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# Pricing Your MSP Offerings

## Key Strategies for Building a Winning Pricing Model

technologies

# Table of Contents

## Executive Summary

Establishing pricing can be one of the most daunting decisions MSP executives have to make. Price too high and get laughed out of the customer's office. Price too low, and you can leave money on the table, compromise margins and jeopardize long-term viability. How do you ensure your pricing models help rather than hinder your business? This paper provides the high-level strategies you need to establish a pricing model that is optimal for your business and services.

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## Introduction

To risk stating the obvious, every MSP leader wants to grow the business and make money. A big piece of that equation ultimately comes down to your pricing model. Quite simply, if you do not get the pricing piece figured out before you launch a new service, your business is in jeopardy.

Given the huge role pricing strategies play in an organization's profits and success, it is no surprise that this topic is often one of the first to come up when we meet with MSP executives. These individuals are the ones tasked with answering some tough questions: I have defined my new offerings in a service catalog and have a well-conceived market approach, but how do I price these offerings? How do I know I am not leaving money on the table? How do I make sure our pricing does not scare off potential customers?

We have developed this paper to provide pricing guidelines that can help you make your way through this battlefield. The reality is that there is no one-size-fits-all approach to pricing MSP services—in fact, as we will discuss later, having a cookie-cutter pricing strategy can be a huge disadvantage. This paper is intended to provide you with strategic guidance on this topic. Rather than offer a hard-wired calculator or other tactical resources, this paper will detail the guidelines you need to formulate a pricing model that works best for your business.

## Understanding the Ground Rules

As you start plotting your pricing strategy, here are the key ground rules to consider:

- **Understand your cost of doing business—and never sell below cost**. Establishing a complete, accurate understanding of your costs is a critical first step. Next, never sell a service below your cost.
- **Establish pricing that optimizes profits and adoption**. Through assessing customers, competitors and the market at large, it is essential to formulate pricing that will set the stage for long-term profitability—but that will not deter prospects.
- **Tailor pricing to your offering type**. It is important to start with an understanding of the type of offerings you are bringing to market, and whether they fit the description of a commodity offering or a value-based offering. The pricing model will vary substantially depending on the answer.
- **Provide tiered pricing**. Establishing a tiered pricing model is often a highly effective way to make pricing attractive and fit the budgets of a range of prospects. Further, it provides an opportunity to sign with prospects and leverage upsell opportunities.

In the following sections, we will provide more details on each of these topics.

# Establishing Pricing Based on Your Cost of Doing Business

## Cost factors

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In order to understand the costs of delivering a given service, it is important to factor in the breadth of costs your organization bears. The following are several cost categories:

- **Operating expenses**. This includes rent and other recurring office costs, such as operating leases.
- **Human capital**. This needs to effectively capture the complete amount it costs to keep people on staff, and so should not just include salary but taxes and benefits.
- **Capital expense**. Capital expenditures can include costs from a range of areas, including IT infrastructure, office equipment and more. Ultimately, you want to amortize costs from across the organization, so, when developing a plan for generating revenue, you need to establish a framework that enables your business to recoup these expenses.
- **Short and long term debt**. It is also important to factor in the cost of any debt that has been accrued through the acquisition of capital from the open market. This can include leases, credit card debt and loans.
- **Software licensing fees**. Factor in all software licensing fees to the cost of providing a service. Be sure to use the licensing options that provide the highest value possible.
- **Issue resolution time**. When calculating the cost of a specific service, it is vital to leverage historical information regarding how long it takes staff to resolve issues. You should assess the average time it takes to solve a specific problem or type of problem and ultimately come up with a precise estimation of the time your staff will need to invest to deliver a given service on an ongoing basis. This is probably the most difficult and most important cost category to get right. No matter how accurate a picture you have of other categories, if you base service costs on an estimate that it will take your team a half hour to provide a service and it ultimately takes two and a half hours to deliver, your pricing will be way off and your profits will not meet expectations. Finally, these historical metrics can be insightful in deciding which type of services to support and which to avoid. If a particular service takes too long to support, has a high failure rate or has been the source of refunds based on service level agreement (SLA) breaches in the past, they may be services that you would want to avoid offering to future customers as a recurring service. Instead, it may make more sense to provide these services within a billable scope of work.

## Never sell below cost

Selling below cost is always a recipe for disaster. However, it is surprising how often people think this can be an effective strategy, a way to get in the door with the customer, establish a relationship, deliver value and build up revenues over time. While this thinking makes some sense on the surface, experience indicates that this is an approach that is prone to failure. Quite often, if you start with this kind of pricing at the outset, customers will expect the same level of discounting in the future. A loss leader is just that, a loss. Service providers should avoid this pricing approach at all costs.

In some very isolated instances this may be a tactic to employ, however. For example, if you are trying to land a marquee customer in a new market, selling below cost may allow for rapid entrance. While many organizations take this approach, bear in mind that if you do, you will be saddled with this relationship and contract for its duration, so taking a loss today means taking a loss in perpetuity.

## Implementing Pricing that Optimizes Profits and Adoption

Your pricing model needs to strike a balance between ensuring profits and fostering broad adoption, no simple feat. The following sections describe some key considerations for making this happen.

"Do not be afraid to set the price high, you can always discount if and when needed. On the other hand, you can never go back and ask for more money after you have pitched a service at a lower price."

### Aim high

While this may be obvious, it bears repeating: you want to maximize the profitability of each and every service you offer. Do not be afraid to set the price high, you can always discount if and when needed. On the other hand, you can never go back and ask for more money after you have pitched a service at a lower price.

### Base pricing on a customer and market assessment

In assessing pricing, it is essential to understand customers and their needs and then align your pricing structure with what the market can bear. This may require market analysis to determine the right pricing strategy. Ultimately, you want to ensure that the price of your minimum offering is within reach of the majority of the prospects you are planning to sell to. In addition, you must make sure that even the highest tier is priced so that it is obtainable to prospective customers. Fundamentally, you do not want to find yourself in a position where your most inexpensive tier is priced higher than anyone in the market will bear. You want to establish a base-level offering that is palatable to a good cross-section of the market, and then provide premium offerings that, while customers may not want or need them immediately, represent viable upsell opportunities longer term.

### Establish a differentiated pricing model

It is important to research your competitors' cost structures. This is critical, not because you want to copy what they do, but because you have to establish differentiation in pricing. If you present a cost structure that is identical to your competitor, you will quickly be forced into an artificially commoditized market. If it is simple for the prospect to make a comparison, for example, with two vendors that have bronze packages with similar services, it will be easy for the customer to pit the respective price points against one another and go for the one that is cheaper. Even if your business offers some important differentiation, whether in business value, customer experience, service levels or the like, those types of distinctions may get lost in basic cost comparisons. That is why it is so vital to make sure you have significant differentiation, not only with your service offerings, but with their pricing structure.

### Avoid "non-optional" options

Pricing should be straightforward and easy for customers to understand. For that reason, you should avoid having a service that is contingent upon the purchase of another service. If two services in your service catalog have to be sold together, combine those offerings into one. If that makes the price higher, that can be ok. Just be ready to articulate the value you bring to the customer.

### Factor in long-term planning

Current services ultimately need to deliver the profits that fund future investments and strategies. Consequently, it is important to factor long-term planning into your pricing.

"Do not be discouraged by losing deals, even if customers say pricing is too high. The reality is that not all prospects will sign on, and you do not want to let a few rejections precipitate a race to the bottom with pricing."

### Plan for flexibility

It is important to maintain a degree of flexibility in your pricing approach. Not every customer will purchase at your established rates, and while you want to accommodate some level of discounting, you do not want to lose money on a given offering or customer either. Allow for some flexibility while maintaining strong enough profit margins to support the customer and grow the business.

### Include setup fees

Regardless of the pricing model you develop, you should always plan to charge a setup fee. This fee is to offset the cost, both in terms of time and materials, that the service provider incurs in "on-boarding" a new customer. This is best calculated by combining the sum of all capital expenditures required for setup and a percentage of the monthly fee. We have often seen this percentage range from 50 percent to 175 percent of monthly revenue. Consider the following example:

A customer is going to be charged a monthly fee of $3,450.00 for a new service. To set up the new customer, the service provider needs to purchase and install a new appliance that houses the monitoring probes required. The cost of the appliance is $900.00. Based on a charge of 75 percent of the monthly fee plus the appliance investment, the setup fee would amount to $3,487.50. (For simplicity, you may want to round up to $3,500.00.) It is a good idea to be flexible and willing to negotiate on the setup fee as a way to gain a longer contract commitment, but always try to make sure you cover any capital expenditures.

### Measure service profitability

To establish an MSP business that is healthy, profitable and growing, it is essential to measure the profitability of each deal. This can help affirm good decisions, and it can also help pinpoint mistakes—so you can be sure you do not repeat them. While you may not be able to undo a mistake within an existing account, you can prevent your business from making those same mistakes in future deals. It is also important not only to measure the profitability of deals won, but to assess deals lost and determine the role pricing may have played. However, do not be discouraged by losing deals, even if customers say pricing is too high. The reality is that not all prospects will sign on, and you do not want to let a few rejections precipitate a race to the bottom with pricing.

## Tailoring Pricing to Your Offering Type

The pricing model you define needs to be aligned with the type of service being offered, depending on whether it is a commodity or value-based offering. Following are strategies for establishing pricing models for each type of service.

### Setting pricing for a commodity service

When we talk about a commodity service, we don't mean it is a low cost service. We use the term commodity to refer to a common service, which in some instances may actually yield a high price point. Your MSP business may have opted to white label another vendor's service. This can include offerings in such areas as spam filtering, antivirus and online backup—basic, commonly understood services in the managed services space that are supported by a number of strong vendors. In this type of context, rather than building your own, it makes more sense to resell. As a service provider, this kind of service can be a way to make some additional revenues, while not representing a service that is core to the company's business.

If you are offering a commodity service, it is relatively simple to come up with an effective price. First, you want to start by tracking your costs, as outlined above. Next, you need to determine how much profit you want to make, and multiply that by your cost to get your price. So for example, if your costs are $1.00, and you want to make a 50 percent profit, you will price your offering at $1.50. That is pretty much all there is to it, and the great thing is that it can be an easy model to replicate.

### Setting pricing for a value-based service

Value-based services are inherently customer benefit driven. One way to look at this is when the customer reviews an invoice for a value-based service, they will not be focused so much on the price, but on the value they know they are getting and the fact that they know it is a service that the business relies on constantly and completely.

Value-based services should be priced based on what the market can bear, rather than a straightforward multiplier on top of costs. First, you need to align services with customer goals and ensure they provide maximum benefit. For example, if your customer has SLAs established with their customers or user groups, you should try to match or exceed those SLAs in the services you provide. Value-based services are typically priced at a premium, but they have to deliver a commensurate level of value. These will often be more high-touch services, and may be associated with business-critical functions or applications. When delivering a service that is core to the customer's business, you can command a premium price.

## Establishing Pricing Tiers

As mentioned earlier, you want to provide pricing that is highly palatable to the vast majority of your target market. Consequently, you want to do everything possible to lower a customer's barrier to entry to buying your services. The best way to meet these objectives is through pricing tiers. With pricing tiers, you can establish different entry points for customers to buy into. When you put tiers in place, you are going to be offering different levels of service, but each tier would be the same deliverable. In effect, most tiered pricing models are broken down across a scale of risk tolerance, a factor of how much the customer is willing to accept "overage" billing for work performed outside of the included services or service hours. The following sections describe two common options for establishing pricing tiers.

### Sample: Pricing Tiers by Hours Serviced

| Pricing Tier | Hours Serviced | On-Site Support Included | Billable Hours Exposure (Risk) | Price |
|---|---|---|---|---|
| Silver | 9x5 | No, billable | High | $ |
| Gold | 12x7 | Yes | Medium | $$ |
| Platinum | 24x7 | Yes | None | $$$ |

### Varied hours

Often, pricing tiers are differentiated by hours of service delivery. The services delivered are the same across all tiers but the hours of inclusive service differ. For example, Silver package customers will get service between 8:00 am and 5:00 pm, Monday through Friday, and have to incur additional billable expenses if services are required outside of those hours. At this lower price point, the Silver customer bears more of the risk: they may incur additional expenses during a given time period if services are required outside the 8:00 am to 5:00 pm service window. At the Gold level, the same services are delivered from 8:00 am to 8:00 pm, seven days a week. Again, all work performed outside those hours is billable. However, onsite dispatches are included.

At a higher price point, the customer reduces their billable hours exposure, and, if more time or effort is required, the provider bears the burden in terms of increased costs and reduced margins for a given time period. By paying for the Platinum service, the customer pays a higher monthly rate but bears no risk of additional billable hour costs. While the Platinum tier on paper is the most profitable for the provider, it contains a higher risk of scope creep and margin erosion as the customer will expect a greater level of service. To ensure that this does not occur, the provider must have a solid service catalog.

### Varied services

With this model, each tier will have a different service offering. As a customer goes up to the next tier, they get an increasing number of services, both those included in the lower tier as well as additional services.

## Conclusion

Devising a pricing model for an MSP business is never easy, and the stakes are high—with the potential for compromised margins on one hand and limited market uptake on the other hand. By following the strategies outlined above, you can execute a pricing model that sets the stage for both market adoption and long-term profits in your MSP business.

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This document has been written by the CA Service Provider Center of Excellence team and is intended to provide our service provider partners with the guidance they need to address some of their most pressing challenges. Our team has rich expertise in service provider businesses, strategic consulting, technical deployments, sales and marketing. Our documents are informed by the Center of Excellence team's extensive experience over the past ten years in helping build successful service provider businesses and by interviews with some of our most successful service provider partners. This document is provided for informational purposes only and on an as-is basis. The guidance and results described herein are based on the unique experiences of our staff and partners, and may not be applicable to all organizations.

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