THE BENEFITS OF GOOD METRICS AND KPIS FOR MANAGED SERVICE PROVIDERS

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INTRODUCTION

To grow and maintain the health of your business, you need good data. Yet, far too many managed services providers lack the comprehensive metrics and KPIs needed to evaluate what is and isn't working.

Simply put, how do you know what's really causing a reduced margin or tepid MRR growth if you don't have detailed data on a client-by-client basis? For this reason, many MSPs can benefit from a change to incorporate smart, measurable goals and the metrics used to measure them on an ongoing basis.

By making these kinds of changes, ensuring every action you take will help to improve your financial performance as efficiently as possible, not only will you grow your margin, you'll see a stronger overall performance with higher MRR from existing clients, and a better sense of your business and how it is operating on a monthly basis.

In this guide, we're going to take a closer look at not only why data matters, but how to utilize good data to measure revenue, grow business, and increase performance for all of these components.

THE VALUE OF GOOD DATA

In 2008 I was employed by Citigroup and it wasn't a good year. We really thought the financial world would stop spinning on its axis. When things actually turned, we began getting interesting emails from management.

- Email #1: No more Starbucks coffee from the kitchen. This was not such a big deal since at the time I was in my soda drinking phase of life. Even now as a coffee drinker, I don't care much for Starbucks.
- Email #2: We can now purchase boxed lunches from the previously exclusive executive dining room. For $11.50, you can get a sandwich, a piece of fruit, and a beverage. We were told it was a good value.
- Email #3: Before replacing the toner in a printer, please consider shaking it vigorously to extend the life.

At this point, we all just had to smile. One of the largest financial institutions in the world, one that was truly too big to fail, was going to right the ship by shaking the toner?

Don't get me wrong, waste is a problem. If you think you can save money by shaking toner, by all means shake away before grabbing a new one. That said, this was a classic case of addressing a massive problem in an incredibly unfocused way.

Why do I tell this story?

After speaking to a few hundred MSPs this year, I have found that some may still be shaking the toner.

For example, how do you respond when you speak to peers in the industry only to find that your 7% profit margin is far below the 12% they are operating with?

Are you cutting costs to the bone to add to your bottom line?

Are you concentrating so heavily on new sales that you're missing what's right in front of you?

Instead of trying to make a sweeping change – that sure, may make a difference - have you considered focusing specifically on the handful of clients who are responsible for dragging down your margins? What about those that might grow your MRR quicker than through new sales?

Are you pulling data at both a granular and company-wide level that will allow you to see the full health of your business? What decisions are you making and how are you ensuring this data is as actionable as possible?

Throughout this guide, we are going to discuss not only the value of good data, but how the right metrics and KPIs can help you increase your MRR, improve performance for low performing clients, and boost your opportunities for growth in several key areas.

HOW TO IDENTIFY GOOD DATA

Decisions should never be made in a vacuum. Without good data it's difficult to improve performance, increase revenue, or do much of anything outside of uneducated guessing.

What exactly is good data then and how do you ensure you have everything you need to make these kinds of calculations and improve overall performance without slashing into the perks that keep your employees happy?

Key drivers for your business are often already in front of you. The data you already have in your PSA can become actionable items with a bit of guidance and automation – the goal should be to identify what those things will be and how you can mine them efficiently for information that helps, not information that's "nice to have".
This will ultimately depend on your business, how you work with clients, and the goals you've set for the coming year. Some important data points may include:

- Daily updates on hers per client vs. target hours
- Client profitability trends
- Detailed contribution analysis by client

With this data you can make important decisions, classifying your clients by the profit they generate, determine how to set client effective rates, and developing action lists to address specific issues you might encounter on a per-client basis.

ACTIONABLE VS. "NICE TO KNOW" DATA

So if data is the key to improving business performance, increasing profit margin, and addressing clients on a one-by-one basis, how do you determine which data is good and which is not.

The key phrase here is "actionable".

More likely than not you are already sitting on a wealth of information – data that can be used to make important decisions for your business. But not all of it is actionable. Some is just good to know, and other bits can be misleading.

There are a lot of numbers you can follow in your business. Everyone has their favorites and some pundits will promote some over others, but what matters most for your business will be different from someone else. Identifying the difference between actionable and nice to know is totally dependent on your circumstances.

To start, let's look at what this really means. Here's what I mean by actionable and nice to know:

- **Actionable Information:** Are you going to use the data to improve your business?
- **Nice to Know**: Are you not going to make decisions based on it?

While both have value, you'll get the most value from the former because it will have a direct impact on your business.

Here's the tricky part, though. The kind of data that is actionable to a given client will vary by company. To help, here are several questions you can ask yourself to determine which data points would be most useful to you in taking specific actions:

- *If you see a client that is 20% less profitable than your other clients, are you going to change your pricing or service model for that client? (To make it fun, consider whether your answer would change if that client is 5% below or 20% above average).*
- *How will you change your compensation model based on the profitability or utilization of your client facing employees?*

- *Are you going to change staffing based on the amount of unused hours you have in a given month? What about in a quarter?*

How you answer these questions will drive what data you need. If it doesn't, then you are spending too much time and too many resources obtaining information that isn't driving profitability for your business. That's not to say that "nice to know" metrics are not useful, but they won't put more money in your accounts.

Finally, remember that these questions are not specific to your company, and it's possible that none of them represent the types of changes you will make (or avoid making) based on data. There is no right or wrong answer here – only what is most important to your business.

Keep this in mind and don't be afraid to develop your own questions that address the specific things that you need to know to drive change and profitability in your business.

MEASURING REVENUE AND GROWING YOUR BUSINESS

Good metrics, tightly defined data, and actionable information about your business are among the most valuable tools you can have. They aren't just for forecasting and sales, either. They drive decision making for the marketing team as much as any other part of your business.

That's why the data you gather and the KPIs you evaluate are so important if you're trying to both measure and grow revenue for your business. Specifically, let's take a look at how good analysis can help you grow your monthly recurring revenue (MRR).

GROWING MONTHLY RECURRING REVENUE

Part of what MSPCFO does is listen carefully to our users and their needs. As part of this, we recently updated our system to show how MRR changes over longer periods of time. We could always see what was happening on a very granular basis for monthly changes, but now we can see:

- Changes quarter to date (QTD)
- Changes year to date (YTD)
- Changes over a custom, user-defined time period

When we look at the changes in YTD MRR for a sample of our clients (we selected 32), we discovered something very interesting:

The largest driver of growth in MRR is not new customers. The largest driver in increased MRR is the growth of existing customers.

When we look at MRR clients, we want to know whether or not clients are changing. They could be:

- New
- Growing
- Shrinking
- Lost

If you look only at the income statement, it's not enough. The truth is that your clients each change almost every month but tend to off-set most months. On a client-by-client basis, the data gets lost. If your business is maintaining a certain level, you're happy and don't know otherwise.

In this sample, we only looked at managed service providers that are growing their MRR because that is what we want to emulate. We looked at:

- MRR Labor vs. MRR Product
- Big vs. small companies based on monthly MRR

Upon evaluating the data, we reached a consistent answer, the same no matter how the data was reviewed:

- 55-70% of growth in MRR was driven by existing clients.
- In 60% of these cases, it was enough to cover combined decline and loss from other clients Shrinking or Lost.

For your business, this means something very important. Based on the research, the most fertile area for growth in MRR is centered within your existing client base. The majority of all growth in MRR comes from these clients and it often takes less effort to grow MRR from an already happy client than to find a new one.

Of course, this doesn't mean you should stop prospecting for new clients. New business still accounts for 40% of MRR growth, so you absolutely need to put effort behind it.

THE ACTIONABLE TAKEAWAY FROM OUR FINDINGS?

You need to spend an appropriate amount of time finding ways to grow your MRR with your existing clients if you want to become a more profitable MSP. The better you work with your existing clients and the stronger those accounts become, the better your business will perform.

METRICS THAT AFFECT MRR LABOR AND PRODUCT

To evaluate opportunities to grow your MRR with existing clients and encourage growth (or to address Shrinking or Lost accounts in the data), you need to separate and differentiate between MRR Labor and MRR Product.

On the face of it, this should be easy. Agreements (and agreement additions) highlight what we want to know. The problem is that PSAs often make that information far too easy to confuse.

WHY GO TO THE TROUBLE OF SEPARATING THE TWO? MRR IS MRR, RIGHT?

Not exactly, and in this case the distinction you make is very important. At the top of the list is margins. Your margins for Labor and Product are very different and need to be separated when evaluating this kind of data.

The margins on MRR product such as storage or A/V is based on pricing (e.g. What was paid for these services and what do I charge my customers?). Anomalies in pricing can be addressed directly by changing the price charged.

MRR Labor margin is based both on pricing and labor utilization. While your pricing can be changed directly, the costs are highly variable and, as such, need to be monitored closed. Metrics such as the client effective rate and pricing efficiency were created to help with this.

It's evident then that these metrics are very different and can have a direct impact on how you both view and parse this data. The question now becomes how to measure them effectively.

Agreement additions don’t explicitly state what is labor and what is product.

Even worse, they don’t require that the line items be separate. Consider the examples of the agreement additions:

Description	Units	Unit Cost	Unit Price
Monitoring	10	0.00	150
A/V	10	1.00	2.50
Storage	500	0.05	0.20

In this example, there are only costs and no labor to consider. It's easy to evaluate the data and determine what is happening. We can add in labor costs as they occur and hard costs are set.

Now consider this agreement addition where it is one line-item, but only the cost of products is shown:

Description	Units	Unit Cost	Unit Price
Full Service	10	3.50	$162.50

Or this one where the cost of labor is approximated:

Description	Units	Unit Cost	Unit Price
Full Service	10	$40	$162.50

We work with a number of businesses in this industry, and different MSPs use different methods (including all of those shown above and more). To develop accurate KPIs we often have to make our best estimate of what is product and what is labor, and as a result we've built systems to accommodate different ways to use additions so that these two remain separate.

HOW CAN YOU USE THIS INFORMATION TO BENEFIT YOUR BUSINESS?

As much as possible, standardize how these additions are made, how line-items are formatted and how your PSAs delineate between Labor and Product for the purposes of MRR. While you may still need to go back and evaluate existing agreements to determine data for existing clients, this can help you start to organize your data better and get the information you need to make smarter decisions about how you handle each client based on this data.

WHAT IS CONTRIBUTION PER HOUR AND WHAT DOES IT OFFER YOUR CLIENTS

We've discussed at great length how different metrics can affect your ability to make decisions for your business, improve the health of certain types of clients and grow your MRR over time. There is one more metric I want to discuss that can help continue to do this – Contribution per Hour.

Contribution is a key metric and can be measured in a number of ways – by client, member or project. To illustrate the concept, let's look at an example multi-store retailer, in this case, a hypothetical company called "The Gap"

Let's break The Gap down into two segments, Operations and Administration. For our example, Operations runs the stores and catalogs, and Administration is everything else.

To measure the success of a single store we need to know how much profit it can generate by itself. This is called the contribution of the store. It is the gross profit of sales at the store less the expenses for that store (e.g. rent, store payroll, etc).

When The Gap measures the success of that single store, it looks at its contribution, and related metrics (contribution/square foot, etc). The Gap aggregates all the contribution and uses it to pay the administrative costs and the remainder is profit. So when The Gap wants to understand which stores are better than others it uses Contribution based metrics.

HOW THIS APPLIES TO MANAGED SERVICE PROVIDERS

While MSPs are not retailers and the strict contribution model doesn't apply the same as it does for The Gap, you still service many relationships. Each relationship can be analyzed independently to measure its impact on your business – whether it is increasing your overall contribution margin or bringing it down.

Evaluating this data is different than it might be for a retailer, but it is something we've worked with many companies to accomplish. To do so, we stack rank customers based on contribution per hour to see where there is opportunity for contribution growth.

That number is incredibly important and represents a culmination of much of what we've covered in this guide.

In a nutshell, your contribution per hour is how much total contribution to your margin you earn from each hour of service delivery. Why is this number so important?

Imagine a single company with a very low contribution per hour but a very high number of hours. By taking that company from the bottom 20% as we discussed earlier in the guide and focusing your efforts on increasing CPH for your worst performers to the same level as those in the middle of the pack, you might see tens of thousands of dollars in increased contribution. For a small MSP, this could be anywhere between 4 and 8 points of net profit growth.

HOW DO YOU DO THIS?

With good data, smart analytics, and a tight focus on metrics that might otherwise remain buried without this extra work. It's not as easy as identifying the lowest performers in CPH, but this first step can have a profound impact on your margins.

USING GOOD DATA TO IDENTIFY A FIX

Here's where a little additional information can really help you excel in identifying and addressing issues such as a low profit margin.

By ranking clients by contribution per hour (gross profit per engineer hour), you'll learn some very interesting facts.

By taking those rankings and addressing the bottom 20% of your clients, you can now calculate how much contribution you would get if you were to increase profitability of this bottom 20% to match the next highest tier – the 21-40% range.

This simple exercise routinely yields an increase of 4-8% in profit margin.

Simply evaluating your clients using data you collect from your existing efforts and determining what is not working for the lowest ranked clients in your portfolio can lead to all the improvement you need to fix a significant problem.

The changes won't happen overnight – you'll need to invest in some additional work and research, but shouldn't you try before slashing costs across every aspect of your business?

Be smart about the toner and all office supplies. Let your employees drink their premium coffee. But know that good reporting will allow you to understand where your problems are and then you can fix the business in a way that will actually grow profits.

HOW GOOD METRICS WILL IMPROVE YOUR BUSINESS

Every day when you arrive at the office, it's your job to make decisions that will maintain and improve the health of your business. From the people you hire to the clients you bring on and how those accounts are managed, you strive to make the best decisions with the data available.

Yet for many business owners and decision makers, that data is either lacking context or there is too much to see clearly what is happening in the business.

This is where smart metrics and clearly defined KPIs can have a huge impact on your business. Imagine being able to pinpoint at a granular level which clients have the lowest contribution per hour and are dragging down your margins, which have the greatest opportunity to increase your total MRR, and how to increase some of your most important financial metrics without signing a single new client or changing how your business operates.

That's what a great metrics tool enables you to do, and it's why we built MSPCFO. Designed to identify client profitability trends, classify those clients by profit level and help you make decisions on how to improve relationships and make them more profitable in the long term, MSPCFO is a powerful tool for your business.

With the right data in hand, you can now act decisively to discovery key insights behind client effective rates and target action items on a client-by-client basis that will likely have a substantial impact on your margin.

To learn more about how MSPCFO has done this for many MSPs and to see some of the data you'll be able to mine for insights about your business, contact us and ask to schedule a demo for your MSP.