Why I Still Believe in the MSP Business Model?

Having been blessed with the opportunity to join the Information Technology revolution in the 1990s just as it was exploding and becoming mainstream, I've participated in many forms of IT Services:

- System integrators and project engineering with fixed priced / time & material contract structures;
- Technology and application service providers (TSPs / ASPs) who initiated the first recurring monthly billing for outsourced monitoring and support services and hosted software subscriptions with the formation of NOCs and SOCs;
- Value-added resellers (VARs) with those Blocktime and maintenance contracts, selling big ticket technology infrastructure and then supporting it throughout the lifecycle;
- Managed service providers covering the full spectrum of outsourced IT services from network to helpdesk and user support to security and disaster recovery to the Cloud (MSPs / MSSPs / CSPs / etc.)

It was exciting to help Microsoft, and other technology solution manufacturers, mature their channel partner programs that incubated MSPs as we know them today … to transform business models based on % margin for reselling software licenses (and the associated hardware needed to run it) + hourly-based costs for services into one simple, fixed monthly price to proactively take care of the entire range of Small and Medium-sized Businesses' (SMBs) IT needs.

I remember reviewing our Managed Service Agreement contract with the head of Microsoft's Channel Division for the Southeast back in 2003-4 … defining the terms that could be morphed into repeatable, recurring cost factors versus those which were too unpredictable and too costly to be automatically included in our fixed-priced service offerings.

> We aligned around the Classic Stack (Servers, Networking, Email, Databases). We were in full agreement that the emerging Dynamics Stack (Line of Business ERP, CRM, BI, etc. applications) was still too new and immature to be routinely supportable. But we never did reach agreement on the PC / Laptop / Desktop components involving mostly Windows and Microsoft Office because of our vastly different perception about what kinds of support the users at our SMB clients really required in order to get and stay productive … Microsoft has always been rather

presumptive about how intuitive and simple their end-user software is to use, let alone how compatible it is with all the associated other end-user tools and peripheral devices!

And I chuckled in 2005 to see the replica of our MSA contract published in the Partner toolkit at Microsoft's website, even if our guidelines differed.

From 1996 to today – 20 years now – it is amazing how the industry has transformed!

We now have a host of structured RMM / systems management automation tools and frameworks that rigidly define standards and best practices via step-by-step instructions, even if they still have a long way to go working out all the bugs…

We now have robust marketing and sales resources about the value of the services we perform, instead of just a ton of datasheets and whitepapers describing why our SMB clients should by *xyz* hardware or software.

Instead of having to build our own time-utilization tracking, ticketing and billing systems (yes, often using Word or Excel or Outlook!), we now have full MSP business management platforms like ConnectWise, AutoTask, Continuum, or N-Central.

Yet, as the old saying goes, "*the more things change … the more they stay the same.*"

After a 5-year stint at AT&T co-creating "big-iron" platforms – those massive $100 Million investments to build the equivalents of AWS, Azure or Google – I came back to the SMB-focused market in 2015 with fresh perspective and a happy heart. It feels so good to be helping real businesses with real problems and really making a difference!

The Small and Medium-sized Business owners have even more challenges, not less, in managing their Information Technology and their employees – our users - present even more unusual troubleshooting scenarios and risks than ever before.

Crypto-Ransomware dealt a body-blow to our industry – it has hit almost every company I've talked to in the past 2 years, often with devastating outcomes. Yet both the MSPs and the SMB clients have withstood the epidemic only to become stronger and smarter.

Backups are done with a rigor and quality that was unheard of back in the early 2000s – because it's essential now. Most often a good backup is the only recourse when these new threats strike. And our business clients found the unintended benefit in their unstoppable data sprawl is that they often had copies of the corrupted or lost information in some of the strangest of places… (A big change that I'm seeing is that SMBs no longer go out of business when they lose some or all of their data. They actually just pick up and carry on. Funny isn't it? The more data we produce, the less mission critical it actually becomes despite our perceptions to the contrary.)

So the market, the customers, the need and awareness of the need is as strong as ever!

MSPs enjoy more opportunity than ever before as the breadth and complexity of IT Services has expanded.

In fact, I would venture to say that the needs of our SMB clients have become so complex that the old argument we used to displace their internal (or part-time) IT resource could now be made convincingly against the local Managed Services Provider… "*technology requires so many specialized skills and expertise, no one ~~person~~ (outsourced IT provider) can master them all.*"

What I've noticed since returning to the industry in 2015 is MSPs drawing sharper lines where their responsibility (and capability) stops and starts – especially as it pertains to line of business applications, security and many Cloud / Mobility Services.

This makes sense. Since we introduced the fixed-price monthly recurring business model, there's been an erosion in net profits from the growth of unintended hidden costs incurred by having to provide more services than simply network/computer infrastructure management and maintenance. For MSPs that struggled to explain to their clients why performing PCI scans, responding to audit requests, and moving Sage or Intuit from on-prem to the Cloud wasn't automatically included in the fixed-fee package, thereby monetizing those costs, their margins have come under pressure.

However, from the clients' viewpoint, it creates a whole new pain point with IT when suddenly they find they have to manage relationships with their MSP, their SaaS providers, their auditors and compliance vendors, etc., etc. It's actually becoming a driver for SMBs to bring back an internal IT resource simply to manage the projects and vendor relationships!

The Need to Balance SMB Client Needs and the MSP Business Model – Door #1

When we started MSPs back in 2003-2004, we all thought massive consolidation was going to come as technology automation commoditized the industry. That was actually how we expected to keep our costs low and grow our margins; how we'd expand into other technology specialties to add the full suite of services of a Fortune 500 IT department, all for the benefit of our SMB clients.

This consolidation and commoditization definitely happened at the large corporation and enterprise level: wholesale outsourcing (offshore mostly) to a tiny number of providers (at rock bottom blended rates of $50-60/hr.) has become the norm.

Yet, I was delighted to find that our Small and Medium-sized Business customers have bucked the trend and refused to allow national, mass-commodity providers degrade the quality, attentiveness and personalism of their IT services by simply chasing the ephemeral $0 cost structure.

There are more MSPs operating today in the Greater Atlanta region than there were when I was a partner at Insol (2003-2009) and the "Bigs" have even less market share than they did then.

Cloud Migration to Management and Everything Between

Let's Chat

That's not to say that some MSPs have successfully navigated the path from local and small to national. Equity buy-outs of MSPs making +$10 Million are all the rage as the market has discovered how steady and reliable our cash-flow, recurring revenue business models are.

I applaud my colleagues who've navigated this particular exit strategy to great personal gain, but also feel such compassion for the clients and employees of their former companies, who are now tasked with Junk Bond-like growth targets and mass commoditization of their service offerings. It was very sobering to hear the presentation from Marco IT at IT Nation last November – From 5 to 50 to 500 now tasked with turning a $500M company into something like $5 Billion in revenues in the next 5 years. For me, that's not an exciting challenge; it's a recipe for ruthless strategies (think Wells Fargo new account scandals) and the type of zero-sum game mergers & acquisitions we've seen from the Fortune 500 since the 2008-9 recession.

Interestingly, as I actively engage the ~300 MSPs in Greater Atlanta and others across the Southeast, renewing my investments in our industry, I'm finding greater Revenue-to-EBITDA margins happening at the smaller, not bigger sizes.

MSPs >$3-4 Million seem to be facing considerable pressure managing their operating costs to attain the same returns they achieved at half that size. While I can't speak to the $10-20 Million MSPs and above (I'm not interested in that market), I am finding confirmation of a new understanding I gained while at the Big-"T": scale, in and of itself, is not "good." In many cases it is wasteful, inefficient and counter-productive.

Moving from either/or to both/and – Door #3

So the market has not consolidated. Big doesn't automatically win. Clients are still preferring a more intimate experience with a trusted partner who knows their needs and environment intimately, and who can wear both hats of IT strategy advisor (and coordinator) across the disparate, growing number of vendors they subscribe to as well as keep their computers working and their information safe.

Now the question is how to flex around the skill limitations of a staff of 10-25 top-notch infrastructure engineers to meet the demands of growing complexity and ambiguity (as well as, let's all agree,

declining quality of software and hardware – all those big corporate enterprise layoffs definitely have had their impact!) Or not, that's Door #2.

Client's want intimate. They want local. And our engineering professionals want hyper-local … especially in Atlanta with our notorious traffic challenges! Yet they also need skills that would seem to require much bigger organizations with highly diverse teams and skillsets. And they want someone available 24x7x365. All of which seems to demand scale.

If we follow the traditional models, this means grow your MSP nationwide (perhaps add a few enterprise client contracts like provisioning server hardware for my former enterprise boss…), and scale the hierarchy with divisions for Cloud, LOB software, Mobility, App Development, Security, etc. as well as our bread and butter Computer / Network infrastructure support.

But then we don't give clients what they want.

Or we do nothing (Door #2), and likely we'll still be able to retain our great clients and most of our teams, but I do worry about the personal toll being stretched too thin and trying to navigate increasing competing demands and priorities take on MSP owners and their staff.

We could also look at a different model which has been around as long (actually longer) than the owner-operated corporation (1 person or a few partners hold 100% of the business equity stake) → The Professional Practice model.

You see it among your clients in the Professions: Law, Medicine, Accounting, Engineering…

It actually was how the first Technology Service Providers and Application Service Providers that I worked with back in the late 1990s were structured. Multiple partners, upward advancement of top contributing employees to become a partner over time, centers of excellence managed within each Practice.

It brings the benefit of economies of scale. It addresses the complexity issue. Yet it preserves the intimate owner (partner) to client relationship that is so important for our SMB customers.

Sustainability

It also addresses a severe challenge that I've personally experienced and witnessed over and over again among my colleagues in the MSP industry: that is, succession planning and exit strategies.

On the employee side, how many top engineers and professional service experts at your companies desire their hard work be rewarded with some form of equity, some investment, something that can help generate a return greater than simply salary and benefits in reward for their hard work? How many dream of starting their own company?

On the owner side, how frustrated are you that the business seems to have plateaued? That you reached a level where the team can't handle new clients and it's one in / one out? That you're exhausted running around putting out customer service or technical issue fires and your team simply can't seem to follow repeatable service delivery time after time?

And when it comes time to step away and retire, or you're just fed up with the stress and burden and monotony of the business? What then?

Despite all the noise about equity buy-outs for MSPs, I also heard at IT Nation (and in many other conversations with industry experts), that there are lots of conversations occurring and a deluge of communications, but very few completed transactions. Literally, it's 1-2% of all those entertaining discussions - on both the buy or sell side - that are actually seeing the deals close.

MSP owners worked incredibly hard to get their businesses built up, to establish their client base. They understandably want to reap the reward of that effort. Almost all that I've talked to also desperately want to make sure their clients will still be cared for in the manner that they've come to expect – they want the buyer to ensure continuity of the relationship, the special consideration, the personal touch. And they want their team to be cared for, to have jobs, chances of advancement, not find their work or roles disrupted.

These are very worthy and reasonable hopes. Unfortunately, if the MSP owner is able to sell, they rarely come true. I myself have been witness to what happens when an MSP owner's succession plan fails and it was devastating for both the clients and the employees. And the owner, of course. Incredibly distressing and emotionally debilitating, not to mention financially destructive.

I've often wondered why more MSPs do not in-sell (turn the company over to the employees as they prepare to retire), but have heard lately about such attempts also going sideways, much like the traditional buy-outs. (Mostly, it seemed to be a problem of training and expectations. There is a learning curve to go from engineering or consulting to running a business.)

My hypothesis, supported by studying 300-500+ years of Professional Practices, is that the Practice model actually provides for such succession transfers and long-term continuity. Sustainability of the firm is paramount as partners come and go without issue or censure. In fact, the entire operating model is based on the premise that partners will buy-in and earn-in to the Practice and, when ready, sell-out and pass along their Practice to new partners over time…

Well I can go on much more about the value of co-operative partnerships with a network of IT professionals to provide essential services as the Practice develops or even if you don't find that model appealing… And about the coming influx of SMB client demand for service and support around Open Source Apps and APIs. But, let's save that for another time.

To sum up: I'm incredibly optimistic about the future for Managed Service Providers and largely thrilled to see how the industry has matured during my stint in corporate enterprises! And I am so excited to be launching this new (old) Professional Practice model. If you're interested in participating or are looking for investment and support, please contact me at cbaird@msp-partner.com or https://www.linkedin.com/in/bustech