SHERIDAN FUNDING & MANAGEMENT

Maximizing your ability to see what's coming, so you can maximize your Profits and company Value

HOW DO YOU REALLY MAKE MONEY?

Most MSPs just use their financial statements just to pay their taxes, not to run their business month to month. As a result, they don't know where they are really profitable and where they are leaving profits on the table. When they do look at their Income Statement, they have only one Gross Margin to look at and many times it's not helpful because they haven't allocated their Cost of Goods Sold (COGS) correctly.

As an owner of an MSP, you are not managing a single business. You are managing a business entity that operates several Lines-of-Business (LOBs) that all have different targeted Gross Margin Percents (GM%), and those GM% differ widely.

Most MSPs today generate revenues from the following LOBs:

- Product Resale (Hardware)
- Software Resale (Packaged Software)
- Cloud Services
- Microsoft
- Backup
- Other
- One-time Projects
- Managed Services
- Networks
- Security
- VoIP

Each of the above services has its own targeted GM% and unless you can measure your GM% by LOB you can't determine if which LOBs are holding back your profits. For example, GM% by LOB are typically 20 – 24% for Hardware Resale, 16% for Microsoft Cloud Services, 20+% for other Cloud Services and 50+% for Managed Services – Networks.

Most MSPs should have an overall GM% of 45% +/- depending on their revenue mix. If you are operating at an overall GM% of 35% and can't calculate your GM% by LOB, where do you begin to fix the problem? You know you either need to raise prices or lower your COGS, but where?

For the MSP example above with 9 defined LOBs, there are 18 possible adjustments that can be made – 9 related to revenue (pricing) and 9 related to COGS. And with GM% by LOB you won't have to guess where to begin making adjustments. Comparing your current GM% to the Targeted GM% for each LOB will immediately show you where you are the least profitable.

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EXHIBIT 1: GM% BY LINE-OF-BUSINESS

	WITHOUT LOB DETAIL	WITH LOB DETAIL	WITH LOB DETAIL & ADJUSTED GM%	INCREMENTAL GROSS PROFIT
REVENUE				
Recurring Revenues	4,125,000			
One-Time Revenues	1,137,500			
Product Resale		775,000	775,000	
Cloud Services - Microsoft		735,000	735,000	
Cloud Services - Other		289,000	289,000	
One-Time Projects		362,500	362,500	
Managed Services		3,101,000	3,101,000	
TOTAL REVENUE	**5,262,500**	**5,262,500**	**5,262,500**	
COGS				
COGS	1,505,780			
Labor	2,034,205			
Product Resale		658,750	589,000	
Cloud Services - Microsoft		610,050	610,050	
Cloud Services - Other		236,980	184,960	
One-Time Projects		235,625	170,375	
Managed Services		1,798,580	1,488,480	
TOTAL COGS	**3,539,985**	**3,539,985**	**3,042,865**	
OVERALL GROSS MARGIN $	**1,722,515**	**1,722,515**	**2,219,635**	**497,120**
Product Resale		116,250	186,000	69,750
Cloud Services - Microsoft		124,950	124,950	- 0
Cloud Services - Other		52,020	104,040	52,020
One-Time Projects		126,875	192,125	65,250
Managed Services		1,302,420	1,612,520	310,100
OVERALL GROSS MARGIN %	**33%**	**33%**	**42%**	**9%**
Product Resale		15%	24%	9%
Cloud Services - Microsoft		17%	17%	0%
Cloud Services - Other		18%	36%	18%
One-Time Projects		35%	53%	18%
Managed Services		42%	52%	10%

Exhibit 1 above provides an example of the benefit of expanding your Chart of Accounts to generate an Income Statement that will provide the needed GM% information. From the Income Statement it is clear that the Overall Gross Margin is low. It should be almost $500,000 higher. Without LOB revenue and COGS accounts you are not able to calculate the GM% by LOB.

The same Income Statement with the needed LOB revenue and COGS accounts clearly shows where the short fall in Gross Margin is coming from. You now have the ability to focus on specific LOBs and determine if pricing or COGS adjustments need to be made.

The third column shows the impact of adjustments to improve Gross Margins. The overall increase in Gross Margin $'s is $497,000. This example assumes all the adjustments were made to the COGS. Typically, adjustments will also need to be made to pricing such as increasing markups on products that are resold, increasing pricing on long-term managed services clients and getting a better understanding of how you are really doing on projects.

After working with dozens of owners of MSPs and assisting a good number of them in getting ready to sell their company by increasing Net Income and therefore the Value of the MSP, there are a few truths I would like to pass on.

- You can't fix your GM% by LOB quickly. There is a lot involved but is worth doing. You didn't get to the point you are at today overnight. For many owners it has been 20+ years of effort and learning to grow their company. It is worth putting in the time and effort because of the added profits and value that will be created.
- If you have been in business for 10+ years you probably have some long-term accounts that you are at best breakeven on. Understanding your GM% by LOB will point you in the right direction, but there will be more detailed work to be done.
- Over 15 years of working with MSPs the biggest drain on GM% I've seen has been Projects. Whether it's due to not estimating correctly, scope creep, or over staffing, many MSPs are not realizing the profits they should be on Projects.
- Your technical staff is your biggest component of COGS and those costs need to be allocated to where those staff members actually spend their time. You cannot generate GM% by LOB without allocating staff costs.
- Over 90% of the MSPs we start working with are overstaffed on Day 1. For most the solution to most problems has been to hire more people.

The easiest way to build the value of your MSP is to increase your earnings. The value of your MSP is a multiple of your earnings. And that multiple will increase as your GM% increases. The easiest way to increase your earnings is to understand your GM%.

I hope you found this information useful. If you would like to discuss your specific situation, I would be happy to schedule some time. Please feel free to schedule time below.

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How SFM can help you increase Profits and Company Value

SFM approaches your business through a long-term lens, laying the foundation for understanding how your business generates profits, and then planning and implementing needed adjustments to realize increased profits and value.

- Lines-of-Business: clarify targeted Gross Margin %'s, adjust pricing and/or cost as needed and align all staff on the path to increased profits.
- Process: establish regular (monthly) financial reviews to identify trends and plan for further adjustments based on how the future is developing.
- Platform: Strengthen financial data quality, implement planning/forecasting and structured reviews.

With SFM, increased profits and value are the result of a structured process that connects analytics, organization, staff and forward vision. The result, your financial data supports understanding performance, decision making and supports the long-term outcomes you want, and deserve after years of effort.

A strong starting point is a Financial Trends Assessment to clarify the current situation, prioritize high-impact adjustments and to map a process to increased profitability and company value.

CONTACT US

Complete the form below to connect with SFM

Name: ____

Title: ____

Company Name: ________________________________

Phone Number: ________________________________

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