

The KloudReadiness Playbook

Step 2: Develop a Profitable Business Model

After you have completed all of the elements of your strategic plan as outlined in chapter #1, you are ready to take the next step in building a scalable Microsoft Cloud Collaboration and Azure X as a Service (XaaS) services business. That step is to develop a profitable business model that includes all of your managed service offerings. This is a critical step because it requires a well-designed pricing and packaging strategy for your service portfolio and getting that right is not an easy process. You will have to balance many conflicting goals – like the goal of simplifying your pricing so that anyone can quickly and accurately quote prices versus the goal of maintaining the flexibility to address each customer situation with a solution that reflects their specific needs. There are also the conflicting goals of price versus margin. The more competitive your pricing, the more deals you can theoretically close. However, competitive prices are in conflict with higher margins and, as they say, it's not how much revenue you collect that matters, it's how much you keep after paying the bills. So you have to think about finding an optimum price point that maximizes your sales and your profit margins at the same time.

D&H Distributing Resources for Pricing and Packaging Your Cloud Services

D&H Distributing provides a number of templates in its Marketing Resource Toolkit to assist you through the process of pricing and packaging your Microsoft Cloud Collaboration and Azure X as a Service (XaaS). Be sure to review them thoroughly and leverage them fully. Then review the pricing and packaging tools described in this chapter to complete the process of integrating your Microsoft Cloud Collaboration and Azure X as a Service (XaaS) pricing with any other IT services that you provide into a profitable and scalable cloud and managed services business model. Here are just a few of the valuable resources provided by D&H Distributing to assist you in pricing and packaging your Microsoft Cloud Collaboration and Azure X as a Service (XaaS) solutions.

Worksheet to Define Levels of Service

This document provides a methodical set of questions for you to complete that step you through the process of defining the service levels for your Microsoft Cloud Collaboration and Azure X as a Service (XaaS). It raises key questions about for you to answer in the areas of branding, service bundling, the nature of backups to be provided and how you intend to charge for services.

D&H Distributing Formal Service Description

This document provides a boilerplate for a formal Microsoft Cloud Collaboration and Azure X as a Service (XaaS) descriptions. It contains typical and customary definitions for what service elements are included and not included in your cloud offerings. It helps you to produce a customer-facing document that fully describes the nature of the collaboration and unified communications solution that will be delivered to the customer.

D&H Distributing Pricing Guidelines:

D&H Distributing provides guidelines on how to price your Microsoft Cloud Collaboration and Azure X as a Service (XaaS) services so that you hit competitive price points and are cost effective relative to the competition while comparing them to the internal cost of performing unified communications with an in-house on-premise approach. Use these guidelines in combination with the pricing and packaging model that we describe to you in this chapter and you will be able to determine the most profitable and competitive price points for all your cloud and managed service solutions.

Service Level Agreement with Terms and Conditions:

In addition to a formal service agreement, you will need to provide a written service level agreement that defines the responsibilities shared by your company and your customers during the delivery of a collaboration and unified communications services. The D&H Distributing Marketing Resource Toolkit provides a framework to help you define the SLA between you and your customers. There is also a standard set of terms and conditions that provides a legal framework for your service description as well.

The KloudReadiness Five Essential Elements of Pricing and Packaging

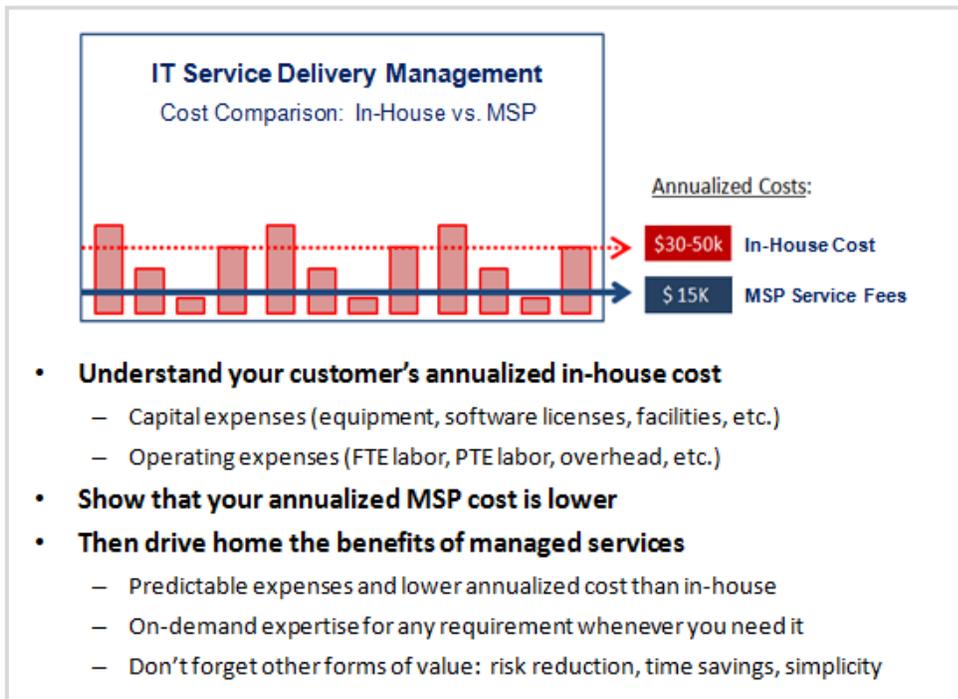
KloudReadiness has defined 5 essential elements of pricing and packaging. They provide the best practices and a structured approach to pricing that helps to balance these conflicting goals.

Pricing Elements	Pricing Strategy for Each Element
1. Cost Effective	<i>Clearly Demonstrate Your Business Value</i>
2. Predictable	<i>Scale Pricing with Your Customer’s Business</i>
3. Packaging	<i>Package Your Services for Customer Value</i>
4. Price Points	<i>Price Your Services for Best Value</i>
5. Simple, Simple	<i>Make Sure Your Value is Easy to Understand</i>

These essential pricing elements take you beyond the creation of a price list and into the realm of a comprehensive cost and margin analysis – and these are the keys to developing a profitable CSP | MSP business model.

Cost Effective Pricing That Clearly Demonstrate Your Business Value

The first element of effective pricing is to think about cloud and managed services from a customer perspective and establish prices that are cost-effective when compared to the in-house cost of IT service management. Fundamentally, cloud and managed services provide much higher value (i.e., a better service for a lower cost) because you have assembled the best people, technology and service practices and you can leverage the cost of delivering highly professional IT services over multiple paying clients. The customer simply cannot replicate what you can deliver for the same price. This is the essence of the CSP | MSP model and it must be reflected in your service pricing.



The diagram above clearly illustrates this point. The customer's in-house cost for IT service delivery is represented by the red columns on the graph. In-house costs will be higher and uneven over the course of the year for the following reasons: (1) they will need to fund dedicated headcount for IT services and (2) they will need to make periodic investments in support tools and facilities. It is very important for you to completely understand and estimate these cost factors. Perhaps you can gather this information from a few of your existing customers or elsewhere from your professional network. These are important data points as they will help determine where you set your own prices as well as cost-justify them during the sales process.

In our example above, we assumed that one full time employee (FTE) or part time employee (PTE) would be required to support the customer's user community and

manage their servers and desktops. Typical ratios for this kind of support resource are in the range of 40 to 50 users for each full time support resource. Of course, the challenge for the customer is how to hire one full or part-time resource that can handle the full range of technical support issues that arise over the course of the year. They may need to address technical issues involving server management, desktop support, network design and troubleshooting, security technologies, mobile devices, collaboration and unified communications (UCaaS) and specialized business applications quite a challenge. And during the year there will probably be times when they will need additional tools and training to perform this job – tools such as management software, diagnostic equipment and the facilities to operate them. We have very conservatively estimated this in-house cost at \$30k to \$50k per year.

Now compare this in-house cost to the cost of cloud and managed services. Very hypothetically, let's assume that you have priced your service at \$50 per user per month and \$150 per server per month. A 20 employee business with 3 servers would pay $(\$50 \times 20) + (\$150 \times 3) = \$1250$ per month to an CSP | MSP to completely manage their IT environment. Annualized, that monthly expense comes to \$15k or less than half of the cost of an in-house resource. Not only is the CSP | MSP cost lower, but it delivers additional benefits as well: (1) your monthly cost is fixed and predictable making it easy for the customer to budget for existing requirements and future expansion, (2) your service is all-inclusive and on-demand – within the boundaries of your service descriptions of course and (3) your model is a turnkey approach making it faster to implement IT solutions and easier and lower risk for the customer to manage. Your pricing must clearly demonstrate this business value.

Predictable Pricing That Scales with Your Customer's Business

In addition to being cost-effective, your pricing must scale up and down in order to adapt to any customer size, growth requirements and business cycles. In the first chapter you defined your target market and ideal customer profile. Now you must use those definitions to anticipate how your pricing will adapt to the range of opportunities those potential customers represent. Your pricing must be equally attractive to companies of all shapes and sizes:

- Small companies vs. large companies
- Companies that have small sites and large sites
- Small opportunities that grow into large opportunities

As you develop your cloud and managed services pricing, be prepared to model how your pricing looks in a variety of scenarios that reflect these different company profiles. Remember, one of the goals of your CSP | MSP pricing is simplicity - so that

any of your direct reps, referral agents or business partners can understand and communicate your pricing. That will enable more scalability for your business. If you do the right modeling up-front, you can establish pricing that is easy to present while keeping it competitive and profitable. Later in this chapter we will introduce a worksheet that you can use to perform this type of price modeling.

Now that we have talked about some of the goals of your pricing and packaging plan, let's now get a bit more detailed about our methodology. One of the first decisions you will need to make is what unit of pricing you will use to scale your managed service fees in a way that tracks with your customer's business. Many pricing strategies have been proposed over the years in a variety of CSP | MSP forums and coaching clinics. We recommend that you focus your pricing on the *users* and the nature of the IT *solution* that you are managing for those users - not servers, not desktops, not mobile devices, not network elements, and not software applications. In other words, base your scalable pricing on business factors not on technology factors. Why? Because it will resonate strongly with your customer. If you base your pricing structure on technology, they will always view your service as a cost, as overhead, as an expense to be minimized or even eliminated over time. On the other hand, if you are charging your customers for solutions and on a per-user-basis, they will view your service as an enabler for growth and expansion and as an investment rather than as an expense. Here are the key points to keep in mind when considering a user-based pricing model as opposed to a technology-based approach:

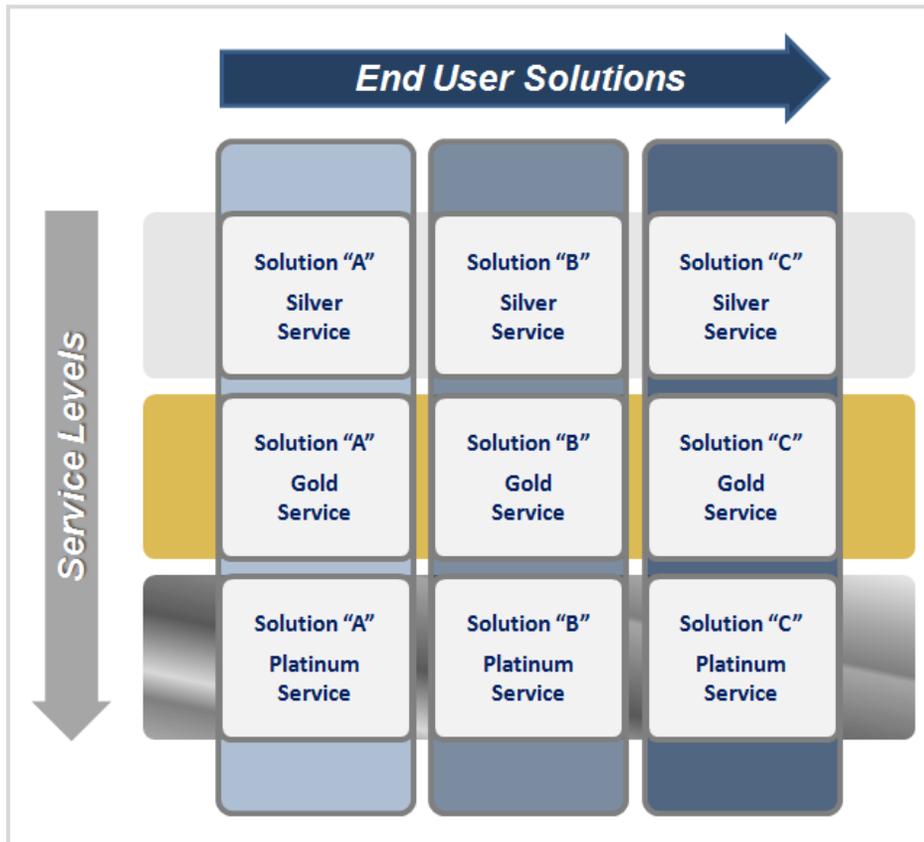
- Don't base your scalable pricing on technology
 - Network elements, circuits, bandwidth, and applications
 - This takes the focus away from business value
- Do base your scalable pricing on business factors
 - Users or sites are scaling factors that resonate with customers
 - Their cloud and managed services expense will increase as their business grows
- Keep the focus on business value
 - Customers pay for what they need & not for what they don't need
 - Your managed service is a predictable and controlled expense
 - You save them money compared to an expensive in-house resource

In the pricing and packaging worksheet described later in this chapter, we will provide you with tools to create your own user-based pricing that will give you the

flexibility to charge differently based on the nature of the IT solutions you provide with a very simple user-based pricing scheme that will scale with the size and technology requirements of your customer’s business.

Package Your Services to Maximize Customer Value

“Packaging” your cloud and managed services refer to the way in which you bundle together individual service elements to form IT solutions. Properly done, your cloud and managed services portfolio will be comprised of several “IT Solutions” that provide your customer with choices for matching IT services to the needs of different user groups within their organization. Additionally, your service description should define “service levels” that establish the hours of support coverage and response time you will provide to the customer as well as any service quality and availability commitments defined by your service level agreement (SLA). Together, the use of bundled IT solutions for different categories of users combined with service levels for different service commitment levels will maximize the value of your managed service to the customer by letting them select the most appropriate blend of solutions and service levels to meet their business needs.



Based on this approach, the pricing and packaging strategy that we recommend can be thought of as a two dimensional matrix where the columns of the matrix represent different IT solutions for different user groups and the rows represent different service levels for coverage, response time and service quality or availability.

You will recognize this approach when you open the pricing and packaging worksheet provided in the appendix and described later in this chapter. The worksheet will allow you to define and price up to five IT solutions (the vertical columns in the chart) and up to three service levels (the horizontal rows in the chart). We recommend that you use simple and descriptive names for your IT solutions (e.g., General Office Solution or Remote/Mobility Solution) and conventional tiered service names for the service levels (e.g., Silver, Gold and Platinum Level services).

A second goal of this approach is to provide a well-defined service description that sets the customer's expectations for exactly what is, and what is not, included in the services they contract with your company to provide. At KloudReadiness, we believe strongly in the principle of setting customer expectations for performance and then meeting or exceeding those expectations. We also believe in the principle that if you are performing a service for your customer, you should be paid fairly for that service. By following this model, you will develop a pricing and packaging strategy that adheres to these very important principles while establishing clearly defined services that set customer expectations and pricing that ensures you are paid appropriately for all services delivered.

We can summarize this framework by saying it provides user-based pricing that offers multiple IT solutions and service levels from which your customer can make choices to customize your service offerings for their business. That allows the customer to only pay for the level of service they need. It also allows you to set limits on the services that you will provide for that price point. Just be sure to define solutions that are truly complete solutions and be prepared to provide unlimited support for those solutions within the confines of the service level commitments that you have set.

Having described what this packaging strategy is all about – let's discuss for a moment what this strategy is *not*. This approach is the opposite of a la carte pricing where each of your services elements is itemized. The a la carte approach only invites a pricing "deep-dive" discussion with the customer ... "*why does this line item cost so much*" or "*we don't need that item, please take it off the quotation.*" Nor does this approach advocate charging separately for managing systems and servers. Build these costs into your user-based pricing. There should be a consistent ratio of users to servers (be they application servers, file servers or exchange servers) for your business that will allow

you to build in a cost allocation for managing these systems. Finally, this model does not address any up-front fees for installation and training services. That is not to say that you should not recover the cost of one-time services, just build them into the selling price of any purchased equipment or software or services that is sold as part of your cloud and managed services solution-set. Remember, your real income will be derived from the long term recurring revenue stream you are activating with each new customer, so worry less about the non-recurring charges and more about the monthly recurring charges.

Here is a summary of the key points in packaging your services:

- Create a tiered pricing plan with *bundled services*
 - This communicates *two* important messages
 - Only pay for the level of service you need for your company
(Or for a given site or user constituency)
 - The service level you select is all-inclusive
(Everything you need for that site or user community)
- Don't fall into the a la carte trap
 - Don't itemize everything
 - This invites a pricing "deep-dive"
 - Why does this line item cost so much*
 - We don't need this item – please take it off the quote*
- Use a familiar model
 - Silver, Gold, Platinum
 - Basic, Advanced, Premium

Follow these guidelines and you will be well on your way to packaging your cloud and managed services for maximum customer value.

Set Your Prices to Balance Revenue and Margin Goals

At this point you should have a solid understanding of the principles for pricing cloud and managed services and a user-based framework for packaging your service elements into solutions and service levels. Now it's time to set price points for your bundled services. This part can be a real challenge because determining price points is always a trade-off. You have to strike a balance between competitive pricing that will drive more revenue and premium pricing that will drive more profits. And it's often difficult to know which direction is the right way to go.

We think the best answer is to strike a balance. First consider all of the factors that will influence you to be aggressive with your pricing. For example, the lower your pricing is, the greater the economic savings will be - allowing you to demonstrate a very compelling

Total Cost of Ownership (TCO) cost comparison to close more deals more quickly. There are also your competitive pressures. What other CSP | MSPs are offering similar services to companies in your target market and at what price? Can you command a premium versus your competition and how much? These are important elements to consider when setting prices.

After thinking about the factors that point to aggressive pricing now consider a premium pricing strategy. Understand your cost structure and estimate your cost of service delivery for each of the IT solutions that you plan to offer as bundled services. What prices will allow you to realize 50% gross margin based on your cost of service? What price premium will drive your margins up to 60% or more?

What stage of growth is your business currently in? If you are in customer acquisition mode, then perhaps you want to price aggressively until you build up your installed base. If you already have a sizeable installed base, then perhaps you want to improve the profitability of your business by selling higher priced services to fewer customers that will contribute higher overall margins. Perhaps you are entering a new market with a solution that has little or no competition. In this case you have a market window in which you can sell at a premium price until competition enters your space and drives prices down.

There are many factors to consider and so the best way to arrive at the optimum price point is by modeling several price points for a variety of customer scenarios and comparing the impact of price on profitability based on your cost structure. Where can you find a worksheet that will allow you to perform this kind of exercise? We have provided one for you in the appendix to this playbook. And we will provide instructions on how to use this worksheet later in this chapter.

Here is a summary of the key points for setting your cloud and managed services prices:

- **Setting price points is always a trade-off**
- **Start by understanding your pricing boundaries**
 - Lowest price to address price sensitive market segments
 - Highest price you command from lucrative market segments
 - Align with your gross margin objectives (50%, 60% or more?)
- **Be sure that you offer a cost savings**
 - Remember Step #1... be lower than the annualized in-house cost
 - Look for a provable claim... "Save 50% compared to in-house cost"
- **Define a competitive discount threshold - Then stick to your guns!**

Pricing Must be Easy to Use

The final essential ingredient for establishing your cloud and managed services pricing is to keep it simple, simple, simple. All too often, pricing becomes a barrier to sales and, in some cases, left to the top executives of the company to determine during the final stage of the sales cycle. That is not a scalable process. In other cases, pricing is a subject that sales reps find difficult to address because it is overly complex and non-intuitive.

Pricing should be a natural part of every sales process. It should be an asset for your sales reps, not a liability. It should be easy enough for every person representing your solutions to communicate and it should be equally easy for every prospect to understand. That is why we prefer an approach based on bundled services and user-based pricing – it is both easy and intuitive. It is also why we placed an early emphasis on comparing the cost of your cloud and managed services to the customer’s

in-house cost for IT service delivery. By positioning your pricing as an investment that enables IT solutions for end-users with a cost-effective TCO, you will establish real business value. Your pricing is at the center of this powerful selling strategy. Pricing can also help you to quickly establish whether you have a real sales opportunity or a window shopper. If a prospect can’t afford your service no matter how much value you represent, then you might as well know sooner versus later.

Easy-to-use pricing should be a natural part of the sales process:

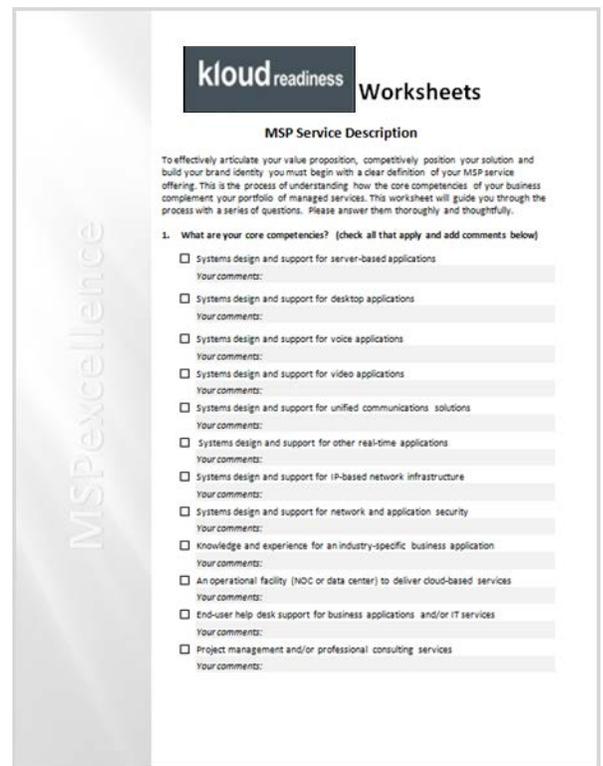
- **Pricing must be easy to use:** *Follow a very simple process...*
 - Discuss the customer’s business requirements
 - Count the number of users or sites (now and in the future)
 - Explain your IT solutions and all-inclusive tiered services
 - Let the customer choose the solutions and tier that is right for them
 - Multiply the number of users by the price/user for tier they selected
- **Value must be easy to understand**
 - Combine your pricing with boilerplate text that explains the business value of your managed service
 - Provide a simple TCO calculation that shows CAPEX and OPEX savings compared to an in-house solution

Now ask yourself - and be honest – does your pricing enable or inhibit your sales process? If you were to implement a simple user-based and solutions-oriented pricing scheme, would it help your business to scale more quickly?

Formalize an CSP | MSP Service Description

Now that we have covered the 5 essential ingredients for your CSP | MSP pricing, we are ready to begin the process of developing your pricing and packaging plan – or revising an existing one. The best place to start is with a formal description of your services. After all, you can’t effectively price something before you know exactly what it is you are pricing. So we have created a worksheet to assist you in the process of defining your CSP | MSP service descriptions.

This work sheet starts at the very beginning – It asks you to describe your core competencies. Go through each of the core competencies carefully and check the ones that apply to your business. It will help you to establish where you have strengths and where you have weaknesses. For example, you may be strong in the area of server management but not as strong in the area of PC desktop support - or perhaps you have a Microsoft Windows resource but no one who understands the Apple desktop environment. Place these detailed observations in the comment line that is provided for each item. This document will help you to focus on cloud and managed services that match your core competencies.



The worksheet also asks you to list all of the cloud and managed services offered (will be offered) by your company - both now and in the near future. These services will form the basis for what we call your “IT Solutions” and they will be priced on a per-user-per-month basis when you begin working with the Pricing and Packaging Worksheet. To give you an indication of where this is going, our goal is to reduce all of your managed service offerings down to a relatively small number of IT solutions – something like three to five solutions – to keep your pricing simple.

Then the worksheet asks you to assess the depth of the resources that you have in place today to support each of these present and planned service offerings. In so doing, it will

help you to identify where you need to obtain additional resources through headcount expansion or through partnerships.

After completing this worksheet you will have a starting point for developing your cloud and managed services pricing model. You will have a very clear idea of where you want to bundle your service elements into IT solutions that support your value proposition. You will have an assessment of where your resources are deep and where they might be thin. And you will be well positioned to create a formal service description that will ultimately become a customer-facing document that clearly defines the services you are offering in return for the monthly cloud and managed services fees that you are charging for them.

Developing Your Cloud and Managed Services Pricing Model

Now it is time to start plugging in some numbers and building a pricing and packaging model that includes all of the ingredients we have been discussing that achieves all of these goals. In the remainder of this chapter we will walk through the worksheet provided in the appendix of this document that enables you to build your own user-based and solutions-oriented pricing model for your cloud and managed services.

Managed Services Pricing Model

Revised 3/27/2011

Monthly Recurring Charges (MRC) <small>Price your managed services fee for monitoring and managing the user's total IT experience and resolving their IT problems by service category.</small>		IT Solutions (Service Categories for Different User Groups)										Total Users & MRC
		General Office Solution		Remote/Mobility Solution		Business Application Solution		Premium Solution		Specialty Solution (Call Center Agent)		
		Users	MRC	Users	MRC	Users	MRC	Users	MRC	Users	MRC	
MRC for Service Categories (For the Standard "Silver" Service Level)		10	\$50.00	10	\$60.00	10	\$75.00	10	\$90.00	10	\$100.00	50
Service Elements	1 Standard PC and user software support	X		X		X		X		X		Itemize all of the service elements that you offer in the far left-hand column. Then define up to Evaluation categories matching the IT service requirements for different user groups and then designate which service elements are included in each category. Next establish an MRC for each evaluation category. Input the number of users for each category based on your market typical customer scenarios. The total MRC for each category is calculated at the bottom of the table based on your silver, gold or platinum service level commitment.
	2 PC/Server configuration change	X		X		X		X		X		
	3 PC/Server warranty repair & HW replacement	X		X		X		X		X		
	4 PC/Server software troubleshooting & resolution	X		X		X		X		X		
	5 PC/Server patching & software updates	X		X		X		X		X		
	6 IP desktop phone support			X		X		X				
	7 IP softphone and mobile device support			X		X		X				
	8 Conferencing and collaboration tools					X		X				
	9 Business application software support					X		X				
	10 Web hosting and related services							X		X		
	11 Network performance management							X		X		
	12 Network security management							X		X		
	13 Backup and recovery services									X		
	14 Call center agent and system support									X		
	15 Other managed services									X		
Total Monthly Recurring Charges (Based on Service Level Commitment)		es unlimited support services for hardware, software and user operations as defined for each service level.										Total MRC
Service Levels	1.00 Silver Service Level MRC <small>M-F, 9am - 5pm, 8hr response time</small>	\$500.00	\$600.00	\$750.00	\$900.00	\$1,000.00	\$1,750.00					
	1.25 Gold Service Level MRC <small>M-F, 9am - 5pm, 4hr response time</small>	\$625.00	\$750.00	\$937.50	\$1,125.00	\$1,250.00	\$4,687.50					
	1.50 Platinum Service Level MRC <small>7x24 coverage, 2hr response time</small>	\$750.00	\$900.00	\$1,125.00	\$1,350.00	\$1,500.00	\$5,625.00					

The picture above is taken from the first tab in the pricing and packaging worksheet. If you refer back to page 5 in this section of the playbook, you will see a diagram that

looks very much like the organization of this spreadsheet. You will see that we have created five hypothetical “IT Solutions” as columns in the spreadsheet and we have also created 3 hypothetical “Service Levels” as rows across the bottom of the spreadsheet. Each IT Solution has been given a representative name. With an “X” we have indicated which of your “Service Elements” are included with each of these IT Solutions. Notice how each solution has a different blend of service elements – some solutions offer more services than others or more specialized services than others. Your job is to define your own IT Solutions and create your own list of included services that map to them. As you do this, think about how your company can best bundle its services to meet the needs of the user constituencies within your customer’s organization. To get you started, we have listed the most common services elements offered by managed service providers. You will see a list of fifteen service elements on the left-hand side of the spreadsheet.

After you have defined your IT Solutions and have indicated which Service Elements are include with them (be sure use a capital “X” to include the service) then set a Monthly Recurring Charge (MRC) that is appropriate for each IT Solution. Don’t worry about where you set the MRC value initially – just put in a ballpark number for now. You will be fine tuning this value later on.

You will see that the spreadsheet automatically calculates a total MRC value for each IT Solution in the bottom rows – one value for a so-called “Silver Service Level”, one value for a “Gold Service Level” and one value for a “Platinum Service Level”. Your next task is to think about these service levels and define your own criteria for what constitutes Silver, Gold or Platinum Service. To get you started, we defined Silver Service as standard business hours of coverage (M-F, 8am-5pm) with an 8-hour response time for problem response time. Gold Service is defined as extended coverage (M-S, 8am-8pm) and accelerated (4hr) response time. Platinum Service is defined as wall-to-wall coverage (7x24) with a 2-hour response time. You can define these service levels in any way that makes sense for your cloud and managed services including any SLA parameters such as service quality and/or availability commitments as appropriate.

The numbers just to the left of the service level definitions are factors that uplift the MRC totals for each IT Solution. Silver Service is the baseline amount and has no uplift. Gold Service is uplifted by 25% over Silver Service. Platinum Service is uplifted by 50% over Silver Service.

After you have defined and priced your IT Solutions and you have established your service level tiers and their uplift factors, you are ready to model some customer pricing scenarios. To do this, simply input the number of users for each of the IT Solutions into the yellow boxes. The spreadsheet will calculate the total number of users and the extended MRC values for each of the service levels along the bottom. Model a few

typical customer scenarios so you can get a sense of the total range of MRC values based on the number and sizes of users and user groups.

Estimating Your Cost of Service Delivery

The next step in the process of developing your pricing and packaging strategy is to understand your cost of service delivery. This critical step is what separates a simple pricing plan from a profitable and repeatable business model. If you are already using Professional Services Automation (PSA) tools then this step will be very easy for you. You can extract most, if not all, of the cost data that you need from your PSA system. However, if you are not using a PSA tool, then you will need to estimate your cost of service delivery. If that is the case, then you will want to use the second tab in the pricing and packaging worksheet. It is labeled “Cost Estimator”.

The cost estimator tab helps you to better understand the cost elements that make up your total cost of service delivery. We have simplified the process by grouping your costs into two main groups: Labor Costs - including 3 levels of salary grade and Other Costs - including facilities expense, software licenses, maintenance contracts, wholesale services and other non-labor costs.

Labor costs are the single biggest cost component and so getting a firm handle on how those costs affect the profitability of each customer is critical to maximizing profitability. With that in mind, we have given you two methodologies for estimating your labor costs on a per-customer basis: One method is based on the ratio of customers to your support staff and the other method is to estimate labor costs with a support task audit.

Revised 3/27/2011

Cost Estimator Methodology: Estimate the Ratio of Customers to Support Staff and Allocate Resources

Labor Cost				Headcount		Cost/Hr	Annualized
Level 1 (help desk)	2		\$30.00			\$60,000	
Level 2 (networks & servers)	1		\$37.50			\$75,000	
Level 3 (applications & services)	1		\$45.00			\$90,000	
Total Headcount	4					\$285,000	

Installed Customer Base	
Total customers	100
Users/customer	20
Total users	2000
Add comments here...	

Other Costs				
	Annual Expenses	Monthly Expenses	Per Customer	Per User
Facilities expense	\$25,000	\$2,083	\$20.83	\$1.04
Software license fees	\$25,000	\$2,083	\$20.83	\$1.04
Supplier maintenance contracts	\$25,000	\$2,083	\$20.83	\$1.04
Wholesale/white label services	\$25,000	\$2,083	\$20.83	\$1.04
Other non-labor expenses	\$25,000	\$2,083	\$20.83	\$1.04
Total Other Costs	\$125,000	\$10,417	\$104.17	\$5.21
Recommendations:	\$5.21	Add comments here...		

Ratio of Customers to Support Staff and Time Allocation			
Customer to Support Staff Ratio	25	to 1	Most MSPs target a User to Staff ratio between 300 & 500 users per headcount. What is your ratio? Is your support staff fully utilized? If not, then you can add customers without increasing staff to increase profitability. If yes, use this ratio to determine your cost basis for supporting existing and new customers.
User to Support Staff Ratio	500	to 1	
Support Hours per Customer	7.56	per month	
Support Hours per User	0.38	per month	
Recommendations:	0.38	This is your average amount of support time per user (in hours). Compare this estimate with the value in the "Labor Cost" section of your cost model on line #24, "Total Labor Hours and Costs".	
	\$13.47	This is the average cost per month for the support resources required per user. Compare this estimate with the value in your cost model on line #24, "Total Labor Hours and Costs".	

The picture above shows the first methodology. On the left hand side of the spreadsheet you will find a section for entering your labor cost. In the yellow boxes input the number of support staff for each of the three levels indicated and their

respective cost/hour. Next to this Labor Cost Section you will find an area to input basic information about your Installed Customer Base. Input the total number of customers that you currently support and the average number of users/customer. The spreadsheet will calculate the total headcount and annualized expenses as well as the total users that your headcount supports.

Just below these sections, you will see the “Ratio of Customers to Support Staff and Time Allocation” has been calculated for you. Most CSP | MSPs target a User to Staff ratio between 300 and 500 users per headcount. What is your ratio? Is your support staff fully utilized? If not, then you can add customers without increasing staff to increase profitability. If yes, use this ratio to determine your cost basis for supporting existing and new customers.

Below this section is a box labeled “Recommendations” with two calculated values. One value provides the average amount of support time per user (in hours). This is the average amount of labor time you are utilizing for each user per month. The other value is the average cost per month for the support resources required for each user. This value is the main cost component that will be used to calculate the average margin per user yielded by your your service pricing (MRC).

On the right-hand side of the spreadsheet is a section titled “Other Costs”. In this section you will input all non-labor costs that contribute to your cost of service delivery. They will also be spread across the number of users in your customer base and added to the labor costs when calculating your gross margin levels. Key in your annual expenses for these other costs into the yellow boxes provided and the spreadsheet will calculate the monthly expense amount, the per customer amount and the per user amount in the columns to the right of the yellow boxes. All of the columns are then totaled and the “Recommendations” box below contains the per-user allocation for these non-labor costs.

At this point you can move from the “Cost Estimator” tab to the next tab which is titled “Cost Model”. In the cost model tab, the cost estimates that are referenced in the “Recommendations” section can be used as the cost of service delivery for one or more of the IT Solutions that you are modeling.

However, if you would like a more detailed estimate of your labor costs, you can follow the alternate methodology provided in the Cost Estimator tab. As stated earlier, this methodology determines your labor cost using a *Support Task Audit*. A task audit is a process in which each of your support personnel keeps track of every support task performed during a 2-week period. At the end of this period, the time devoted to each task is totaled. These time estimates are then used to determine labor costs based on using this audit data as a representative sample that can be extrapolated into a full

month or a full year’s labor cost. These costs can be further broken down by headcount, by service task and by customer.

The picture below shows a form that can be used to collect the data that is gathered during the support task audit. Just scroll down from the top of the spreadsheet and you will see a two-page form just like the one below. The form is designed to track the cost of all service elements identified in the pricing model. As a result, all of the “Service Tasks” in the far left hand column of the form directly correspond to the “Service Elements” listed on the “Pricing Model”, “Cost Model” and “Margin Model” tabs in the worksheet. After you collect this information you will have granular cost data that you can use to populate the cost model and thereby improve the accuracy of the gross margin numbers that are calculated by formulas in the margin model.

Alternate Methodology: Estimate Your Labor Cost in More Detail with a Support Task Audit

Service Tasks - Page #1	Week #1							Week #2							Totals
	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday	
1 Standard PC and user software support	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	
	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	
	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	
2 PC/Server configuration changes	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	
	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	
	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	
3 PC/Server warranty repairs & HW replacement	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	
	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	
	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	
4 PC/Server software troubleshooting & resolution	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	
	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	
	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	
5 PC/Server patching & software updates	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	
	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	
	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	
6 IP/desktop phone support	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	
	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	
	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	
7 IP/desktop and mobile device support	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	
	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	
	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	
8 Conferencing and collaboration tools	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	Customer	
	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	Time	
	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	Duration	

The form lists 15 Service Tasks in the left hand column and it provides a 2-week grid for entries corresponding to each day of the week - Monday through Sunday. For each day there is space for a 3-part entry for any service task that may have been performed on that day. One part of the entry is for the customer name, the second part of the entry is for the time of day the task was performed and the third part of the entry is for the duration of the task. Tracking the customer name will tell you how many customers of your installed base required support and who they are. Tracking the time of the task will tell you if it was required during normal business

hours or after hours. Tracking the duration of the task will tell you how much support time it consumed and what level of resource was required to perform the task. Performing a Support Task Audit can be a cumbersome process, but it will reveal a great deal of information and insights about your cost of service delivery.

Creating a Cost Model for Your Cloud and Managed Services

As stated earlier, estimating your costs is greatly simplified with the use of a PSA system that tracks all of the cost elements associated with the delivery of cloud and managed services. If that is the case in your business, then you can simply plug in your cost figures directly in the spreadsheet that is provided in the “Cost Model” tab. A screen shot of the spreadsheet is shown below.

Managed Services Cost Estimates

Revised 4/27/2011

IT Solutions (Service Categories for Different User Groups)												
Monthly Recurring Charges (MRC) <small>Price your managed services fee for monitoring and managing the user's total IT experience and resolving their IT problems by service category.</small>		General Office Solution		Remote/Mobility Solution		Business Application Solution		Premium Solution		Specialty Solution (Call Center Agent)		Total Amounts
Labor costs (per user per month)		Hrs/Mo	Cost/Hr	Hrs/Mo	Cost/Hr	Hrs/Mo	Cost/Hr	Hrs/Mo	Cost/Hr	Hrs/Mo	Cost/Hr	
1	Standard PC and user software support	0.10	\$30.00	0.10	\$30.00	0.10	\$30.00	0.10	\$30.00	0.10	\$30.00	
2	PC/Server configuration change	0.10	\$30.00	0.10	\$30.00	0.10	\$30.00	0.10	\$30.00	0.10	\$30.00	
3	PC/Server warranty repair & HW replacement	0.10	\$30.00	0.10	\$30.00	0.10	\$30.00	0.10	\$30.00	0.10	\$30.00	
4	PC/Server software troubleshooting & resolution	0.10	\$40.00	0.10	\$40.00	0.10	\$40.00	0.10	\$40.00	0.10	\$40.00	
5	PC/Server patching & software updates	0.10	\$40.00	0.10	\$40.00	0.10	\$40.00	0.10	\$40.00	0.10	\$40.00	
6	IP desktop phone support	0.00	\$30.00	0.10	\$30.00	0.10	\$30.00	0.10	\$30.00	0.00	\$30.00	
7	IP softphone and mobile device support	0.00	\$40.00	0.10	\$40.00	0.10	\$40.00	0.10	\$40.00	0.00	\$40.00	
8	Conferencing and collaboration tools	0.00	\$40.00	0.00	\$40.00	0.10	\$40.00	0.10	\$40.00	0.00	\$40.00	
9	Business application software support	0.00	\$40.00	0.00	\$40.00	0.10	\$40.00	0.10	\$40.00	0.00	\$40.00	
10	Web hosting and related services	0.00	\$40.00	0.00	\$40.00	0.00	\$40.00	0.05	\$40.00	0.05	\$40.00	
11	Natural performance management	0.00	\$50.00	0.00	\$50.00	0.00	\$50.00	0.05	\$50.00	0.05	\$50.00	
12	Network security management	0.00	\$50.00	0.00	\$50.00	0.00	\$50.00	0.05	\$50.00	0.05	\$50.00	
13	Backup and recovery services	0.00	\$50.00	0.00	\$50.00	0.00	\$50.00	0.00	\$50.00	0.10	\$50.00	
14	Call center agent and system support	0.00	\$50.00	0.00	\$50.00	0.00	\$50.00	0.00	\$50.00	0.10	\$50.00	
15	Other labor costs	0.00	\$50.00	0.00	\$50.00	0.00	\$50.00	0.00	\$50.00	0.10	\$50.00	
Total Labor Hours and Costs		\$0.50	\$17.00	\$0.70	\$24.00	\$0.90	\$32.00	\$1.05	\$39.00	\$0.95	\$39.00	
Other costs (per user per month)		Alloc %	Amount	Alloc %	Amount	Alloc %	Amount	Alloc %	Amount	Alloc %	Amount	
16	Facilities expense allocation	100%	\$1.04	100%	\$1.04	100%	\$1.04	100%	\$1.04	100%	\$1.04	
17	Software license fees	100%	\$1.04	100%	\$1.04	100%	\$1.04	100%	\$1.04	100%	\$1.04	
18	Supplier maintenance contracts	100%	\$1.04	100%	\$1.04	100%	\$1.04	100%	\$1.04	100%	\$1.04	
19	Wholesale and white label services	100%	\$1.04	100%	\$1.04	100%	\$1.04	100%	\$1.04	100%	\$1.04	
20	Other non-labor expenses	100%	\$1.04	100%	\$1.04	100%	\$1.04	100%	\$1.04	100%	\$1.04	
Total Other Costs			\$5.21		\$5.21		\$5.21		\$5.21		\$5.21	
Total costs (per user per month)												
Silver Service Cost Totals <small>M-F, 8am - 5pm, 4hr response time</small>		\$22.21		\$29.21		\$37.21		\$44.21		\$44.21		
Additional Gold Service Costs		A441 Coverage 25%	A441 Cost \$4.25	A441 Coverage 25%	A441 Cost \$6.00	A441 Coverage 25%	A441 Cost \$8.00	A441 Coverage 25%	A441 Cost \$9.75	A441 Coverage 25%	A441 Cost \$3.75	
Gold Service Cost Totals <small>M-F, 8am - 5pm, 4hr response time</small>		\$26.46		\$35.21		\$45.21		\$53.96		\$53.96		
Additional Platinum Service Costs		A441 Coverage 50%	A441 Cost \$8.50	A441 Coverage 50%	A441 Cost \$12.00	A441 Coverage 50%	A441 Cost \$16.00	A441 Coverage 50%	A441 Cost \$19.50	A441 Coverage 50%	A441 Cost \$19.50	
Platinum Service Cost Totals <small>7x24 coverage, 2hr response time</small>		\$30.71		\$41.21		\$53.21		\$63.71		\$63.71		

The cost model uses the same general layout as the pricing model spreadsheet. Your IT solutions are represented by columns and your service levels are rows across the bottom. What is different about this spreadsheet is that each of the IT solution columns and service level rows has been populated with cost data. The yellow boxes in each of the IT Solution columns contain default values – a time value for the

average Hours/Month each task is allocated and a dollar value based on the amount of time and the Cost/Hour that is associated with performing the task.

The cost model calculates the total Labor Hours and Costs for each IT Solution. After the labor costs are totaled, the non-labor costs are totaled as well. The two columns here are slightly different. One column has an “Allocation %” heading and the other has an “Amount” heading. The “Amount” column is populated with data from the cost estimator page using the information that you provided for each non-labor cost item. The Allocation % can be used to allocate a full share of the cost (e.g., 100%) or a lower allocation for any of these cost items. Change these default entries as necessary to reflect the data from the “Cost Estimator” spreadsheet or with cost data taken directly from your PSA system.

You will see the total labor and non-labor costs for each of the IT Solutions have been totaled in the row at the bottom of the spreadsheet labeled “Silver Service Cost Totals”. As stated earlier, Silver Service represents the standard, or baseline cost. This numbers represent your cost of service delivery for each IT Solution.

In order to calculate the cost of service delivery for the Gold Service and the Platinum Service, the spreadsheet contains an “Additional Coverage” percentage allowing you to uplift the cost of service for the additional hours of coverage that are required for these service levels. In the case of the Gold Service, the default value of the uplift percentage is 25%. In other words, it will cost you 25% more in labor expenses to provide the expanded coverage and accelerated response time for customers who choose the Gold Service Level. You can change these percentages if you want to increase or decrease the amount of the uplift. You can also insert your own cost data directly into the “Gold Service Cost Totals” row with data taken from your PSA. Similarly, the Platinum Service Level has a default value of 50% for the additional cost of expanded coverage and accelerated response time. And you can make the same changes to the “Platinum Service Cost Totals” row with data from your PSA.

Measuring the Gross Margin of Your Managed Service

After you have entered all of the costs into the Cost Model tab, you are ready to view the gross margin dollars and percentages for each of your IT solutions as well as the blended gross margin for the combined solutions. Just go to the “Margin Model” tab in the worksheet to view the gross margin values that have been automatically calculated for you by the spreadsheet. The Margin Model uses the same layout as the Pricing Model and Cost Model and summarizes the number of Users, the Revenue, the Cost, the GM\$ and the GM% for each IT Solution. It also

shows revenue and gross margin for each of the Silver, Gold and Platinum Service Levels. All numbers are recalculated each time you change the number of users so that you can model a variety of deal scenarios and their impact on profitability.

The screen shot on the next page shows the gross margin model spreadsheet. All fields on this sheet are calculated fields so if you want to make changes to any of your input fields, make them on the Pricing Model, Cost Estimator and Cost Model tabs. We have made the input fields that drive the calculations for the worksheet easy to find - they are all yellow input boxes. All other color-coded fields are either static or calculated fields.

Managed Services Margin Model

Revised 3/27/2011

		IT Solutions (Service Categories for Different User Groups)										Total Users & MRC	
Monthly Recurring Charges (MRC) Price your managed services fee for monitoring and managing the user's total IT experience and resolving their IT problems by service category.		General Office Solution		Remote/Mobility Solution		Business Application Solution		Premium Solution		Specialty Solution (Call Center Agent)			
MRC for Service Categories (For the Standard "Silver" Service Level)		Users	MRC	Users	MRC	Users	MRC	Users	MRC	Users	MRC	Total Users	
		10	\$50.00	10	\$60.00	10	\$75.00	10	\$90.00	10	\$100.00	50	
Service Elements	1 Standard PC end user software support	X	Users	X	Users	X	Users	X	Users	X	Users	Itemize all of the service elements that you offer in the far left-hand column. Then define up to 5 solution categories matching the IT service requirements for different user groups and then designate which service elements are included in each category. Now establish an MRC for each solution category. Input the number of users for each category based on your most typical customer scenarios. The total MRC for each category is calculated at the bottom of the table based on your silver, gold or platinum service level.	
	2 PC/Server configuration changes	X	10	X	10	X	10	X	10	X	10		
	3 PC/Server warranty repairs & HW replacement	X		X		X		X		X			
	4 PC/Server software troubleshooting & resolution	X	Revenue	X	Revenue	X	Revenue	X	Revenue	X	Revenue		
	5 PC/Server patching & software updates	X	\$500	X	\$600	X	\$750	X	\$900	X	\$1,000		
	6 IP desktop phone support			X		X		X		X			
	7 IP softphone and mobile device support		Cost	X	Cost	X	Cost	X	Cost	X	Cost		
	8 Conferencing and collaboration tools		\$222		\$292		\$372		\$442		\$558		
	9 Business application software support					X		X		X			
	10 Web hosting and related web services		GM %		GM %		GM %		GM %		GM %		
	11 Network performance management		\$278		\$308		\$378		\$458		\$558		
	12 Network security management							X		X			
	13 Backup and recovery services		GM%		GM%		GM%		GM%		GM%		
	14 Call center agent and system support		56%		51%		50%		51%		56%		
	15 Other managed services									X			
Service Levels	Total Monthly Recurring Charges (Based on Service Level Commitment)	Total MRC	GM%	Total MRC	GM%	Total MRC	GM%	Total MRC	GM%	Total MRC	GM%	Total MRC & GM	
	Silver Service Level MRC M-F, 8am - 5pm, 8hr response time	\$500	56%	\$600	51%	\$750	50%	\$900	51%	\$1,000	56%	\$3,750	53%
	Gold Service Level MRC M-S, 8am - 8pm, 4hr response time	\$625	58%	\$750	53%	\$938	52%	\$1,125	52%	\$1,250	57%	\$4,690	54%
	Platinum Service Level MRC 7x24 coverage, 2 hr response time	\$750	59%	\$900	54%	\$1,125	53%	\$1,350	53%	\$1,500	58%	\$5,628	55%

We have populated all of the sheets in our pricing and packaging worksheet with default values and calculated results that are based on the number of users in an imaginary customer of 50 employees. These users are evenly distributed across the five IT solutions which have been pre-defined with various service elements that meet the needs of these imaginary users. This is only meant to provide you with an example of how to use the worksheet with your own target customer profiles. You will obviously define your own IT solutions and you may decide to use less than five or more than five different IT Solutions. The MRC values found in the worksheet are not recommended price points; they are simply there to illustrate the concept of setting different prices for different solutions based on the level of services included. The cost

assumptions are hypothetical values as well. They are not meant to represent your cost targets. They are there for example purposes only. Now it is your turn to populate this model with your own data: Your scenarios, your IT Solutions with your Service Elements, your MRC pricing and your Cost Estimates. Then work with the model to optimize your price points and their profitability.

Optimizing Profitability and Formalizing Pricing

Use the Pricing and Packaging Worksheet to model a variety of scenarios until you are satisfied that you have arrived at the right balance between price, cost and margin. Be sure to identify where you have the greatest opportunities for margin improvement and then create a plan to focus on driving down costs over time. For example, what is the most frequent support task? What is the support task with the longest duration? What type of customer places the highest burden on your support organization? What type of customer represents the lowest support burden? Are there areas of service delivery that could benefit from automation? Are there high margin services that you can add to your portfolio? Is one of the technologies that you manage particularly expensive to support? And so on. Improving profitability is a combination of driving down costs while targeting the most profitable customers. So as you go forward with your new pricing, be sure that you have a strategy to achieve both objectives.

Now you are ready to formalize your pricing. That means building a price list, a quotation tool for your sale reps, a formal service description for each IT Solution and contract terms for your managed service offerings. As for the length of your cloud and managed services agreement, terms of 2, 3 and 4 years are customary. We recommend that you associate your standard MRC with the longest contract term and then uplift the price for the shorter term agreements. For example, if your MRC for a “General Office Solution” is \$50 per user, this would be the price for a 48 month (4 year) contract term. If the customer prefers a 36 month contract, then you can uplift the MRC by 5% and so it becomes \$52.50 per user. If they prefer a 24 month agreement then it becomes \$55 per user. Use the same approach to adjust the MRC prices for your Gold and Platinum Services as well.

We recommend that you carefully prepare all documents to clearly represent your managed service solutions and to define the rights and responsibilities for you and your customers. You can put as much service description and contract language as required on your website and then reference these standard terms and conditions in a one-page quotation that includes pricing. The same document can then serve as the final agreement after it is signed by the customer. This approach will protect you, your sales reps, your agents and your customers from any misinterpretation of your proposal or how you perform when delivering services based on that proposal. One

final note – don't expect to get your pricing perfect the first time out of the gate. Be prepared to measure and refine it for the first few months. Eventually it will stabilize and become a key asset for your business and an integral part of a scalable sales process that will support long term and profitable growth.