35%	75%
Average Revenue / Employee	Total Revenue / Total Number of Employees	\$90k to \$100K	\$150K to \$200K
Managed Devices / Tech	Total Number of Client Devices Managed / Total Number of Technical Staff Required	1,000 to 3,000	5,000 to 10,000

About Kaseya

Kaseya is the leading provider of cloud-based IT management software. Kaseya solutions allow Managed Service Providers (MSPs) and IT organizations to efficiently manage IT in order to drive IT service and business success. Offered as both an industry-leading cloud solution and on-premise software, Kaseya solutions empower MSPs and mid-sized enterprises to command all of IT centrally, manage remote and distributed environments with ease, and automate across IT management functions. Kaseya solutions are in use by more than 10,000 customers worldwide in a wide variety of industries, including retail, manufacturing, healthcare, education, government, media, technology, finance, and more. Kaseya is privately held with a presence in over 20 countries. To learn more, please visit www.kaseya.com

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