WAYS TO BOOST MSP MARGINS

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A MOTTO IN LIFE

A motto in life we live by is that if it doesn't make dollars, it doesn't make sense. If you're currently working with a vendor and raking in slim margins that barely cover your operating expenses, at what point do you ask yourself that enough is enough? Eventually, you need to step back and re-evaluate your business model and seek ways to boost MSP margins. Many Service Providers are stuck using the archaic cost-plus model, which hasn't been kind to anyone and is severely outdated. As an MSP, it's vital to learn about the options available to you.

It's hard to ignore that everything around us is getting more expensive. If you haven't been hit with additional costs to your business, you'll likely incur them somewhere down the line. At this point, if your margins are razor-thin, you'll need to solve this seemingly complex issue fast. The thing is, it doesn't have to be complicated or rushed – simple options exist that'll help you become dominant again in your niche.

You can be the top-performing MSP by adopting new strategies and adapting to the modern marketplace.

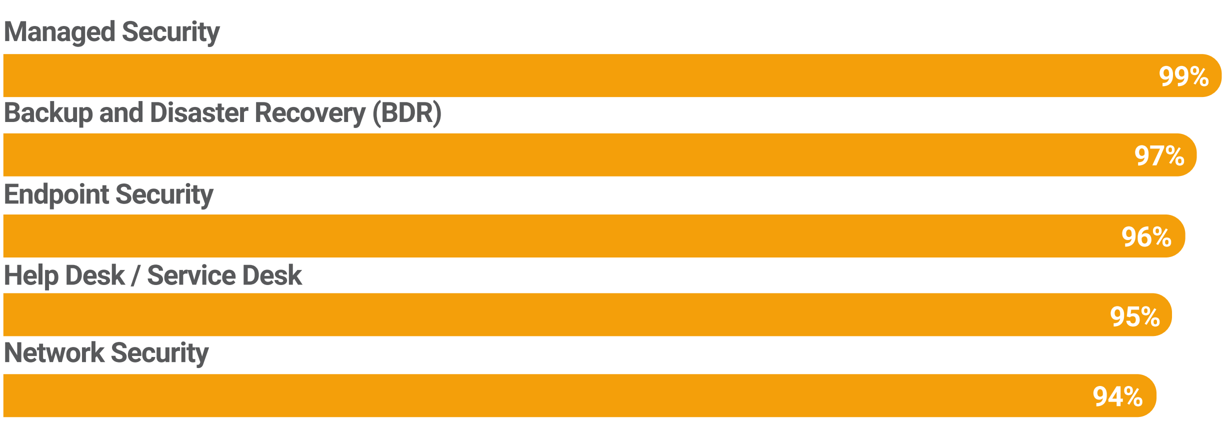
If you're not focused on margins, the line between success and failure is enhanced. Margins matter – if anyone tells you otherwise, you should seek advice elsewhere. The more money you make selling a unique service, the greater your ability to boost margins. Increased margins allow you to improve the business by investing in it, developing a niche-specific service, and becoming sticky. As an MSP, you provide an invaluable service to your client, but you can't leave money on the table.

If you're an MSP struggling to break even or drive your valuation higher, a renewed focus on the bottom line is crucial.

Top 5 Services MSPs are Offering Today

Unless you're Nostradamus, predicting the future isn't a tool in our arsenal. It's tricky to know what the trends will be in the next year because so much can change in an instant. For example, take Covid – no one saw that coming. Instead of trying to predict the future, it's more sensible to look at the past and learn from it. Data doesn't lie, and it helps us understand the top services MSPs are offering today.

According to a Channel Futures 2021 MSP 501 report, these are the top five services MSPs offer today:

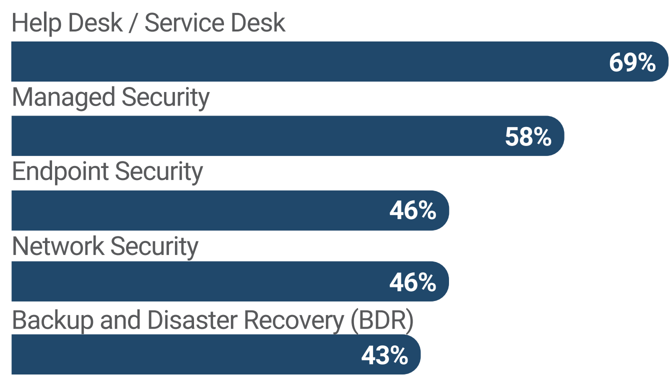


What is the revenue mix?

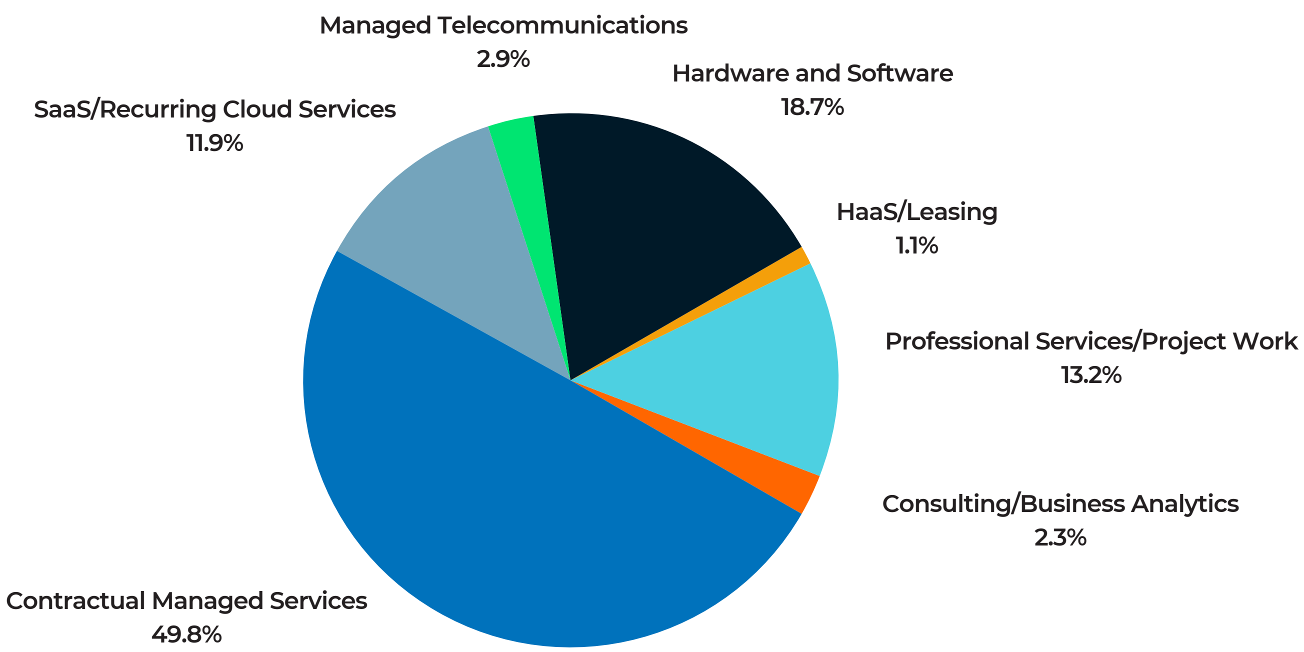
Channel Futures 2021 MSP Report surveyed MSPs and asked in the last 12 months which managed service they considered to be the top revenue-producing solutions? Respondents answered with the following:

Respondents were then asked what percent of revenue their business generates from the following services:

Top MSP Revenue Solutions



Breakdown of MSP Revenues by Channel Futures 501 MSP Report



Managed telecommunications were not mentioned in the 2020 report, despite telecommunications trending upward at a frenetic pace.

$184.6B

Global TAM 2024

Source: Gartner, 2020

15.3%

CAGR

Average Size of Monthly Managed Services

In 2020, 72 percent of MSPs' average monthly service contract per client was less than $5,000. Twenty-eight-percent of contracts per client totaled between $1,000 and $2,500, down from 30 percent in 2019. However, in 2020, contracts of $2,501 to $5,000 were up to 21 percent from 20 in 2019, demonstrating the average size of a managed services contract is growing, albeit slowly.

Contract per client	2020	2019
Less than $1,000	23%	22%
$1,001 - $2,500	28%	30%
$2,501 - $5,000	21%	20%
$5,001 - $7,500	9%	7%
$7,501 - $10,000	2%	4%
More than $10,000	3%	4%
Not applicable	12%	13%

Source: Kaseya

This lack of MRR growth is best summed up in the graphic below. The primary takeaway is that the largest chunk of MSPs MRR growth is a paltry six to 10 percent, with 27 percent falling in this category.

Not only that, 70 percent of MSP's Gross Margins for Cloud Services are < 30 percent, this is a serious problem MSPs need to lean into in order to thrive.

Average MRR growth over the past 3 years	Americas
Less than 0%	5%
0% - 5%	17%
6% - 10%	27%
11% - 15%	20%
16% - 20%	15%
More than 20%	16%

Source: Kaseya

Gross margin range for cloud services	Americas
Less than 5%	7%
6% to 10%	18%
11% to 20%	25%
21% to 30%	20%
31% to 40%	9%
41% to 50%	5%
More than 50%	5%
We do not offer cloud services at this time	10%

Source: Kaseya

The chart, as mentioned above, indicates that revenue growth is in the tank. Even worse, margins are a genuine concern for over 70 percent of MSPs.

Cloud Migration Update

Today, you either get with the times or get left behind. That's never been more evident than the shift we've taken to the cloud. Cloud adoption and migrations are at the top of the priority list, accelerated by the transition to a remote workforce.

The Cloud Maturity Model (CMM) can help you determine where your customer's organization stands.

01 **Legacy**: Here, there is zero cloud awareness.

02 **Experimental**: Lack of executive sponsorship, no cloud adoption strategy, experimenting with the cloud.

03 **Opportunity Based**: Cloud adoption strategy is being defined, cloud adopted based on needs, process for cloud adoption followed on an ad-hoc basis.

04 **Defined, Systematic**: Starting to follow cloud best practices, starting to move from VMs to containers.

05 **Measurable**: Mature cloud COE, hybrid and multi-cloud deployments, various born-in-the-cloud projects, applications are cloud aware and interact with other cloud services.

06 **Optimized**: Complete hybrid implementation, metrics are gathered to improve capability and credibility, non-private, on-premise infrastructure becomes redundant.

According to Datto, fifty percent of MSP clients have shifted more than half of their workloads to the cloud. This figure is expected to reach a staggering 93 percent in the next three years. As was discussed above, the need for cloud services is increasing dramatically. If you don't adapt and work to develop the maturity of your cloud offering, you'll be left playing catch up while others grow.

50% **93%**

The Importance of Adding New Services: How Many Should You Add?

Adding new services will help improve your revenues as an MSP. In 2020, 91 percent of MSPs found it important to frequently add new service offerings, which is a staggering figure. The most significant chunk of MSPs is adding four to five new services each year as a part of their offering. A focus on higher-margin services and perhaps fewer additions will have a multiplier effect on your business, especially when it comes to valuation.

91%
of MSPs

found it important to frequently add new service offerings

Source: Datto

New services added to offerings	2020	2019
1 to 3	35%	40%
4 to 5	39%	39%
6 to 7	10%	9%
More than 7	14%	12%
None	2%	4%

Source: Datto

How Are MSPs Billing Their Clients?

The MSP billing models are evenly distributed across the four types in the MSPs surveyed. Three-quarters of MSPs bill on a Per-User and/or Per Device model. With that, pay attention to how low the usage of tiered pricing of good/better/best is at only 20 percent of the MSPs using it.

New services added to offerings	All Respondents
Combination of per user and per device	30%
Per user (all-in seat price)	30%
Per device	23%
Tiered bundles for managed services (e.g. Gold, Silver, and Bronze)	22%
Other	20%

Source: Datto

Imagine another model, but this time it's on your costs, not pricing. You continue to charge the customer the way you want but disconnect your costs from your billing model and pricing.

The concept might sound too good to be true, but it’s not; it’s the most practical means of maximizing MSP margins. As we transition toward the cloud and change the way we do business, moving away from the cost-plus model is the most significant opportunity staring MSPs in the face.

Stop Paying Your Vendors Per Seat or Per User

Up to 70 percent of the global workforce doesn't have a desk, equating to 2.7 billion people. We break this down by type of work. As a result, many MSPs are ignoring 70 percent of the workforce! Of the 30 percent who have a desk, Cisco found they're away from their desk 60 percent of the time.

Percentage of the workforce who do NOT have a desk:

Job Type	US	World
Knowledge Workers	15-25%	10-15%
Info/Task Workers	35-45%	25-40%
Service Workers	25-45%	55-70%

Source: PKE Consulting from Gartner, World Bank

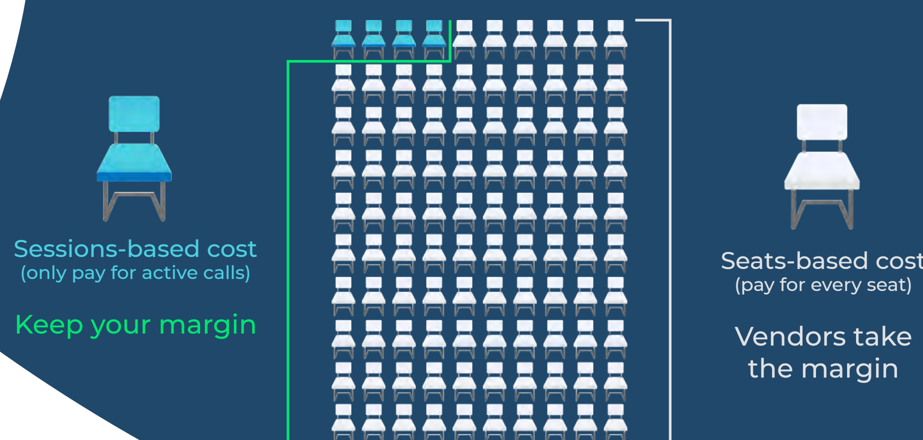
Service Providers are wondering why they need to pay their vendors for underutilized and seldom-used seats that are pulling their margins way down. Nearly two-thirds of MSP Cloud services operate at under 30 percent Gross Margins, making MSPs the Security Van driver carrying the Software Vendors money to the vendors' bank of choosing.

If you could disconnect your cost from pricing, were no longer tied to per user or device, and could average 80-90 percent gross margins, you'd jump at the opportunity, right? Fortunately, it's all possible, and these services exist. You don't have to look far to find examples of high-margin services that leverage this model.

One example of this is phone companies, which have practiced the "Oversubscription" model for a long time. MSPs can learn quite a bit about the high margins from phone companies.

A great example of this can be found in NetSapiens user base, who have two million subscribers on their Communications plat form. They found that only four percent of business phones are being used simultaneously. Now, imagine this - you pay your vendor for only four percent of those users while you bill for 100 percent of those users. If it sounds too good to be true, it's not.

Only 4% of employees are on a call at any one time



Source: NetSapiens

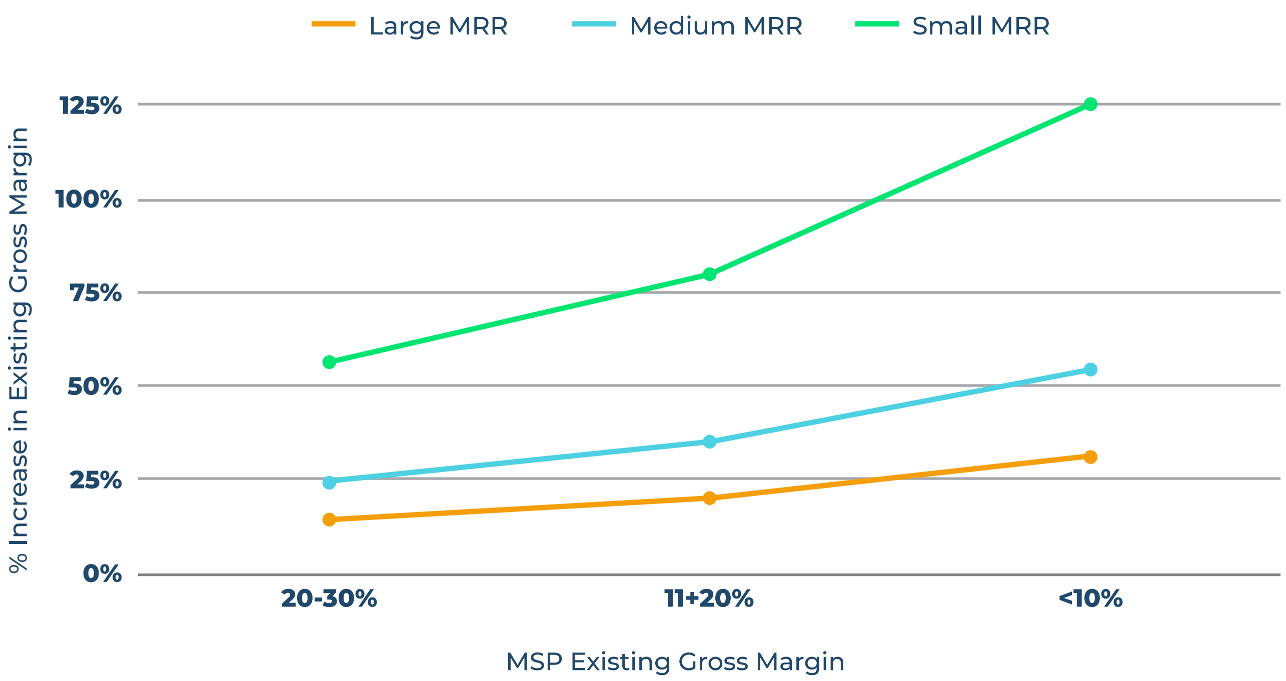
Case Study:
Adding High Margin Unified Communications (UCaaS) to an MSPs Gross Margins

Now that we've established how the top-performing MSPs are gaining traction and making waves, it's time to focus on the silver lining that's captivating MSPs and changing the landscape. MSPs are fed up with paltry margins and services they can't control with an off-the-shelf cost-plus model. It's causing them to gravitate toward partnerships with vendors that support the strategy of disconnecting their costs from their pricing, which profoundly affects their gross margins.

The most popular high margin service supporting this strategy is Unified Communications (UCaaS), ie. business communications, which consists of desk phones, softphones, video conferencing, and collaboration.

Below, you can view a table that highlights the impact of the addition of UCaaS on MSP's gross margins. It shows the exponential effect by adding a single high margin cloud service. When a simple solution exists, there is no time better than the present to take advantage and boost your margins. So, what are you waiting for?

Increase in Gross Margins When You Add Unified Communications



Source: NetSapiens

Note: This assumes a predominantly Cloud Services MSP, with an existing MRR average of (Small MRR < $1k, Medium MRR is $1k-$2.5k, Large MRR $2.5k-$5k).

Interested in learning more about a Sessions-based cost model? Check out our eBook- Sessions, Not Seats.

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