White Paper

Optimize your business:
3 key challenges MSPs need to overcome to increase profit margins
Introduction

Today's managed service providers (MSPs) are constantly striving to attract new business while retaining and growing their current customer base. As organizations increasingly require support for their IT initiatives, MSPs are well positioned to capitalize on a robust market — if they can deliver what customers need.

But driving revenue growth is only one part of the equation for maintaining a healthy business. MSPs must be able to simultaneously manage their operating costs and internal processes to increase profitability. And when it comes to dynamic service areas like cloud, doing so can be even harder than winning business in the first place.

There are three main challenges MSPs face with cloud when it comes to generating and optimizing profits.

Challenge 1: Improve cloud unit economics

As MSPs scale their cloud businesses, optimizing the costs of cloud resources becomes one of the biggest opportunities to achieve greater margins. But doing so is complex for a single customer, much less across a large portfolio. Best-in-class MSPs must have a clear view and the right strategies in place to consistently drive down how much they pay for cloud.

Challenge 2: Develop an effective pricing and billing strategy

Service pricing is the critical component to MSPs ensuring healthy margins. Whether it’s firm fixed-price engagements or scalable pricing based on usage or environment size, MSPs must clearly show their customers the most value. Especially in the case of an offering that’s based on cloud spend, once the final cloud spend totals are available, MSPs must be able to accurately and efficiently invoice their customers based on the defined pricing approach.

Challenge 3: Optimize internal operations

In addition to managing the economics of the cloud, MSPs must also closely manage their team members and the processes that deliver support for customers each day. By embracing automation and standardizing service delivery, MSPs can see greater efficiency and scalability with their existing staff.

In this white paper, we’ll walk through each of these issues and the obstacles they present as well as solutions and profit enhancement suggestions to optimize managed services businesses.
Challenge 1
Improve cloud unit economics

Increasing profit margins remains dependent on reducing operating costs. That means getting the lowest possible price on cloud services to achieve the greatest possible margins. Below are three suggested solutions MSPs can use to overcome the challenge of improving their cloud unit economics.

Solution
Aggregate customer cloud costs

As the adage goes, “the more you spend, the more you save.” Cloud providers do offer discounts for larger purchases. The good news, for MSPs, is they don't need to spend more. They just need to aggregate what they were already going to spend. However, purchasing cloud based on the spend of individual customers versus an entire customer portfolio simply doesn't lend itself to an effective volume discount strategy.

To save more on cloud costs, MSPs need to consolidate these charges to obtain a higher level of discount over list price. Even higher margins can come from aggregating commitment discounts, such as Reserved Instances (RIs) and Savings Plans across an entire portfolio and apportioning them across the customer base.

Solution
Apply the right cloud purchase commitment model to your portfolio

MSPs need to have a holistic view of their customers' cloud spend portfolio, trends, and future projects to determine the right commitment purchasing strategy for themselves and their customers.

Calculating the maximum amount to commit to is one thing; knowing what to commit to is yet another. There are many different permutations of purchase commitment models, based on resource type, when payment must be delivered, and commitment length. Therefore, being able to identify the right blend of cloud pricing approaches and commitment options to balance savings and risk is difficult across a diverse and dynamic cloud portfolio.
Before committing, MSPs should explore the answers to questions such as:

- How quickly are we able to modify our portfolio in the event that customer utilization or behavior changes?
- Can we sell back commitments on a cloud provider marketplace or use them for another customer?
- Are we able to identify and actively manage these purchasing opportunities with our current cloud solutions?
- Do we have any workloads that are better suited for certain commitment types?

To meet these requirements, MSPs must be able to select and actively apply the right mixture of RIs, Savings Plans, and Spot Instances based on their customers’ applications and long-term infrastructure and business needs.

But identifying and managing a portfolio of commitments is challenging and extraordinarily time-consuming without leveraging the right technology. An appropriate cloud management solution can give MSPs insights into their cloud spend and help identify the right plans to maximize volume purchasing opportunities.

Advanced solutions take this a step further. Some leading cloud management products automatically analyze, recommend, and optimize RIs and Savings Plans throughout their lifecycle, so that MSPs can achieve deeper cost savings. Additionally, these solutions enhance core cloud visibility and reporting, providing detailed analysis of the commitment portfolio — including what is being spent and by whom, with current, historical, and projected cost and usage visualizations across all cloud deployments.

**Solution**

**Avoid absorbing unnecessary cloud provider costs**

Oftentimes, there are expenses that MSPs may chalk up to “the cost of doing business.” But when it comes to cloud charges, it’s important to keep these to a minimum. One common problem with cloud-related charges is that MSPs incur some cloud costs differently than the ways in which they pass costs on to the customer. For example, the costs to the MSP may be variable, but the customer may want fixed, predictable pricing each month.
Some MSPs may respond by absorbing some of the items as a cost of doing business, especially when the costs can’t be easily charged to a specific customer. Examples here include costs for support, upfront charges, or certain cloud tools that the MSP uses to conduct its business and operations.

Cloud cost amortization approaches can help MSPs avoid absorbing valuable discounts and service charges. They should consider upfront costs — and make sure they account for those costs when they deliver the associated value to the customer.

**Challenge 2**

**Price and bill effectively**

Profitability is also predicated on pricing models. MSPs need to craft a methodical approach to pricing for services and bill customers effectively. The following four solutions can address key issues around MSP billing and pricing strategies.

**Solution**

**Determine pricing packages**

Pure cloud infrastructure resale margins are thin, and trying to build a business on reseller margins alone is a losing proposition. Customers often expect to use an MSP to avoid the monthly challenge of cloud resale and optimization, and they may be leery of an MSP that charges more for the cloud infrastructure than the cloud provider. After all, they can always buy those services on-demand or at a discount themselves.

Therefore, it is critical when applying a markup on cloud costs for the MSP to articulate the value of the offering that they can provide as a result of that additional percentage. Further, it’s then incumbent on the MSP to be transparent about how they optimize the cloud environment given that their revenue is tied to increased cloud spend.
MSPs then need to package these services into coherent offerings, which can further help justify the added service charges. Bundling cloud resources can be more profitable for an MSP when paired with additional support, reporting and analysis, consulting, or other expertise they have to offer. However, they may need to avoid a one-size-fits-all approach to bundling services, or at least to explore tiers of solution offerings based on services provided.

MSPs can also charge a percentage on top of the infrastructure costs for ongoing management of the environment as well as ongoing cloud optimization services. To further increase margins, an MSP can use a cloud management platform to perform optimization at low to no cost to the MSP versus the more time-consuming manual auditing and assessment work.

**Solution**

**Account for the correct rates**

MSPs need to develop their pricing strategy and also have the tools in place to actually bill for it. Traditional tools — like spreadsheets, calendar reminders, and even some cloud native tools — are inadequate for implementing sophisticated billing at scale.

Technology can help enforce policies and increase the flexibility in billing processes, so that service providers don't have to spend time manually calculating rates. A cloud management platform should enable the MSP to re-rate pricing and provide contractually appropriate charges to their customers, rather than the blended costs a cloud provider supplies via its typical billing file.

Blended costs are cloud costs that are shared across multiple customers. An example of this is an RI purchase shared across several customers. However, this rate is generally not appropriate for customers, given that they may not be entitled to some aspects of what creates the blended rate, such as partner credits, volume discounts, or benefits of other customers' RI purchases.
Unblended costs, on the other hand, show the rate of actual usage aligned with the list price of the cloud provider, creating a better method of charging individual payees. By working with true list cost as the baseline for pricing, an MSP can capture the breadth of volume pricing and upfront investment made across their partner base. By using blended costs as a starting point, some customers will benefit from volume discounts and upfront purchases without having met that criteria for such price advantages, limiting what an MSP may realize in profitability. To be most efficient, MSPs should leverage a cloud management platform that re-rates cost to align with list pricing and then displays contractually agreed upon discounting to the customer’s portal.

Depending on business need, neither blended nor unblended costs should be displayed alone. What many MSPs need to do is display the list cost of the services to the customer. For this, they need a cloud management platform to translate the usage charges within the cloud into a price, as if each payee account were a standalone account. List cost allows an MSP to create invoices that correctly represent the cost had the payee account not been in the MSP’s consolidated billing family. This is a more accurate cost to report to a payee over blended or unblended costs.

**Solution**

**Build a strategy for premiums and discounts**

MSPs need to determine an approach to apply markups or markdowns for cloud infrastructure in a way that won’t affect their existing relationship with customers. Sharing some discounts with customers is a good way to get a foot in the door; however, MSPs need to evaluate the proportion of value sharing as the relationship evolves.

For example, MSPs must decide whether to apply a fixed price or a percentage increase to a cloud resource type. A fixed price allows margins to expand as the MSP reduces its own cost, while a percentage markup keeps margins constant and demonstrates reduced costs to the customer.
A cloud management platform can help MSPs set custom billing charges, which can also include additional fees for service, such as support, or other surcharges. These custom charges can be dollar- or percentage-based, or a combination of the two. That may mean charging a premium or offering a discount, depending on the agreement with each customer. The MSP can also charge the customer at a price point between their discounted pricing and the typical on-demand rate to get their business without sacrificing all of the potential margin, especially when it comes to RI s.

Displaying the list price for the customer’s individual cloud costs versus the rate that the MSP pays with volume discounts is one way to appease customers who want to know that they’re being charged fairly. Another option is to re-rate the bill, which lets the MSP charge a different rate for a service than the one they pay as the reseller, either as a markup or a markdown. While a markdown may seem like it’s sacrificing margins, it may give the customer a reason to choose the MSP initially. Additionally, the markdown may not represent the entirety of the MSP’s cost for cloud, but it gives the customer a benefit and leaves some margin in place for the MSP.

**Solution**

**Automate cost allocation**

Attributing individual customers to their granular cloud costs is difficult. However, when MSPs do the work to set up the cloud environment correctly, they can easily track a customer’s exact usage and resource costs in even the most complex multi-cloud estates.

This begins with tagging. A tag is a label assigned to a cloud resource. Some are automatically assigned by Amazon Web Services or Microsoft Azure, such as instance IDs, whereas others are user-defined and can be customized. By tagging resources appropriately, MSPs can set up their customers’ cloud environments to enable accurate chargebacks to the right cost centers and create reports based on that information.

Tagging enables MSPs and their customers to gain clarity around their cloud costs, usage, and resource management. It also helps with cloud governance and access control management within an account by identifying resources that may hold sensitive business or personally identifiable information (PII) and thus may require additional protections to reduce potential security breaches.
Challenge 3
Optimize internal operations

There’s more to running a managed services business effectively than billing and invoicing. MSPs need to be strategic about how their teams approach everyday problems. The following suggestions can help create an operating model that enables efficiency.

Solution
Onboard data into a single platform

Accurately capturing cloud cost data, both historical and ongoing, for customers can be a challenge for MSPs without the right tools in place. Once the MSP does capture the data, it’s critical that the data is made available to various stakeholders. This drives even more emphasis on flexible and customized views of the cloud environment.

Additionally, managing multi-cloud environments is challenging using native tools alone since billing data and processes live in disparate systems. The solution is instead to onboard billing data into a single platform that can manage and surface all cost data.

Solution
Automate manual tasks

Manual tasks related to billing, cloud operations, and other account management tasks can be time-consuming, tedious, repetitive, and labor-intensive. Some MSPs can spend two weeks per month or more breaking down customers’ costs and reflecting charges back to them accurately. As a result, staff may not have the time to focus on higher-margin services and upsell opportunities.

The answer: automation. The goal of automation is to make the work around routine billing easier for an organization. With a cloud management platform, MSPs can automate many time-consuming manual tasks based on policies, including customer-specific requirements for billing, invoicing, and other tasks. That equates to spending mere hours — not days — on invoicing and cost allocation.
Solution
Standardize service delivery

Fragmented tooling and processes make it difficult to train, manage, and optimize an MSP's client delivery teams. Without clear, standardized processes in place, employees are left to develop their own methods and records for solving customer billing problems. If a person leaves the company, they take their expertise with them, which can create knowledge gaps among remaining staff.

Standardizing operations by building scalable, repeatable processes helps to reduce human error and eliminate the knowledge gap brought about by typical business turnover. Cloud management tools give everyone the same platform to work from, so that information isn't lost if or when an employee leaves. These platforms have the added bonus of helping to automate tasks, so that the employee is using their time effectively and can avoid unnecessarily duplicating work.

Solution
Have a plan for profit reporting and analysis

With multiple factors influencing profitability, it’s challenging to regularly analyze profit margin performance. MSPs must track profitability trends over both short- and long-term time horizons. They must then be able to see the drivers of changes, such as specific services that are driving profitability up or down.

The solution is to collect the right data, standardize it, analyze it and share it with the right stakeholders to determine appropriate actions to take. Shareable and easy-to-understand dashboards and customizable reports can help to demonstrate what’s impacting profitability. That information can also go a step further in suggesting improvements for the future.
Conclusion

MSPs face many challenges, but they are not without solutions. A robust cloud management platform with multi-cloud billing, cost optimization, and resource utilization capabilities can go a long way in helping MSPs automate their businesses and optimize for profitability.

CloudCheckr, now part of Spot by NetApp, is trusted by MSPs to solve their most complex business challenges.

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