Managed IT Profitability

Achieving 25%-plus versus the 6% industry average

by: Tim Schatz, Technology Assurance Group (TAG)

For most in the industry, in the competitive landscape of managed IT services, the goal of achieving profitability margins of 25% or higher is elusive. Instead, most squeak by with an average of 6% earnings before interest, taxes, depreciation and amortization (EBITDA). However, after advising hundreds of managed IT services, voice and office technology dealerships over the past 26 years, we at Technology Assurance Group (TAG) have discovered the proven strategies that can help dealerships avoid mistakes to unlock their full profit potential in IT, propelling them to new heights.

While this transition does not happen overnight, there are still a handful of common mistakes that can be quickly corrected in the short term that yield exponential impacts on profitability. There are five pitfalls dealerships make when they move into managed IT services. In this article, I will address, in part, those pitfalls and how to avoid them.

The Common Pitfalls

(1) Delegating Entrepreneurial Responsibilities to "IT Guys" (Non-Entrepreneurial Leadership) — Typically, a dealership hires a general "IT guy" to be responsible for its managed IT services department. This person is obviously technically savvy, but not business savvy. Then the dealership lets the IT guy sink or swim under the mistaken pretense that the strategy is empowering the employee.

Instead, when an IT guy is placed in an entrepreneurial role — without the real entrepreneurial experience of what it actually takes to turn something from a mere idea into a profitable venture — such a hire often ends up breaking even, at best. Even though some IT managers are fantastic at what they do, they are not necessarily automatically fantastic entrepreneurs, too — especially without being given any training, support or financial models to set them up for success. Technology is what they know best.

Dealerships that hire leaders who possess both technical expertise and the necessary entrepreneurial acumen to drive success have a far greater likelihood of breaking through the early stages of building profitable IT businesses. Unfortunately, the majority have not, which is why very few dealerships have profitable IT businesses. The majority are subsidizing their IT businesses with their MFP businesses.

(2) Misaligned Sales Strategies & Sales Process — It is natural to use the same MFP salespeople to sell managed IT services. However, we have found that most convenient decisions do not typically lead to the highest profits. In fact, expecting MFP salespeople to succeed at selling IT services without any support or training often leads to subpar results for many reasons.

First off, MFPs are only one aspect of a customer's network. Sales conversations are more focused on customer service, relationships and ensuring orders can be fulfilled. There is a fixed customer need and an element of "order taking" instead of needing to assert technical authority.

However, when you are selling managed IT services, you are essentially pitching a company to effectively become the prospect's external CIO and IT department, and that conversation needs to be handled completely differently. The IT sales process is much more complex than the MFP sales process.

You are no longer selling a product or service; you are selling advisory capacity. You are ultimately asking a business owner to trust you with his (or her) most precious asset — his network. That includes all of the critical information that ensures the livelihood of his business.

In accordance with that, managed IT services salespeople must command their places as authorities and serve as consultative experts who will help customers scale their operations. It is a whole different sales process when you are selling the management, optimization and protection of the entire network and every endpoint on it.

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Instead, dealerships should invest in salespeople equipped (or trained) with the expertise to effectively market and sell IT solutions with the right compensation plan. Most dealerships implement a comp plan similar to the plan used when selling MFPs and it fails miserably because of the nature of the solutions.

(3) Inaccurate Pricing Models — Dealerships tend to underprice their managed IT services offerings by roughly 20% due to a lack of understanding the true cost of support, which can severely impact profitability. The lowest pricing we have seen in the IT industry has come from BTA Channel dealerships selling managed IT services. So, out of the gate, dealerships are fighting an uphill battle to achieve profitability because of incorrect pricing.

Does that impact the bottom line? Well, what would happen to your managed print department if revenues were cut by 20% overnight? Dealers who are new to managed IT services tend to focus too much on hard costs instead of soft costs.

The real question managers should be asking themselves is: "How many hours of support are we going to put into servicing the sale?" These metrics of standard support requirements are regular and foreseeable, yet often not effectively considered when making pricing decisions.

When dealership leaders do not take the time to build out an appropriate model with accurate cost forecasts, they are effectively launching a venture that is guaranteed to fail.

Then, and worst of all, leadership may mistakenly conclude that perhaps managed IT is not profitable. In truth, managed IT is wildly profitable if it is done right. That is why so many players continue to enter this space every year.

(4) Inadequate Technology Stack — Selling the wrong technology stack or failing to standardize solutions are other mistakes that drive up costs and erode profitability quickly. The typical path most dealers take is to hire an IT guy to build their managed IT services businesses versus someone with business acumen fixated on profitability and customer experience.

The problem here is that in attempting to demonstrate his expertise, your IT guy may also complicate the sale. Additionally, many IT guys may develop a solution bundle that is lacking the right technology for the customer, and providing low profitability for the dealer. Since IT is foreign to most dealership owners, their IT businesses are left alone, operating in the red and ultimately subsidized by their MFP businesses.

Furthermore, we advise standardization and have vetted technology suppliers keeping the most important thing in mind: "What is the best technology for the end user?" When you carefully select and standardize your technology, profitability is far easier to attain on a consistent basis because you get to benefit from the leverage of simplicity.

(5) Incorrect Technician Ratio — A final common mistake dealers make is misjudging the technician-to-customer ratio. Instead of accurately assessing the number of techs required based on the volume of computers and servers to support, they often overestimate and overhire. This occurs because they want to ensure that they are delivering exceptional customer service. However, this overhiring tendency leads to an inefficient allocation of resources and unnecessary overhead costs.

Ideally, techs should spend around 75% of their time addressing customer-facing issues, with the remaining 25% allocated to non-customer-facing — although not unimportant — activities such as meetings, project updates, technical training and administrative tasks. By optimizing the technician ratio, office technology companies can enhance productivity, improve customer satisfaction and boost profitability.

The Key Profit Inflection Point

Reaching what we affectionately term "nirvana" marks a pivotal moment for a dealership. It is the point where every cost in its managed IT services business is covered and profitability soars to unprecedented levels. This milestone unleashes a "hockey stick" trajectory of profit growth, making every deal significantly more lucrative.

So, how do dealerships reach this coveted state of profitability on their IT businesses? The journey involves three key elements:

(1) Prioritizing Recurring Revenue Above All Else — Establishing a foundation of recurring revenue streams provides stability and predictability to cash flow, laying the groundwork for sustained profitability. Once all monthly operating costs are covered by prior recurring revenues, the profitability of each new deal "hockey sticks" from a 25%

potential profit to 100% profit on every single additional deal.

Consider this example: If recurring revenue covered every single cost in the business, such as all payroll, op-ex, sales expenses and overhead, what is the impact of selling just one additional hour of labor? The payroll cost is already absorbed and that hour of labor drops straight to the bottom line.

(2) Optimizing Service Offerings — By maximizing profitability on additional service offerings and IT deals, dealerships can significantly boost their bottom lines. From cybersecurity solutions to cloud services, each offering presents an opportunity for increased profitability. There is no reason to reinvent the wheel when we have access to billions of dollars in transactional data for this industry.

Furthermore, each additional IT offering creates a cumulative level of IT advisory equity that makes clients progressively more reliant on your expert advice for how they can optimize their own businesses as they scale, exposing you to new sales opportunities much earlier in the sales process than your competitors.

(3) Strategic Business Management — When dealerships can shift out of chasing cash flow and move into deliberate planning and execution of strategies to achieve long-term objectives, their managed IT divisions start to improve as a whole. This shift in focus allows them to step back and evaluate their operations from a strategic perspective. Instead of solely focusing on short-term gains or addressing immediate financial needs, they dedicate time and resources to analyzing their business processes, identifying inefficiencies and implementing strategic changes to streamline operations and drive profitability.

In other words, by working on the business rather than just in the business, dealerships can proactively address challenges, capitalize on opportunities for growth and make informed decisions that contribute to long-term success. This may involve optimizing workflows, investing in technology solutions to improve efficiency, refining customer acquisition and retention strategies, or enhancing employee training and development programs.

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Unlocking Profitability: A Call to Action

As dealerships embark on their journeys to IT profitability, it is crucial to embrace a strategic mindset, leverage proven best practices and remain agile in the face of evolving market dynamics. By addressing the previously mentioned common pitfalls and implementing sound business strategies, office technology dealerships can achieve profitability margins of 25% or higher and secure their positions as industry leaders.

This level of profitability is not a lofty, abstract fantasy. It is a reality that TAG members are achieving because of our guidance and their steadfast commitment to the long-term, the implementation of proven strategies, a dedication to adopt new methodologies and, lastly, proper execution. ■

Tim Schatz is executive vice president and a partner at Technology Assurance Group (TAG), an organization of managed technology service providers (MTSPs). Collectively, TAG's members do more than $800 million per year in IT, cybersecurity, telecommunications, video surveillance, access control and MFPs. They are located in 150 marketplaces across the United States and Canada, and are presently serving more than 780,000 SMBs. Schatz is responsible for providing financial analysis, industry benchmarking, KPIs, M&A, advice and counseling to TAG members. In addition, he is a partner at TAG's MTSP, i-NETT, located in Southern California. Schatz can be reached at tim@tagnational.com. Visit www.tagnational.com.