

# Key Strategies for Beating the Commoditization Curve

**Whitepaper**



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## Key Strategies for Beating the Commoditization Curve

### Introduction

We've all seen it many times. Margins on profitable products and services erode as they become commoditized. And now, the same process is starting to happen to the IT services market.

It began with the commoditization of hardware and software sales and service. IT service providers saw their margins steadily shrink as more and more companies undercut prices to gain market share. The price decline meant there was almost no profit attached to a sale, making it virtually impossible for companies to thrive.

To escape this situation, VARs and IT companies started to rely more on delivering services but found, once again, the market was becoming inundated with competitors who were selling services as a unit of time — creating a new wave of commoditization.

This led many IT service providers to make the move to managed services. The majority are at the “reactive” stage of service delivery, which means they are delivering basic managed services – involving primarily network monitoring and on-site resolution efforts – to build a loyal customer base and a recurring revenue stream, while transforming their business into a full managed service provider (MSP).

But now there is a stampede of companies entering the lucrative managed services market. Many VARs, large telcos and big box retailers who have seen their margins on hardware and software sales and service diminish, are now starting to offer their own brand of managed services, which are typically time- or device-based as opposed to value-based. Because they don't have the expertise or experience to deliver true managed services, they are lowering their prices to attract small- and medium-sized business (SMB) customers.

The result is commoditization – competition based on price, which devalues the true benefits of managed services. The large companies and retailers may not be able to compete when it comes to service levels but they can win new clients by undercutting prices and outspending the average MSP in marketing. But for IT service providers who can't rely on volume sales and don't have large marketing budgets, competing on price is the nightmare they wanted to escape when they moved from hardware and software sales and services to managed services.

To avoid the commoditization trap and distinguish their services from their competitors, MSPs need to develop a two-pronged strategy that involves:

1. Developing a mature managed services practice that will enable them to deliver higher-value services that yield greater profit margins.
2. Drive down service delivery costs so MSPs can effectively deliver responsive, tools-based services to compete efficiently in a commoditized market.

There is a strong temptation to abandon tools-based managed services and concentrate on value-based services, but in order to succeed MSPs need to adopt both strategies listed above.

This whitepaper explores the commoditization process and key strategies to help MSPs beat the commoditization curve.

## The Commoditization of Managed Services

Managed services is one of the fastest growing sectors of the technology industry. This trend towards more predictable, proactive IT services is providing tremendous opportunities to IT service providers, particularly those targeting the SMB market.

SMBs are choosing IT service providers that can deliver better services, more efficiently and help mitigate compliance and security risks – all at more predictable costs. And because SMBs make up 48 per cent of overall U.S. IT spending, according to a recent Forrester report, they wield considerable power. By 2007, Forrester expects SMB IT spending to eclipse enterprise IT spending.

***According to Gartner, the SMB IT services market was estimated to be worth \$220 billion USD in 2003 and is expected to grow at a compound annual growth rate of 7.6 per cent from 2004 to 2008. In a recent study, Forrester said the SMB market accounts for 48 per cent of total U.S. IT spending and will surpass enterprise IT spending by 2007.***

But that's not to say that the SMB market is a guaranteed source of instant profit. In the increasingly competitive race to attract SMB customers, there's rising pricing pressure from VARs, large telcos and big box retailers.

This increase in competition is forcing many MSPs to re-evaluate their business to increase productivity, efficiency, service levels and market differentiation. Because most MSPs have time-based engagements with their customers (instead of delivering value-based services), they fail to establish tight bonds with customers – the kind of bonds that protect them from losing lucrative accounts to lower-priced competitors.

### Strategies for Combating Commoditization

MSPs face two choices when it comes to combating commoditization: “fight” by squeezing out costs and competing on price, or “flight”, which means abandoning low-end programs and maturing your service delivery so you can offer higher-value services. The idea behind this is to move away from the VARS, large telcos and big box retailers who are mainly offering tools-based managed services.

The first impulse for many MSPs is to take “flight” and only offer high-value managed services. The problem is that the majority of the market isn’t ready for advanced managed services. Currently, “reactive” customers constitute the largest group of users in the SMB market. They:

- Have some appreciation for the cost of IT failures on their business but are not convinced that they need to invest more in their IT infrastructure and support
- Are value-minded, always balancing costs versus benefits
- Want to outsource their IT services and are relatively loyal to their provider, assuming the appropriate value/cost/effort criteria are met

But over the next two to five years, as the SMB market recognizes the importance of IT and becomes more reliant on it, the demand and need for advanced managed services will increase. What this means is that MSPs have to attract, nurture and educate these reactive customers and not abandon them in favor of high-level managed service customers. While not as profitable as the proactive or managed service customer, reactive customers will mature to become more profitable accounts. By ignoring reactive customers, the MSP is restricting its ability to acquire higher-end customers in the future.

Some MSPs choose to “fight” and compete on price alone but, to do this effectively, they need to develop a highly efficient service offering by squeezing out all excess costs. This might work in the short run but customers will start demanding more advanced managed services and if the MSP can’t deliver, those customers will take their business to an IT company who can.

The best approach to combating commoditization is to mature your service offering so you can offer value-based services at a higher profit margin. But because most IT service providers don’t and can’t enter the managed services market immediately at the top level, driving down service delivery costs through automation is an important first step to deliver tools-based managed services. It will help you maintain customers and attract new ones while squeezing out excess costs. If you can hold on to reactive customers, you’ll be able to move them to higher-level offerings over time by educating them on the benefits of proactive and managed services and the costs of IT failures.

At the same time, you need to mature your service delivery model. To do this and be successful, you need to align yourself with experts in the field to help you in the process from both a service delivery perspective but also a business perspective for pricing, marketing, program development and selling.

The key is to develop strong bonds with your customers because, as the saying goes, “vendors are expendable but partners are invaluable.” Delivering tools-based services through automation will help you squeeze out costs while you develop a higher-value business by improving your ability to attract and retain high-quality, loyal customers and provide IT services in the most effective manner possible.

## **Educating Your Customers and Building Relationships**

Educating SMB prospects and customers on the benefits of managed services and the cost of IT failures is a necessary but time-consuming process.

Most business owners aren't actively looking for an MSP to help them with their business – not because managed services isn't a fit for them but because they have no idea what they are or how they can benefit from them. This places the selling of managed services in a category known as “missionary sales”, where sales professionals must educate the customer by advocating the value of managed services. This requires a thorough understanding of the customer's business model and the ability to demonstrate how effective IT management can support that model and contribute to the customer's success.

MSPs create value very differently from the typical, break-fix approach to IT services by continuously monitoring the customers' environment and stopping incipient problems through preventive maintenance. Most value creation activities occur offsite and so are not visible to the SMB decision maker – unlike the break/fix approach where the technician is onsite to fix problems. MSPs need to ensure their customers understand the difference between time- and value-based services. Watching a technician fix a problem doesn't equal value, it just equals time. But preventing a problem before it happens, that's value.

Even once the customer understands the benefits of managed services, MSPs must continuously demonstrate the value they bring. Effective value illustration shows not only what customers are paying for – the most common question voiced by managers looking to trim IT budgets – but also what they're not paying for. In other words, properly communicating the genuine value of MSP offerings can reveal the costs that your service is saving your customers every day: reduction in security risks, elimination of emergency IT services, for instance, or a reduction in costly server down time.

Only by clearly and consistently communicating your unique value to your customers can you hope to attain the role of trusted advisor – a position that helps to protect MSPs from losing business to lower-priced competitors.

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### Squeezing Out Service Delivery Costs

In order to compete on price with large telcos, big box retailers and VARs, MSPs must squeeze out any excess service delivery costs. Often, service providers just entering managed services are still transitioning away from a chaotic mode, which means that 100% of their billable technical resource time is dedicated to responding to customer problems. With the right combination of remote monitoring and management technology, automated services and best practices, MSPs can provide managed services in a cost-effective, highly profitable manner to a wide range of customers, each with different needs.

### Remote Monitoring and Management Technology

Currently, many IT service providers do not use any remote monitoring and management technology. Instead, they rely on customers or technicians in the field to report problems. In other cases, they are using freeware or low-cost tools that aren't designed for managing multiple customers. Because they have a scattering of tools, each with different interfaces and different operating paradigms, the cost of training technicians and managing customers increases. The absence of a single view of all customers raises the risk of something important being overlooked by harried technicians.

A remote monitoring and management platform allows MSPs to boost the productivity of their technicians and use their skills more effectively. If a technician doesn't always have to be at a customer's site to resolve issues, then they can deal with more customers at one time.

MSPs need a remote monitoring and management solution that offers:

- Broad protocol and operating system support – this allows you to support more types of customers and more verticals than your competitors
- Comprehensive managed services feature set – including monitoring, management, notification, reporting and interoperability capabilities.
- Scalability – it needs to be designed to manage small networks and large networks as well as scale from a few customers with dozens of devices to hundreds of customers with thousands of devices.
- Monitoring flexibility with agents and probes – agents are critical to monitoring mobile devices such as laptops that are not always connected to the network, while probes are essential for cost-effective monitoring to avoid the expense of installing agents on every device.

### Operational Best Practices

The most significant cost of any managed service is labor, which is why it is critically important that the MSP adopt operational best practices to use their remote monitoring and management platform effectively and efficiently. But many MSPs have little or no experience on how to effectively use RMM technology to deliver profitable managed services and few have the time or resources to develop these processes without guidance. That's why MSPs need to align themselves with experts in the field who have the tools and resources to help them configure their platform and use it effectively.

Best practices help MSPs avoid the long and costly exercise of learning how to configure the technology. Without best practices, for example, it could take four hours to configure an Exchange server rather than following best practices and doing it in an hour. Another example is alerts. Setting the threshold too low will cause too many false positives, which wastes time. Set it too high and you'll miss customer issues, which will impact the service level.



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### Automating Services

It is essential that MSPs automate as many customer services as possible to reduce the time, labor and costs associated with these resource-intensive activities. By grouping services and tools, MSPs can offer a more differentiated managed services offering with greater margins, better service levels and higher revenue.

### Advanced Desktop Management

According to a recent IDC study, adopting centrally managed PC configuration best practices resulted in an average savings of \$190 per desktop per year. (IDC: Optimizing Infrastructure: The Relationship Between IT Labor Costs and Best Practices for Managing the Windows Desktop, October 2006). The potential savings for a 20-seat customer installation is almost \$4,000 per year.

A managed desktop solution gives MSPs the power to centrally configure, manage, secure and protect desktops centrally from a single interface, and prevents most of the problems that necessitate a visit to the site where the affected PCs are located. Standard and enforceable configurations save enormous time for troubleshooting problems and greatly reduce the risk of the user modifying the PC settings and breaking the system or exposing it to risk. Centralizing desktop configuration tasks reduces the hidden costs of supporting PCs.

### Remote PC and Server Support

Remote support enables MSPs to control, manage and gather information from remote computers, in real time, while users continue to work without disruption. By providing technicians with access to in-depth management and detailed troubleshooting information, remote support solutions help MSPs improve efficiencies and operations by lowering support costs and decreasing average resolution time. A remote support solution that can be automatically deployed also minimizes rollout costs.

Capabilities of a remote support solution should include:

- Point-to-point file transfers
- Stopping and starting services
- Support agent chat
- Advanced remote control
- Access to the command prompt
- Detailed service and process information
- Event logs
- Local disk manipulation
- Real-time performance and capacity status

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### Reporting

The key to customer satisfaction is value. Helping your customers understand the value you provide them is one of the greatest challenges that an MSP faces. MSPs need a comprehensive, easy-to-use reporting solution that supports daily operations, troubleshooting and capacity planning.

Reporting is essential for four critical functions:

- Demonstrating your value to the customer decision maker
- Identifying and justifying system changes and new hardware and software
- Internal operations
- Troubleshooting

Reports should provide customer and system information as well as insight into the customer's infrastructure and ongoing incidents. Reporting should also support tactical operations through utilization, detailed status, capacity and event reporting.

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### Professional Services Automation Tool

Many IT service providers today rely on spreadsheets, whiteboards and manual or homegrown solutions to run their business. These ad-hoc systems and stand-alone solutions create information “silos” and MSPs that use them reach a point where they cannot manage their growing number of employees, customers and managed service contracts. They do not have a cost-effective way to service customers, deliver consistent, repeatable, quality services and gain visibility into service delivery operations.

A professional services automation tool helps you:

- Understand your sales pipeline and performance against goals.
- See all the work that is being done for any given customer, including implementations, custom development and professional consulting and management services.
- View your complete portfolio of in-house projects and customer service work.
- Drill down to any level of detail to assess which customers or projects are profitable and which are not.
- View resource and staff availability, resource utilization and billable hour reports.
- Analyze how individual team members are performing.
- Run reports on profitability and other key business metrics.

A professional services automation tool will help you dramatically improve response times by having complete control over your customers’ business processes.

### Offering Higher Profit Services: Moving Up the MSP Maturity Scale

Squeezing out costs is essential to competing in a commoditized market but to beat the commoditization curve, MSPs also need to mature their service delivery by developing operational and business best practices. Accomplishing this requires a company commitment from the top down and an understanding that business transformation is a process that involves a steady evolution through a service delivery maturity process.

Moving through each stage of the MSP Maturity Model helps MSPs develop a higher-value business by improving their ability to attract and retain high-quality customers while providing IT services in the most effective manner possible.

Below is a brief overview of the five stages.

**Chaotic** — Chaotic service providers have unpredictable service delivery, undocumented processes, no service level objectives and 100% of technician time is dedicated to reacting to failures discovered by the customer.

**Responsive** — Responsive service providers have some documented processes. They offer up/down monitoring and while 100% of billable technical resource time is still dedicated to correcting failures, the failures are often discovered by the monitoring tool and not the customers.

**Proactive** — Proactive service providers differ from the first two levels in that they offer preventative maintenance. They can predict and minimize the threat of failure, capture performance and capacity utilization information and use service level objectives to set targets. In addition, 50 to 70 per cent of billable technical resource time is dedicated to correcting failures.

**Managed** — This is the first level in the hierarchy that takes a “utility” approach to service delivery. This level is one of the most challenging to attain because until now these companies have sold time as a product.

**Value** — This is the logical evolution from the Managed level. While the Managed provider manages IT based on the value of the IT components, the Value provider manages IT based on the business process that it supports – regardless of the infrastructure that requires the service. As with the Managed level, the Value provider generally abstracts the amount of time required to provide a service in favor of a flat-fee based on the value of the business service.

Successful migration through the MSP Maturity Model enables MSPs to:

- Maintain consistent, higher quality services.
- Allocate work more efficiently.
- Offer higher-margin services that won't become commoditized.
- Attract larger, more sophisticated customers.
- Create customer relationships that are difficult for other service providers to penetrate.

# Developing Operational and Business Best Practices

## Operational Best Practices

Delivering true managed services in a profitable manner requires a very consistent approach to service delivery and service management. MSPs need clearly defined processes to help them continually improve in terms of quality of service and cost of service.

Good process management ensures that anyone who performs a task does so according to the process – in an identical fashion, time after time. This gives MSPs the ability to assess the amount of time to execute the process with very little variance from individual to individual – and even that variance can be measured and optimized. Regular process reviews provide an opportunity for the MSP to reduce the number of manual steps required either through automation or through process improvement. They also help lower the cost of delivering managed services while maintaining, or even improving, service levels.

MSPs also need a clear understanding of the specific services they're going to offer, how they'll be provided, and their ongoing cost. By working with an expert in the field, MSPs will be able to develop a preferred approach to the management of specific IT services, as well as effective automation strategies to minimize the overall cost of the management of the services.

Your service delivery strategy should include:

- Service Overview – A description of the service being provided.
- Service Details – A breakdown of the components that affect the service.
- Operational Management Plan – The details of the tasks that must be performed to provide the service. The operational plan includes:
  - The task schedule
  - The task description
  - The cost estimate for the task (in terms of time)
  - An automation strategy for the task
  - Efficiencies gained when leveraging automation for the task
  - A cost estimate for the automated task (in terms of time)
- Monitoring Strategy – A detailed analysis of the services, processes, event IDs, etc. that should be monitored
- Efficiency Gains – An analysis of the monthly costs associated with the service as well as efficiencies gained by leveraging automation.
- Reporting Strategies – A schedule of reports to support the management activities.
- Referenced Documents
- Required Skills

## Business Best Practices

Unfortunately, marketing and sales program development for managed services is a typical area of weakness for most MSPs. This places the MSP in a position of significant risk. Without understanding who its customer is, what its customer requires and how to present a compelling value proposition, the MSP dramatically reduces

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its odds of selling advanced managed services. Selling hardware or blocks of time or just waiting for the phone to ring is how most organizations currently run their business. But managed services is all about selling business value, security, compliance and uptime. In order to be successful, companies need to change the way they package, price and sell to customers. They also need to change compensation packages and find new incentives for their sales representatives and technicians.

MSPs need to align themselves with experts who have a comprehensive and proven set of tools and resources that demonstrate how to configure a remote monitoring and management platform, and use it effectively to service multiple customers. MSPs also benefit from having access to a tested go-to-market strategy, marketing collateral, sales and marketing training for efficient and effective knowledge transfer, and dedicated experts to help plan, develop and implement marketing programs and sell managed services.

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### Summary

The commoditization of lower end managed services is coming in 2007 and 2008. It's already happened to the hardware, software and services markets. To be successful, MSPs will need to nurture their existing responsive customers while maturing their service delivery model. Chaotic services will no longer meet business requirements and responsive monitoring will become a minimum value added service to ensure business continuity and customer retention. But by maturing and standardizing service provision, delivering higher-value services with better margins and driving down service delivery costs, you will beat the commoditization curve by building strong, financially rewarding customer relationships that can't easily be broken. As we've seen, differentiating yourself in a commoditized market is all about building relationships and maturing your service delivery model. The ability to capture and retain lasting customer relationships is proving to be a determining factor for long-term profitability. The best way to do this is to team up with a partner who has the right tools and technology and will help you develop best practices and sales and marketing expertise.

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