2018 Trends in North American Managed Services

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A Special Report by SolarWinds and The 2112 Group
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Executive Summary

The continuing progress of managed services across North America

For more than a decade, the channel community watched managed IT services transform the landscape, picking up converts and rendering resale models obsolete. Once just one of many common partner business types, the managed service model is pre-eminent today among the channel’s most successful and fastest-growing organizations.

The 2018 Trends in North American Managed Services, a special report by SolarWinds and The 2112 Group, shows that managed services—with a core recurring-revenue model that delivers consistent earnings and predictable profits—continue to drive channel partners’ growth and profitability.

Among the key findings of our research:

» The average North American channel partner gets 28 percent of gross revenue through managed services

» or businesses that identify as primarily managed service providers (MSPs), the average gross revenue derived from managed services exceeds 40 percent

» The average profit margin on a typical managed service contract in North America is 32 percent

» North American channel partners expect the share of their gross coming from recurring-revenue engagements to climb 13 percent this year to more than 31 percent

» More than 60 percent of channel partners say they will add more managed service offerings next year

» The average North American partner employs 6.5 technicians and supports 52 active managed service customers

» Only about one in four partners (26 percent) feel their managed service skills are expert-level

» 48 percent of channel partners expect managed service prices to increase in the next two years

» 57 percent of channel partners say managed service profits will increase in the same period

The 2018 Trends in Managed Services study reveals nearly all channel partner types offer some sort of managed services and earn at least 16 percent of their revenue from recurring-revenue engagements. Managed service engagements are helping to drive growth in other areas, particularly in professional services, a segment that shows strong performance in revenue and profit among all partner types in direct proportion to their recurring-revenue businesses.

Our research also shows managed services are maturing as providers start to confront issues of capacity and capability that can hinder scale, growth, and expansion in the recurring revenue-driven market. The average North American company surveyed has been in business for just over 15 years and has offered managed services for about eight years.
To battle headwinds of commoditization and consolidation in the maturing managed service market, MSPs are increasingly looking to technology. Tools, such as remote monitoring and management (RMM) and professional services automation (PSA) platforms, often an afterthought for fledgling service providers, are universally deemed critical to success for more established practitioners.

The 2018 Trends in Managed Services research offers valuable insights not only into the performance of today’s managed service provider but into their habits, practices, and aspirations. As more channel partners look to adopt or expand recurring-revenue businesses in an effort to remain competitive and viable, the emergent profile of the ambitious, tech-enabled, successful MSP serves as a fitting model for best practices in this promising yet challenging space.

## Managed Services: Trends and Opportunities

Managed services are approaching universality in the North American IT channel. Recurring-revenue, subscription-based technology services transcend business models, with the majority of organizations—from traditional VARs and solution providers to systems integrators, consultants, and dedicated MSPs—making managed services a significant portion of their operations, value proposition, revenue, and profitability.

Those forces are fueling sturdy growth in the addressable managed service market worldwide. According to global market research from Mordor Intelligence, global managed service spending will climb from over $155 billion last year to more than $296 billion by 2023 at a healthy CAGR of around 11 per cent (see Figure 1: Global Managed Service Market Size).

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Respondents to our 2018 Trends in Managed Services survey have been in business for just over 15 years, averaged $3.8 million in total annual revenue last year, and expect to close 2018 closer to $4.6 million, figures that put them in line with the known channel population in North America (see Figure 2: Average Revenue Breakdown).

![Figure 2: Average Revenue Breakdown](image)

Around 97 percent of respondents have a service offering that's earning money, leaving just 3 percent of partners on the outside of the managed service evolution. The average North American channel partner enjoys 28 percent of gross revenue from managed services (see Figure 3: Average Revenue Breakdown).

![Figure 3: Average Revenue Breakdown](image)
Unsurprisingly, for those firms that identify primarily as MSPs, the figure jumps to 41 percent of gross (see Figure 4: Revenue Breakdown by Business Model).

![Figure 4: Revenue Breakdown by Business Model](image)

While the calculus in managed services decidedly favors those organizations dedicated to the model, even traditional VARs and systems integrators are seeing an uptick in managed services’ contribution to their top line, with each reporting around 16 percent of total sales coming from their managed service bill of fare.

The data demonstrates how fundamental managed services are becoming to the channel. Services not only make up a solid portion of revenue but are also fueling a steady increase in profitability for recurring revenue-focused practitioners (see Figure 5: Percent of Gross Revenue from Managed Services).

Overall, companies surveyed average 31.6 percent profit margins on managed services. Those firms that self-identify as MSPs report an average profit on their service engagements of 43 percent (see Figure 6: Services Profit Margin by Model).

![Figure 5: Percent of Gross Revenue from Managed Services](image)
While that far outpaces organizations with alternative channel business models, other partner types are earning respectable managed service profits in the 15 to 20 percent range. IT consultancies, meanwhile, are inching closer to their MSP peers with average service margins of around 32 percent.

Clearly, the channel at large recognizes the upward pull a robust, subscription-based business can have on the health of the business. When asked what motivates them to develop and maintain managed service practices, eight out of 10 partners say generating recurring revenue tops their list (see Figure 7: Top Reasons for Offering Managed Services).

Between 30 and 40 percent also give a nod to boosting net-new sales, protecting their customer base, and reacting to market demands as significant impetus for their service practices.

If there’s a downside here, it’s in the tepid response to maturity-based motivators, such as controlling more of the IT service life cycle (27 percent) and doing more business with existing customers (12 percent). As the managed service market continues to mature, those holistic kinds of efforts will be critical to sustaining growth and staving off the effects of commoditization.
Top Services

Solution providers serve up a broad mix of managed IT offerings, most focused on business technology fundamentals such as network, endpoint, and server management, as well as backup and recovery services (see Figure 8: Managed Services Offered).

In an environment where more than 95 percent of solution providers offer some kind of managed service, roughly seven in 10 (68 percent) offer complete managed services to their clients. Wrapping together those that deliver comprehensive services and those with individual, à la carte managed service offerings makes it clear that solution providers still lean heavily on legacy fare like endpoint management (82 percent), network management (79 percent), server management (78 percent), backup and disaster recovery (BCDR) (76 percent), and email (63 percent).

Managed security services and specialized storage services are on the roster for about half of our respondents, while more complex items, such as software, risk, database management, as well as virtual desktop infrastructure (VDI), lag with only minority representation.

The results are indicative of a still-maturing playing field for managed services where solution providers are sticking close to their comfort zones and to their network management roots. While traditional IT solutions make solid entry points for resellers wading into the recurring-revenue pool, there's an inherent, long-term risk in remaining focused on low-touch, swiftly commoditizing managed service offerings.
Partners expecting real growth in managed services are unlikely to get it with commoditized offerings alone. High-touch, high-value solutions—the kinds of offerings vital to protracted success in the service model—still command too little attention among solution providers, our data shows.

That disconnect appears in starker relief in the roster of products and services (other than managed services) solution providers tend to offer. Endpoint, networking, server, and storage hardware, along with basic security products, top the list of offerings (see Figure 9: Other Product and Service Offerings). Nearly three in four respondents (72 percent) offer break/fix services, a number that’s slightly higher (75 percent) among those who describe themselves as primarily managed service providers.

As with our managed service findings, the roster of products and nonmanaged services reveals a dearth of complex, high-value fare, such as specialized security offerings, line-of-business applications, and the kinds of smart-device solutions that make up the burgeoning internet of things (IoT) space.

**Partners avoiding these higher-value offerings in favor of traditionally tried-and-true solutions put their prospects for competitiveness, long-term growth, and profitability at risk.**
To understand the state of the channel’s managed service segment, examining how partners sell is at least as important as examining what they sell. When it comes to market-facing sales approaches, respondents with managed service offerings favor fixed-fee services (50 percent), followed by more flexible options that vary from deal to deal (see Figure 10: Service Sales Methods). Tiered services based on a quantification of the work being done outpace similar tiered approaches based on time spent delivering the service (38 percent to 8 percent, respectively).

When it comes to securing the relationship with recurring-revenue customers, managed service providers of all types favor annual contracts over any other agreement terms (see Figure 11: Average Contract Term). Locking subscribers into predictable terms greatly reduces churn and allows fledgling service practices to focus finite sales resources on adding new customers while
reducing the impact of attrition. It’s concerning, therefore, that one in three partners (33 percent) is still serving up managed services with no contract or on a simple, month-to-month basis.

The bright spot in the managed service mix is the determination among those we polled to make managed services a larger part of their businesses in the next 12 months (see Figure 12: Changes to Service Portfolio Next Year). More than 60 percent said they’d increase the number of services they offer, while just 22 percent said their service menu would remain about the same.

That data is almost certainly a harbinger of movement by solution providers toward the higher-order service offerings necessary for sustainable advancement and profitability in managed services.

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**Maturity and Growth Factors**

Measuring channel growth over the past several years shows us the typical partner company grows, on average, between 16 and 20 percent annually. North American respondents to the 2018 Trends in Managed Services survey fall right in line with that growth curve, with anticipated top-line revenue expected to rise just over 19 percent in 2018.

Many factors account for the positive trajectory of companies that offer managed services, including overall size of the organization. Our data consistently shows managed services are the most significant driver of overall growth for midtier businesses, with annual revenue of $1 million to $15 million. Smaller partners with less than $1 million in revenue typically depend more on traditional hardware and software sales, while larger firms with more than $15 million in annual sales rely more on professional services and systems integration to drive their value.

One factor that greatly influences growth for purveyors of managed services is persistence; how long a solution provider offers managed services is a strong indication of their recurring-revenue growth.

The average solution provider in our survey has been offering managed services for 8.2 years. The complete dataset shows the roughly parabolic distribution of a maturing market with participants sloping away from the mean in either direction (see Figure 13: Time Offering Managed Services).

Roughly one in three (32.7 percent) have been at the managed service game for five to 10 years. Newer entrants to the MSP world—those with five years or less in the field—outpace veterans with a decade or more of experience by nearly 2 to 1 (40 percent to 26 percent, respectively).

Viewed through the lens of revenue realized through managed service sales, it’s clear that time in the field pays dividends (see Figure 14: Revenue from Managed Services by Time as MSP).
Four in 10 companies with two to five years of experience in managed services realize average recurring revenue as a percentage of gross. (Average share is defined as 25 to 35 percent).

In that same group, one in three has below-average recurring-revenue share, while less than one-quarter garner above-average subscription-service sales performance. Those ratios change dramatically for firms with more experienced practices. Companies with five to 10 years in the field consistently enjoy above-average recurring revenue as a portion of gross, our data shows. The gap between average and above-average revenue share is a significant 22 points.

While the environment is still friendly for long-time managed service veterans with experience of a decade or more, the advantage levels a bit at some point, with the gulf between average and above-average share narrowing to just six points. That plateau might be attributable to customer attrition, a factor that can have a withering effect on established managed service practices, and one that channel partners have failed to address with sufficient urgency.

**Success in a recurring-revenue model relies on two factors: adding customers and retaining accounts. If a provider of managed services can accomplish these two things, they can have consistent, predictable recurring revenue.**

Respondents to the 2018 Trends in Managed Services survey say they’re adding an average of four service customers per month. On the flip side, though, they’re losing slightly more than three clients in the same period. This treading of water in customer acquisition and retention is pushing down overall managed service performance, particularly among older partner firms.

There appears to be recognition of the gravity surrounding this negative force among the partners surveyed (see Figure 15: Top Strategic Goals for Growth). Asked about their top strategic goals for growth of their service practices, respondents overwhelmingly see net-new customers and upselling to current clients as the top two priorities, scoring them a 6 and a 5.5, respectively, on a 7-point scale. Adding new services and developing expertise in a vertical industry fall in the middle of the pack, while taking on new vendors and selling to non-IT buyers in lines of business drop to the bottom of the priority list.

| Attract New Customers | 5.97 |
| Sell more to current clients | 5.45 |
| Add new services | 3.83 |
| Develop vertical specialization | 3.16 |
| Add new vendors | 3.05 |
| Sell to line-of-business leaders | 2.82 |

Figure 15: Top Strategic Goals for Growth
Capacity and Capabilities

Partners saying they want to grow their businesses is one thing; how they’ll accomplish that feat is another. Making the growing managed service practice increasingly attractive to new and existing clients requires ongoing investments to expand capacity and capabilities, particularly in sales, marketing, and technical support assets.

Research by The 2112 Group consistently shows sales and marketing capacity strongly correlate to service growth metrics, such as customer acquisition, customer retention, and overall recurring-revenue business growth. Previous 2112 research puts the average number of salespeople per organization at around seven. Respondents to our 2018 Trends in Managed Services survey fall far below this threshold, however, coming in at fewer than two salespeople per firm (see Figure 16: Full-Time Employees by Role). Marketing fares even worse, managing fewer than one full-time employee per company on average.

This dearth of sales capacity has a measurable dampening on growth. Our research consistently shows solution providers with no salespeople tend to be small, with revenue of less than $500,000 annually and year-over-year growth of less than 3 percent. Meanwhile, organizations with annual growth of 25 percent or more have, on average, three times the average number of dedicated salespeople.

On the other hand, the solution providers we surveyed are well staffed with technicians and technical support personnel in furtherance of their managed service ambitions (see Figure 17: Full-Time Technicians). The average partner boasts 6.5 techs, on average—more than double the number of full-time customer support and operations workers and three times more than the number of dedicated sales staff.
There is, naturally, a correlation between technical workforce and the number of managed service clients served (see Figure 18: Active Customers by Number of Technicians). Firms with a below-average number of technicians tend to deliver services to a smaller client base, while half (49 percent) of those with above-average technical staffs serve 76 clients or more.

Nearly all polled solution providers with more than 100 managed service clients have large technical staffs of 10 or more employees.

Technical staffing, however, is typically a trailing indicator of service success. Whereas investment in dedicated sales and marketing resources shows a desire for future growth, many solution providers tend to add technicians and tech support help only after new accounts are on the books.
Partners may be bullish on managed services as a core part of their growth strategy, but most aren’t yet voting for the model with their wallets. Solution providers in our survey are reinvesting an anemic 12.3 percent of their net revenue, on average, to bolster their managed service capabilities and capacity. Business and investment experts, including famed investor Warren Buffet set the mark for adequate reinvestment of profits at between 25 and 50 percent of net.

Short-arming strategic reinvestment in service practices comes even as partners admit they need at least some improvement in their managed service delivery acumen (see Figure 19: Managed Service Capabilities Assessment). Two-thirds of respondents (65 percent) claim only basic managed service skills, with room to improve, while 5 percent admit they lack basic skills or capabilities altogether. Just one in four surveyed partners considers itself a managed service expert.

The average channel partner is reinvesting 12.35 percent of gross to expand its managed services.
While most solution providers lack the strategic business planning or investment to take full advantage of the managed service opportunity before them, there are some notable bright spots. Solution providers in the survey overwhelmingly see service solution suites, such as RMM and PSA platforms as key to an MSP’s success. The majority say they plan additional investments in RMM and PSA tools in the coming two years, and survey respondents rated the solutions an 8.9 out of 10 in importance to their managed service aspirations.

When it comes to assessing and selecting managed service solutions, the overwhelming majority pick functionality and cost over most other criteria (see Figure 20: Selection Criteria for Managed Service Solutions). Performance and technical support are on the radar for a scant one-quarter of respondents, while a small minority cited other product features and vendor services.

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Percentage</th>
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</thead>
<tbody>
<tr>
<td>Functionality</td>
<td>64%</td>
</tr>
<tr>
<td>License and maintenance fees</td>
<td>55%</td>
</tr>
<tr>
<td>Performance</td>
<td>24%</td>
</tr>
<tr>
<td>Technical support</td>
<td>23%</td>
</tr>
<tr>
<td>Integration with third-party apps</td>
<td>11%</td>
</tr>
<tr>
<td>Extensibility/flexibility</td>
<td>5%</td>
</tr>
<tr>
<td>Technical training</td>
<td>4%</td>
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<tr>
<td>Other</td>
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<tr>
<td>Business training</td>
<td>3%</td>
</tr>
<tr>
<td>Professional services</td>
<td>2%</td>
</tr>
</tbody>
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Figure 20: Selection Criteria for Managed Service Solutions

Pricing and Profitability Trends

The challenges of a maturing market and lack of strategic planning by partners notwithstanding, solution providers remain guardedly optimistic about the prospects for managed services in the foreseeable future, as evidenced by an aggressive outlook on profits and pricing.
One particularly positive finding in the 2018 Trends in Managed Services data is the apparent reversal of what had been a trend toward price erosion and fee fatigue in previous research. As is often the case with recurring-revenue, subscription-based services of any stripe, customers’ perception of value diminishes over time without regular, well-timed reminders.

End users grow weary of continually paying for products and services they once purchased with one-time fees. This leads to demands for price concessions or for increased services at the same price point come renewal time, a pressure that can force some creative approaches to setting prices among service practitioners (See Figure 21: Strategy for Setting Service Prices). The typical discount offered from published managed service pricing is 18 percent in North America, the research found.

The MSP market’s combination of commoditization headwinds is reflected in partners’ assessment of the service marketplace over the past 36 months (See Figure 22: Market Price and Profitability of Managed Services: Past Three Years). In that period, managed service pricing was seen as mostly neutral and profitability only marginally on the uptick.

The downward pressure on pricing and profitability is easing, however, with these same partners now expressing confidence that service prices and margins will increase in the coming 24 months (see Figure 23: Market Price and Profitability of Managed Services: Next Two Years).

Nearly half of the solution providers surveyed (48 percent) expect service prices to trend upward through 2020. Nearly three out of five (57 percent) expect margins to increase in the same period, with 16 percent anticipating significant profit increases.

What’s equally significant is that just 2 percent of respondents expect prices to fall significantly and fewer than 3 percent worry about a dramatic downturn in managed service profitability. Even then, they expect only a slight decline in prices.
Pricing

- Constantly trending up: 10.98%
- Somewhat trending up: 33.73%
- Neutral - no gain or loss: 39.22%
- Somewhat trending down: 13.73%
- Constantly trending down: 2.35%

Profitability

- 2.75%
- 1.96%
- 34.90%
- 35.29%
- 13.94%
- 14.90%
- 26.27%
- 14.51%
- 2.35%
- 2.35%

Figure 22: Market Price and Profitability of Managed Services: Past Three Years

Figure 23: Market Price and Profitability of Managed Services: Next Two Years
State of the North American Managed Service Market

The managed service segment continues to prove strong and profitable. For many solution providers, managed services served as their first foray into a subscription-based, recurring-revenue business—a model that has transformed the channel over the past decade. Getting their MSP legs under them allowed early adopters to leverage similar delivery models—cloud services and software-as-a-service chief among them—while simultaneously moving beyond the eroding margins and limited value of transactional IT solutions.

Today, growing customer demand is a significant part of the fuel driving ongoing growth and profitability in managed services. Modern end-user businesses adapted well to services as an IT delivery mechanism for both managing costs and addressing the shortage of skilled technicians required to run in-house IT departments. As the data reveals, these parallel trends allow managed service practitioners to charge higher prices, maintain solid margins, and drive development and expansion of their practices.

To keep the drumbeat going, the 2018 Trends in Managed Services research shows channel partners beginning to deal with shortcomings in capacity and capability that can hinder scalability and growth in increasingly mature ways. Expanding services beyond basic offerings, demonstrating increased value to customers, and relying more heavily on force-multiplying tools such as RMM and PSA platforms all demonstrate positive steps in the fight against commoditization and consolidation in a maturing service marketplace.

It’s also clear from the data these providers will need to do more—more strategic business planning and investment in new capabilities—if they hope to remain competitive and fully realize the financial opportunity in a promising but challenging market. Focusing solely on technology will not be sufficient to sustain growth in this space. Savvy service providers will also need to invest in sales capacity and work to improve customer engagement to maximize returns in a recurring-revenue world.
Methodology and Demographics

The 2018 Trends in Managed Services study was conducted via an aided-response online survey fielded in the summer of 2018. That data was augmented with responses gathered by SolarWinds MSP Pulse, a self-serve online diagnostic tool used by solution and service providers to measure and compare their managed services capabilities. In all, the research sampled 721 qualified providers of managed services worldwide, of which 521 were proportionately population-dispersed across the United States and Canada (see Figures 24a and 24b: Respondents by US Region and Respondents by Canada Region). The study has a margin of error of +/- 5 percent, with a 95 percent confidence rating.
The sample contained a census-balanced representation of channel business models, consisting largely of MSPs and other companies that resell and deliver managed services (see Figure 25: Sample by Business Model). As noted earlier, the average gross revenue of the respondents was around $4.6 million annually.

Figure 25: Sample by Business Model

Managed service provider (MSP) 64%
IT consultant 29%
Value-added reseller (VAR) 5%
Systems integrator 2%
Managed service provider (MSP) 64%

Participants hold roles at the C-level or as owner-operators, making them qualified to answer the survey questions (see Figure 26: Sample by Participants’ Titles).

Figure 26: Sample by Participants’ Titles

CEO/President 42%
Owner/operator 24%
Director/manager 23%
CFO/CIO/Chief CXO 7%
Vice President 4%
The majority of respondents had 10 or fewer full-time employees (see Figure 27: Number of Full-Time Employees) and served a variety of vertical markets—mainly professional services, health care, legal, financial services, and manufacturing. (see Figure 28: Vertical Industries Served).

![Figure 27: Number of Full-Time Employees](image)

![Figure 28: Vertical Industries Served](image)
ABOUT THE 2112 GROUP

The 2112 Group is a business strategy and research firm focused on improving the performance of technology companies' direct and indirect channels through a portfolio of market-leading products and services. The 2112 Group leverages proprietary intelligence with qualitative research, market analysis, tools, and enablement programs. Industry experts approach each engagement by applying innovative solutions customized to meet the needs of clients. By looking at the technology market from the viewpoint of vendors, partners, and end users, The 2112 Group is uniquely positioned to develop go-to-market strategies that are beneficial to all parties from both a channel and enterprise perspective.

ABOUT SOLARWINDS

SolarWinds is a leading provider of powerful and affordable IT infrastructure management software. Our products give organizations worldwide, regardless of type, size, or IT infrastructure complexity, the power to monitor and manage the performance of their IT environments, whether on-premises, in the cloud, or in hybrid models. We continuously engage with all types of technology professionals—IT operations professionals, DevOps professionals, and managed service providers (MSPs)—to understand the challenges they face maintaining high-performing and highly available IT infrastructures.

Targeted for MSPs, the SolarWinds MSP product portfolio delivers broad, scalable IT service management solutions that integrate layered security, collective intelligence, and smart automation. Our products are designed to enable MSPs to provide highly effective outsourced IT services for their SMB end customers and more efficiently manage their own businesses. Learn more today at solarwindsmsp.com