AN INSIDER'S TAKE

ON

THE MSP INDUSTRY

WHY CHOOSING A MANAGED (IT) SERVICE PROVIDER IS CHALLENGING

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endsight

A Lesson From Microeconomics

I'll never forget the lecture when I first learned about the concept of "information inequity" and its nefarious impact on trade. I think that was when I really understood the IT service industry. Information inequity is a common economic problem that occurs when the buyer and seller of a product or service have asymmetric information. A used car transaction provides a good illustration of this point. The seller of the car has perfect information about the automobile, but the buyer's information is extremely limited. Without tools like Kelly Blue Book and/or intermediaries like dealerships, these information inequities will make the transaction difficult. Naturally, the buyer wants the price to reflect the risk of the unknown, but the seller is not willing to give up value for a well-maintained car. By increasing symmetry of information, we increase the likeliness of trade and the chance of a fair outcome.

The IT industry is loaded with information inequities. The consumer of the service has a very difficult time inspecting the quality of the work and frequently doesn't understand the technology well enough to even know whether the promised "work" has been done at all. They have a difficult time measuring the quality of "advice," and they frequently undervalue any work that is not directly observed.

Information inequities like these are not uncommon in industry. We expect that our lawyers understand the law and that our doctors understand medicine far better than we do. We don't typically worry about our house burning down on account of our lack of expertise in mechanical and electrical systems.

However, most industries that are built around information inequities have created market-based solutions to protect the consumer. Lawyers are required to get a law degree from an accredited school and to pass their state bar exam. They must maintain their status with the bar association in order to continue to practice. Doctors have similar requirements, and professionals in both fields face severe economic penalties for malpractice. If you take the example of an electrician, the consumer is protected by building codes and government inspector to protect uneducated consumers.

Unfortunately for the IT service consumer, no such safeguards exist. Think about this: does it really make sense that your hairstylist needs a license but the consultant who manages IT security for your bank does not?

The Marketplace Dynamic:

The dynamics above have created an extremely low bar to be an IT professional or an IT service provider. It's almost comical how little you need to start an IT service business.

You don't need –

- a business degree;
- a technical degree;
- a certification of any kind;
- a formal apprenticeship;
- employees;
- a physical office;
- credit from a bank;
- investors;
- any capital whatsoever;
- a board of directors; or
- a background check.

All you need is a single consumer who is willing to write you a check and, voilà, you have an IT service company. The result is many small or very small businesses. These companies are typically run by an IT professional who was at some point working in the internal IT department for a small or medium sized company. The stories I've heard over the years are incredibly similar. They usually involved some type of perceived injustice, like being fired, followed by what Michael Gerber calls an "entrepreneurial seizure" in his 1998 book E-Myth.

These entrepreneurs find a client or two. Some do a good enough job to get a few referrals, and the business grows to a small group. I call these entrepreneurs "Alpha Technicians". They are the top (AKA alpha) technical resource at their company. However, most of them know very little about business operations, financial operations, human resources, leadership, management in general, sales and marketing, and/or any other essential components required to scale a business. The result is that they eventually hit a ceiling with a core of very loyal customers followed by a revolving door of new clients that become old clients because the business doesn't have the capabilities necessary to scale.

In each metro market in the United States, there are thousands of companies that fit this description. While small IT providers like this represent 95% of the marketplace, there is another type of IT service provider to look out for. In search for return on capital, private equity companies have flocked to the IT Managed Service sector. They are searching for recession-proof companies with predictable recurring revenue streams. IT Managed Service businesses fit that bill. To the outside, these "roll-ups" look like large, well-capitalized companies with professional managers, great marketing, and mature operations. However, from the inside, they are usually an unintegrated confederation of the tiny companies cobbled together. What's worse is that the entrepreneurs that were the soul of the customer service engines have been replaced by New York investors whose only interest is in growing EBITDA (Earnings Before, Interest, Taxes, Depreciation, and Amortization) to arbitrage "exit multiples" at the next capital turn, always just five years away.

The IT Service Customer:

Perhaps the most under-appreciated reason the IT Managed Service industry struggles so much is the customer themselves. For years, the customer's selection process was dominated by a drive to lower total IT spend.

The customer didn't understand the differences between providers. They were also reluctant to pay a premium for work they couldn't see or feel. They didn't have a good way of valuing what a "crisis averted" and they didn't have a good understanding of how to dollarize small increases in employee productivity over time. Since they didn't have a good understanding of how to quantify IT risk, they didn't have a way to value reducing IT risk.

So the customer signaled to the industry that they wanted "low-cost leaders". Customers continued to reinforce this mentality even after the selection by refusing to upgrade equipment at the appropriate and recommended life cycle. Customers also resisted best practice recommendations whenever it meant allocating more resources toward IT. These small and financially constrained IT service providers were so desperate to stay open that they couldn't afford to take a stand with the client to demand the necessary spending levels to do the work correctly.

The Labor Market

Over the 20 years I've spent in the industry, there has been some maturation. Unfortunately, some other global trends have made things even more challenging for our industry. The first is the supply/demand trends for IT workers. The global demand for humans who understand computers and networks has soared. Each year, the demand grows higher, and yet there is no developed feeder system for educating and/or retraining people in the field. It's a talent war. There is almost no unemployment, and wage inflation dramatically outpaces CPI (consumer price index). What's more is that our industry has operational immature companies that do not have a competency in human resources. They don't manage culture, recruiting, retention, training, mentorship, or career pathing. With minimal financial resources, they also can't compete for talent on direct compensation and benefits.

The Squeeze

Caught between customers who don't understand the value of spending on IT and the challenge of recruiting and retaining talent, IT Managed Service providers focus only on what they need to do in order to keep customers. In a word: customer service. It's the one thing the customer can easily understand and inspect. A customer can tell if you are slow to respond, if you treat them poorly, or if you resolve issues slowly.

This means the laundry list of things IT professionals must do to maintain a healthy network, that cannot be easily inspected, often goes undone completely. How is the customer supposed to know whether software patches are applied, backups are maintained, alerts are monitored and cleared, security policies and best practices are adhered to, and so on? Consumers are getting poor strategic consulting at best—and none at worst. Proactive management is a totally lost art in the field. All too often, this leads to a pinnacle event of downtime, data loss, or a security breach. And even in those circumstances, the customer has no way to really understand how and why it happened and whether it could have been avoided. Understanding the costs of such events is challenging as well, especially when downtime is spread across many users in the form of an hour here and an hour there.

Industry Consultants Create More Confusion

As the industry has developed outfits like *TruMethods*, *Robin Robins*, and *Service Leadership*, these consultants have attempted to "help" small IT service businesses mature. Instead, they have created turnkey (MSP in a box) templates and collateral that enable very small and immature operators to sound and look similar to more mature competitors. This has made a difficult choice even more confusing for IT service customers who don't have the ability to differentiate between two competing firms that are broadcasting the same basic message.

Cyber Security

When I first started in IT, the cyber security landscape was completely different. It was basically rogue computer scientists who wanted to prove to themselves—and to the world—that they were smarter than the software giants. They would write exploits to embarrass big tech companies—and the end users were simply collateral damage.

Then, in 2009, Bitcoin was founded. An unfortunate side effect for computer users everywhere was that cryptocurrency created an anonymous way for someone across the world to accept a payment. Cybercriminals quickly realized that the ego boost from hacking big tech didn't pay bills, and now with bitcoin, they had a way to monetize their skills.

Over the last 10 years, the volume of these attacks has grown exponentially. What might not be obvious to the outside is that cybercrime is no longer a few smart software developers in Russia. It's an industry—it is well capitalized, and it has a supply chain. There are developers that write code and lease it (software as a service) to attackers who aren't even developers themselves. They use a combination of social engineering along with code. They are patient and clever. There are even intermediaries to negotiate payments.
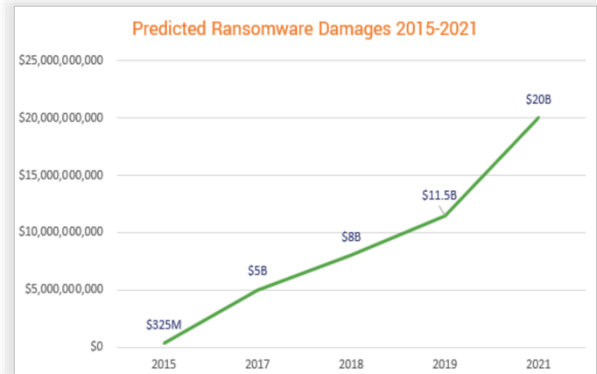

Figure 1 https://www.thesslstore.com/blog/ransomware-statistics/

It is no longer just your computers and network that provide an attack surface either. Every single one of your users offers a way to exploit the network. It's no longer a matter of if you will be attacked, but when. Your users will be phished and your network will be probed. It's only a matter of when and how hard. While prevention is extremely important, as the threat vectors grow, detection and response have become just as critical. *See Figure 1.*

If ever there was a time to have well-managed professional IT support, that time is now. If ever there was a time to allocate the appropriate spending to managing and mitigating IT risk, it is today.

Selection Process

Visionary business leaders do not need to wait for calamity to understand the impact of Information Technology on productivity. They can feel and sense the business-killing risk of poorly managed and under-built information systems. However, they should also recognize that this field is changing at a rapid pace that requires constant attention to detail and commitment to learning. Visionary business leaders understand that they are unlikely to be capable of building, maintaining, and managing this expertise in-house. Yet, they are torn because they can also see massive pitfalls in outsourcing and managing a relationship in an industry that is essentially the Wild West.

At my company, Endsight, we have found that while customers don't want to spend any more than they have to, they are willing to spend what they need to but only if and when they understand what they get for the additional spend. This is why the process for selecting an IT Managed Service Provider is critical.

Let's talk about a few common selection processes and why they don't yield predictably good results.

Referrals:

Referrals are by far the most common way customers find IT service providers. Of course, there are times when we benefit from this greatly; however, it is seriously insufficient. Having great references is a requirement. Yet it is just one of many boxes that needs to be checked and cannot be used in place of a thorough evaluation.

Every single IT service provider out there has a small group of loyal customers who are very willing to provide a reference or a referral. However, the happy customer doesn't have a good way of inspecting much of the work that might not be getting done. The only thing they can reliably testify to is the level of customer service they receive and experience. That's important, but bad customer service won't take your business down…a security breach might. Furthermore, even a small IT service business that is doing a good job probably does not have the skills required to scale. Likely they have already achieved their ceiling. In order for them to successfully take on new customers, they would have to master a whole new set of business disciplines: operations, finance, HR, etc. It's critical that you satisfy your belief that they are prepared not just to take on your business but other customers behind you—without dropping the ball.

RFP:

Another big mistake is the "tried and true" request for proposal process. This process basically consists of finding a large number of providers, lining them up in a spreadsheet, comparing attributes in columns, and selecting the firm that appears to have the greatest value on paper. This process fails due to the information inequities. The RFP examiner has no way to inspect how well systems are patched, whether backups are maintained well, the quality of strategic advice that is given, whether firmware is actually being upgraded, or whether risks are being avoided. The end-customer also cannot see whether or not the firms in the spreadsheet have the ability to scale, as discussed above. Furthermore, the spreadsheet doesn't show whether firms are going to be able to navigate service changes required to be relevant in the future of a rapidly changing industry. New tools, best practices, and risks surface every passing day.

Typically, these RFP processes are optimized to yield the worst possible choice: the "low-cost leader."

Incumbents:

Some firms recognize the landmines they face in selecting a new provider. Often, this is primal 'subconscious' understanding that executives wouldn't even be able to articulate. However, the result is the same—they stay with the "devil they know." Even when firms explicitly know their IT needs are not being met, they are not confident enough in their ability to select a better partner, so they simply stay put.

Conclusion

You cannot select an IT partner in the same way you would select a facilities management firm or other commodity service provider. What's worse, is that you can't even select an IT partner the way you would select a lawyer or an accountant due to the lack of regulation.

At Endsight, we recommend an evaluation process that plays to the strength of our prospective customers. Our customers run great businesses. They know what great businesses look like and what they feel like. They understand that a great business consists of more than one "alpha" technologist and a bunch of helpers. Great businesses are complex structures with culture, leadership, processes, organizational charts, and metrics. Great businesses can demonstrate expertise in multiple business disciplines.

We believe that selecting a great IT service provider is as simple as selecting a great business. Consider evaluating your IT provider on the basis of whether or not this is a company you would want to be a shareholder of. Since our industry is littered with operational immature companies run by technologists, running your process through this lens will eliminate most of the bad partners. Those businesses that are left will likely have both the organizational, business, and pricing models necessary to provide competent, consistent, and scalable service, now and into the future.

About the Author

Mike has competed in this marketplace for more than 20 years. He has seen from the inside after winning hundreds of clients, as well as collaborating with competitors.

He's met thousands of industry CEOs at hundreds of industry conferences. He has participated in an IT service peer group for more than 15 years, meeting with industry CEOs for 6 days per year sharing best practices and financials. He has been a member of various industry groups with thousands of other IT service businesses (*TruMethods, Venture Tech, True Profit Groups, Service Leadership*, to name some).

He currently serves on the CEO advisory council of a multi-billion-dollar software company in the IT service industry called Kaseya. That board is made up of a dozen of Kaseya's top MSPs internationally, which gives him an international perspective on the industry.

Mike is a paid consultant and serves on the board of directors for a private equity fund that has invested hundreds of millions of dollars in the sector. And he earned his MBA from *Columbia Business School* in 2010. That formal business training gave him an analytical framework for thinking through the strategic landscape of this industry, after having worked in it for years.

Closing Notes

Though much of what is disclosed here is a sensitive topic to many MSP industry peers, we at Endsight aim to be an open book about it. And if you made it this far I can tell that you are interested in the MSP industry and what it may be able to offer. If you would like to further discuss your business and or perspective, please reach out though contact form on this page and specifically make mention of this report in your inquiry.

Also, by reading this report, you are helping to loosen the entangled knot that this industry and the market have created. So please share this report with anyone you think would find it useful.