THE 2112 GROUP | WHITE PAPER

SUCCESS: TURNING YOUR MSP STRATEGY ON ITS HEAD

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EMPHASIZING SALES TO DRIVE SERVICES GROWTH

Managed services is among the most important business models in the channel, soaring toward maturity with its promise of deeper customer entanglement, increased recurring revenues and greater profits for solution providers that can master its idiosyncrasies. Moreover, the rapid onset of cloud computing in key managed services areas such as backup and recovery is accelerating the model's potential for growth.

Despite managed services' lucrative potential, the MSP community remains mired in low growth. Through varying degrees of habit, tradition and fear of the unknown, many MSPs still focus their core value on underlying technologies rather than the business outcomes produced by their services. They expend more energy and resources servicing existing accounts and less on cultivating new markets and account opportunities for their managed services practices.

Cultivating successful and profitable MSP relationships requires an evolution toward consultative sales.

Overcoming these entrenched legacy obstacles and attitudes to realize the full value of managed services requires a paradigm shift on the part of channel partners. The road to MSP success will not be built on increased technological acumen or capabilities – service providers must measure value in terms of their focus on customer needs and desires if they are to have any hope of managed services success. Cultivating successful and profitable MSP relationships requires an evolution toward consultative sales and a view of the client-partner engagement that assigns value to real-world outcomes.

THE MANAGED SERVICES MODEL: TODAY AND TOMORROW

Growth figures suggest customers facing unique and complex business technology challenges are increasingly choosing managed services over other forms of IT delivery. MSPs give end users more malleability, flexibility and cost-effectiveness in their IT operations. Managed services can streamline IT with improved efficiency and less reliance on physical infrastructure and other expensive overhead.

This trend has partners eagerly jumping into managed services. According to *The CTTA State of the Cloud Channel* report, 71 percent of the channel already at least one form of managed services; and solution providers are rapidly expanding their managed services in parallel with their cloud computing capabilities.[1]

$864 Billion
Worldwide IT services spending in 2012
— Source: Gartner

In addition to capitalizing on swelling client demand, early adopters of the MSP model find that offering managed services enable them to boost revenue by extending offerings to a greater number of customers across a wider area, removing geographic barriers as obstacles to sales and growth. Managed services appeal to a wider and more diverse pool of potential users, thanks largely to their predictability and cost-effectiveness. With the addition of cloud computing capabilities, this expansion of simplified and affordable managed services has extended down market, touching small and midsize client segments often excluded from enterprise business technology solutions and complex services due to budget constraints and lack of staff and infrastructure.

For example, today's cloud-enabled MSPs have radically altered the delivery of backup and recovery services, putting high-end eDiscovery and archiving solutions — once limited to large enterprises — within reach of SMBs. The public cloud portion of overall IT spending is expected to exceed $200 billion in 2016, with the lion's share of growth driven by SMBs, according to Gartner. Global IT services spending was expected to top $864 billion last year, while demand for global consulting services was forecast to remain high because of the increasing complexity of environments and the rise of other market segments such as Big Data and business analytics.

For the channel, this rapidly widening customer base represents an open playing field poised for dramatic growth.

[1] *The CTTA State of the Cloud Channel Report*, March 2012

THE STICKINESS AND FOCUS OF MANAGED SERVICES

The win-win scenario in managed services is its indisputable stickiness. Clients get more focused and transparent IT operations at fixed costs while the service provider reaps higher margins and predictable recurring revenue.

Moreover, the managed services model provides a solid foundation from which providers can identify, tailor and subsequently build out an almost limitless combination of solutions designed to meet the exact and specified needs of the customer.

With backup solutions, MSPs have the opportunity to create unique and valuable medleys of backup, archiving, disaster recovery, eDiscovery and other compliance-related services. Value can be enhanced by bundling multiple services that boost ROI and lower TCO for customers, while providing a viable springboard for additional service add-ons, upgrades and future cross-sell opportunities.

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Going forward, managed services opportunities will be more diverse and specialized as customers' IT environments become more complex and heterogeneous. The biggest driver will likely be the cloud: Cloud solutions have reduced traditional barriers-to-entry by decreasing reliance on infrastructure and staff, while providing greater operational efficiency and diminishing capital-expense costs for customers. The cloud also enables greater platform flexibility, which facilitates a more expansive range of service options. This allows MSPs to cultivate wider and more diverse services around mobile, virtual and physical infrastructure – a recipe that leads to higher margins and greater overall profitability.

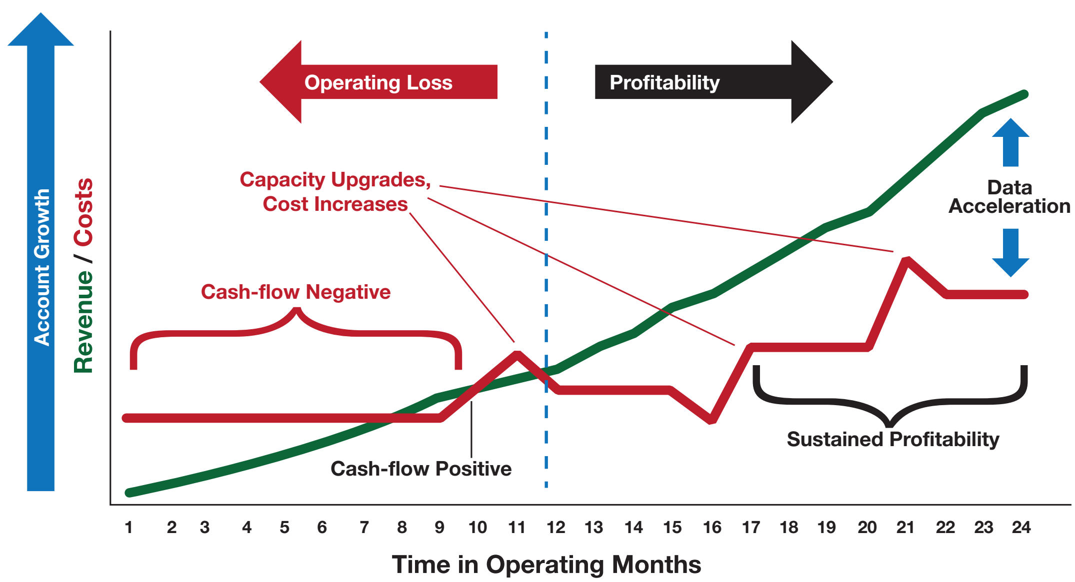
MSPs: A STUDY IN ECONOMICS

Unlike traditional business models that run up against cash flow and other financial challenges, managed services provide a consistent, predictable and recurring revenue stream. Solution providers may fundamentally understand how the managed services model works, but they frequently fail to internalize how to leverage it to maximize ROI and elevate profitability.

Managed services revenues have the potential to grow exponentially as solution providers scale offerings and grow their customer base. Shared infrastructure that can scale to service numerous accounts lowers total cost of ownership and increases ROI for managing partners, while generating higher revenue streams without requisite increases in the overall level of maintenance.

On average, managed services take between nine months and one year to become profitable, according to research conducted by The 2112 Group.[2] Once they reach that level of success, however, they can generate impressive growth, provided the practice is sustained by a steady flow of new accounts. Ideally, the constant care and feeding of net-new accounts that expand consumption should outpace operational costs for MSPs to consistently remain profitable.

Taking that compounding-profit formula into account, MSPs must ensure revenue streams exceed the ever-growing list of operating expenses. And they should maintain "room for growth" capacity that exceeds current services delivery needs by about 50 percent.



On average, managed services take between nine months and one year to become profitable.
Source: 2112 Group research

[2] *Artificial Commoditization in Managed Services*, The 2112 Group, December 2011

Such an approach affords MSPs more flexibility in financing options to maximize profits. Where most MSPs used to set simple monthly pricing based on delineated service value, many now adopt upfront, per-person or per-device pricing models, creating a blended rate depending on the mix and complexity of what is delivered within the managed services contract. Still others are migrating toward more service-centric models in which customers pay for services as they're consumed. Regardless of approach, the underlying axiom assumes that an MSP has a constant flow of sales coming in and a manageable level of account churn.

Here is where MSPs often fall short; They put exceptional effort into cloud and managed services, but forgo necessary sales and marketing efforts to keep the flow alive and the model functional. When providers weigh technological prowess and acumen too heavily in the sale and delivery of managed services, they emphasize disruptive platforms — such as cloud or mobility — as selling points in the false hope these innovations will provide enough of a differentiator for the resulting products to "sell themselves." While it may feel familiar and comfortable to many in the channel, this "tech-first, sales-second" tactic mires the service provider in day-to-day aspects of managed services like monitoring and routine maintenance — functions that feed the business in the short term, but do little to build it out.

Sales and marketing must occupy a greater portion of channel effort with a diminished emphasis on technology and partnerships.

Organizations that stay true to traditional models are doomed to fail in managed services. The strategy needs to be turned on its head for managed services initiatives to flourish. Sales and marketing must occupy a greater portion of channel with diminished emphasis on technology and partnerships.

This requires a two-pronged paradigm shift on the part of the channel. First, services providers will need to put unprecedented amounts of effort into bulking up their sales forces, following through on sales and lead-generation efforts, and aggressively pursuing new accounts and incremental business. This includes identifying cross-sell and upsell opportunities and placing renewed emphasis on services value-adds as high-margin differentiators.

Second, MSPs will need to make significant efforts to retain customers and prevent the kind of churn that can stifle growth and continued profitability. If it takes up to a year for an MSP to recoup its initial startup costs and become profitable, even modest customer attrition will dampen profitability and, in some cases, cause a business to slide into the red.

The stagnancy that has slowed overall growth in managed services is a direct result of the channel's failure to take steps toward a sales-centric approach. Giving sales and marketing efforts short shrift and overemphasizing "break-fix" servicing have pushed up infrastructure costs while delaying MSP profitability. The entire model is at risk; this cycle is a deterrent to additional managed services projects, stymieing revenue growth and creating undue challenges that impede investments.

CREATING AND SHIFTING VALUE: A CONSULTATIVE APPROACH

It is clear partners that want to generate new value and spur high-margin differentiation in managed services need to take a leap of faith and redirect efforts into sales and marketing. But what will that shift look like? To convey managed services value to customers, a rejuvenated sales approach must focus on solutions instead of products. For that to occur, partners need to know the difference between the two.

Products are dedicated tools that fulfill a specific function or purpose. They aren't answers to a business problem *per se*; they serve as isolated components of an overarching solution that will ultimately resolve the challenge or problem at hand.

A true solution, on the other hand, is an amalgam of products and services aligned strategically achieve a comprehensive objective or address a greater problem. Solutions are intended to resolve big-picture challenges, often through a multi-layer approach incorporating products, services, policies and expertise to obtain the desired outcome.

Solutions are designed to fulfill customer needs; they generate inherent value for the organization. That value is defined by how the customer's business is affected.

Products that tout technological innovation can be leveraged to address a particular need, but if that product fails to integrate with existing infrastructure, or otherwise creates additional hardship (e.g. a backup and recovery solution that bogs the system and creates productivity headaches), it diminishes in value for the customer.

Solutions are designed to fulfill customer needs; they generate inherent value for the organization. That value is defined by how the customer's business is affected. If the solution fails to meet customer needs or falls short of goals, it is no longer a real solution, but rather a series of misaligned products.

A high-capacity backup solution, for example, is of little value to an SMB storing a small amount of customer data. Similarly, a backup and recovery solution with few reporting or data-loss management capabilities will fall short of requirements if the client is beholden to numerous, stringent compliance regulations.

The fundamental difference between selling products and selling solutions is this: Product sales focus on technology and convincing the customer of the value in a tool or platform. Solution sales, on the other hand, take into account what the customer needs and wants up front, then tailors a set of products and services accordingly to achieve a satisfactory outcome.

To retain customers and generate new business, it is imperative that the channel focus on the latter when it comes to managed services. One sure route to solutions-focused value is via consultative sales. Taking a consulting approach places an emphasis on the customer's unique needs, setting the tone for all sales and services offerings going forward.

Technological capabilities are not at the heart of consultative sales. The onus here is on the ability to listen and understand the client business. As with any relationship, listening and internalizing the customer's individual needs is key. Admittedly, customer experience can be difficult to quantify with its numerous, often unrelated, variables. But being able identify and assess specific pain points represents a crucial step in delivering solutions that boost value by meeting or exceeding their expectations. The net-net? The resulting customer experience — determined not only by how well the solution works, but by the client organization's setbacks and financial losses should the solution fail — will serve as the qualitative metrics that determine overall and future managed services value.

69% Estimated growth of managed services over the next five years

— Source: Infonetics

In terms of backup and recovery, success is most often measured when the customer doesn't even know the system is working. Backup solutions should facilitate a seamless user experience and uninterrupted workflow that doesn't burden other systems, require an abundance of resources or impede productivity. In the event of an outage, natural disaster, external data breech or other incident, users should be able to easily access the entirety of their data, including the instant availability of critical data and other sensitive information.

When backup services fall short of these benchmarks, the customer experience is compromised. The ensuing ripple effect impacts their performance and subsequent customer relationships. A backup solution that fails will naturally place undue burden on customers' IT staff and resources, but it will also jeopardize customer data, which puts those relationships at risk. If an organization is tasked to adhere to compliance regulations, a backup and recovery glitch could put the company under increased scrutiny of auditors, or invoke stiff financial fines and other penalties.

Conversely, customers that are able to instantly access all desired data with short recovery times and minimal impact or disruption to business processes will see that reflected in their own customers' satisfaction levels. They will also be able to maintain or even accelerate productivity levels and efficiencies that will sustain or contribute to their bottom line.

Whether negative or positive, the customer experience will inevitably influence future IT purchasing decisions, even if the technology "worked" or performed as intended. Within those parameters, the customer experience becomes the crux of value definitions. Why? Satisfied customers are more likely to stay loyal to their MSPs. That loyalty produces a voluntary customer retention and stickiness that paves the way for add-ons, cross-sell and upsell opportunities. Simply put: Channel revenue potential increases as customer trust and relationships deepen. Customer satisfaction is more than a mere indicator; it is the most salient value metric of IT services.

RETHINKING ENTANGLEMENT

Trusted MSPs that execute well in consultative sales can expect to command top margins. Customers will be willing to pay premium rates for IT solutions that optimize efficiency, accelerate productivity and otherwise reduce business headaches. One measure of value will be if customers return, and how and where they are willing to invest in subsequent solutions.

Within this approach, solution providers should be thinking about the dynamics of customer entanglement. Entanglement often implies a customer is inextricably tied to a solution provider without any clear ability to leave at their discretion. As with most relationships, such arrangements as rarely healthy. It insinuates the provider-customer relationship is sustained not by choice.

Entanglement should be perceived as a voluntary — and quite temporary — commitment and should never be taken for granted.

For example, backup and recovery customers might be committed to a particular solution because it integrates with other bundled products, such as deduplication, archiving or data loss prevention – even if that solution falls short in terms of capacity or can't perform well on cloud, virtual or mobile infrastructure. Solution providers will often continue to sustain such services once they are sold without any real, ongoing assessment of how well they address the customer's unique and changing needs.

This sort of blind entanglement might keep the customer tied to the services provider for a while, but it is far from optimal or sustainable. Customers will begin to feel trapped and re-evaluate the relationship, which will often end with the ultimate decision to look for alternatives and sever ties with the provider. Thus, entanglement should be perceived as a voluntary – and quite temporary – commitment and should never be taken for granted.

Rather than simple entanglement, MSPs and solution providers should strive for client engagements in which the customer not only stays committed by choice, but demonstrates that commitment with additional, long-term investments. If the solution provider is putting the customer's needs first, customer satisfaction will be clearly exhibited through continued consultation with the MSP to identify nuanced problems and add on margin-rich, specialized services into their IT strategy. This means paying close attention to resulting indicative behaviors, which include the desire to renew subscriptions, make technology additions and infrastructure investments, downsize infrastructure, replace products or reallocate budgets..

RESHAPING THE MANAGED SERVICES PARADIGM

In rethinking value, MSPs must make tangible changes to create and sustain a robust and growing managed services business. MSPs need a posture that contains costs and maximizes returns to ensure profitability.

Upon entering the market, MSPs need to aggressively pursue new accounts and secure incremental business to lower total cost of ownership. While perhaps not second nature to most solution providers, this means strong and relentless marketing and sales efforts.

While aggressive marketing is a crucial and necessary step to a flourishing managed services business, the ability to identify new margin opportunities is fundamental to success. For MSPs, this means they have the ability to expand their reach to capture more horizontal business. But capturing business is a wasted effort if lost to customer attrition. MSPs have to ramp up efforts aimed at sustaining renewals, an endeavor requiring less energy than onboarding new accounts, while representing an opportunity to achieve a higher ROI.

Without such focus, even by “doing everything right,” managed services come with no guarantees of attached success.

ABOUT

THE 2112 GROUP is the premier provider of channel development, market research, partner communications and strategic content to IT vendors, distributors and solution providers around the world. Based in New York, 2112 is dedicated to helping all members of the channel community achieve greater and sustained levels of success through strategic planning, market intelligence and smart decision-making. Our clients span the Fortune 500 to startups, distributors to next-generation cloud providers, and value-added resellers to managed services providers, all sharing a common view that the indirect technology channel is the best route to market. Our premier publication, Channelnomics, is an analysis Web site devoted entirely to providing the channel community with insights into the trends impacting the IT marketplace. Together, 2112 and Channelnomics provide the most comprehensive set of strategic, analytical and actionable products and services in the channel.

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