



FIXED FEE AGREEMENT PRICING

Finding Your Sweet Spot

MSPCFO

Business Intelligence for MSPs. Delivered.

FFA PRICING

FINDING YOUR SWEET SPOT

Fixed Fee Agreements are powerful tools to drive consistent, monthly revenue; and for most MSPs, they are responsible for the majority of profits ...if they are priced right. But when you have many different technicians, engineers and even admin servicing each client, it may be difficult to assess just how well priced each fixed fee agreement actually is.

In this guide, we will focus on the pricing aspect of MSP business strategy: How to make sure that your fixed fee agreements are priced in a way that is most representative of the value you are delivering.

We will look at both ends of the client spectrum: clients to whom your MSP is dedicating more hours than you're getting paid for, and secondly, clients whose relationship with your MSP is so efficient that they pose what we call a "flight risk." (Flight risks are especially dangerous – because the entire monthly revenue of the client is in jeopardy.) First, we'll look at how to spot potentially under-priced agreements using Effective Hourly Rate. We'll then use Efficiency Ratios to determine if pricing is indeed too low or too high, and what the underlying cause of that might be. Understanding the efficiency of your fixed fee agreements allows you to take action to address both ends of the spectrum, so your clients will all fall within the "optimally priced" range.





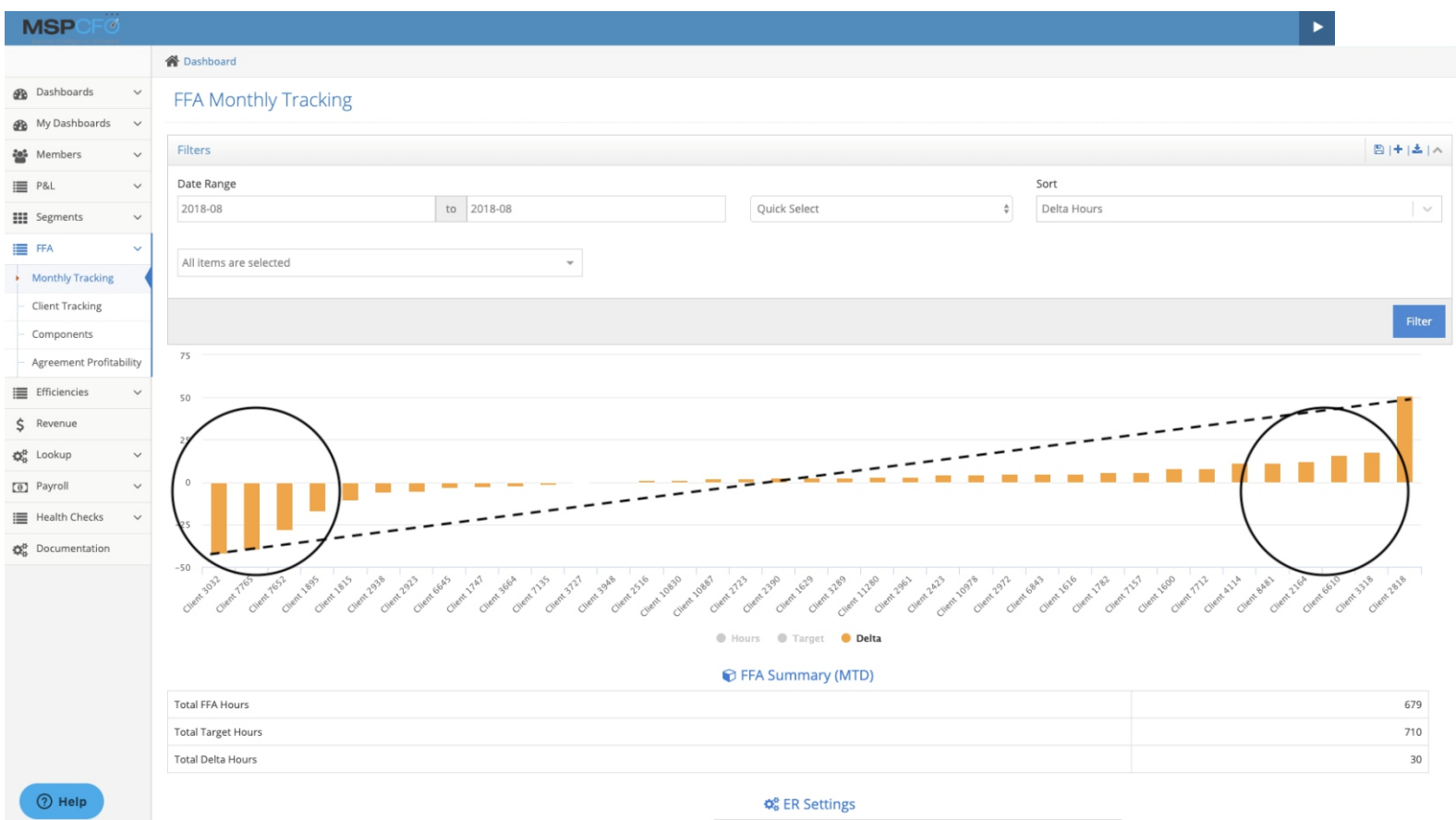
EFFECTIVE HOURLY RATE

Even though we are able to see the most granular analysis of agreements by examining the Efficiency Ratio, this does not mean that there is not also value in examining Effective Hourly Rate. Effective Hourly Rate provides a straightforward view into how many hours are delivered as compared to expectations of work performed on the agreement. When an MSP is servicing a client for more hours than was expected at the time of the agreement, either the MSP is being paid too little, or its engineers are doing too much work. If you take the revenue of the agreement divided by your target Effective Hourly Rate, you get your target hours for a given client. If your actual hours are more than your target hours, you're not getting paid the rate you anticipated for the work you're doing.

$$\text{target hours} = \text{labor revenue} / \text{target Effective Hourly Rate}$$

For example, if you have a \$3,000/month client, if you want to have an Effective Hourly Rate of \$150/hours then you will want to deliver 20 hours for that client. But if you end up delivering 30, then you are delivering 10 hours more than your goal. Since time is your cost, this client is now costing more than expected, and you're essentially doing 10 hours of work for this client for free.

Using the **FFA Monthly Tracking** report in MSPCFO on a client basis can help begin to identify problem customers. The FFA Tracking report shows you total FFA hours, total target hours, and total delta hours. Positive delta hours are good; negative ones are less so. For every partner we work with, there are clients that are on both ends of the spectrum. This report shows you where you may want to focus management efforts on improvement.



Notice by the dotted line that the average hours per client for this company are good, but when you look at either end of the graph, you can spot issues. On the left side of the graph, you can see that in just the bottom 4 clients alone, there are more than \$16,000 of unbilled hours in just this one month alone. On the right side of the graph, not including the outlier, \$93,000 of yearly revenue is at risk because the contracts are under-served.

What we want to instill is that even though *averages* may show profitability, once you begin looking at individual clients and agreements, you can see that there are real areas to improve profitability and mitigate risks. Put another way, if you fix the problems in your most underperforming clients, your averages will improve. It is also the best way to get a good return on your investment.

To address the issue of underpayment or overwork, consider increasing your agreement price with the client. Show the client the numbers, and explain that they're not where they need to be, but that you want to make the relationship work. Indicate exactly what the rate would need to be in order to make that happen. MSPCFO was designed to provide completely transparent reporting. Why not extend that transparency to the MSP-client relationship?

FLIGHT RISKS

If you look at the other end of the Monthly Tracking report above, you can see that there are also clients who are paying for many more hours in their fixed fee agreements than they are actually receiving. And, believe it or not, there is such a thing as too much efficiency with a client. Our data shows that clients become a flight risk when the delta (or difference between the hours they are paying for and the hours they are getting) is too high. These clients are under-served, and at some point, they may realize the discrepancy and leave. Therefore, when the delta of any client is too high, their entire monthly revenue is at risk. In the real, anonymized company above, the 4 clients on the right of the graph represent more than \$179,000 of recurring revenue yearly. A substantial amount of revenue at risk – worth looking into.

If you know that the client is underserved and may be a flight risk, one solution is to offer a discount, or you may begin pro-active steps to show value. Weekly or bi-weekly check-in calls may reinforce the value of your relationship, and uncover potential areas that may need attention. You may want to even consider showing the client the reports which indicate that hours anticipated are more than the hours delivered. You want to establish a long-term relationship. Clients will appreciate your team's capabilities, efficiency, and transparency. Greater client satisfaction results in greater stability, and mitigates flight risks.



EFFICIENCY RATIO

To analyze the pricing of an agreement, we like to use what we call “Efficiency Ratio,” a somewhat more robust concept than Effective Hourly Rate. Efficiency, unlike Effective Hourly Rate, takes into consideration that the value of an hour of work could be different (Project Engineer vs. Call Center or after hours vs. regular hours, etc); while Effective Hourly Rate assumes every hour is the same. In short, Efficiency is what you get paid versus the value of what you do.

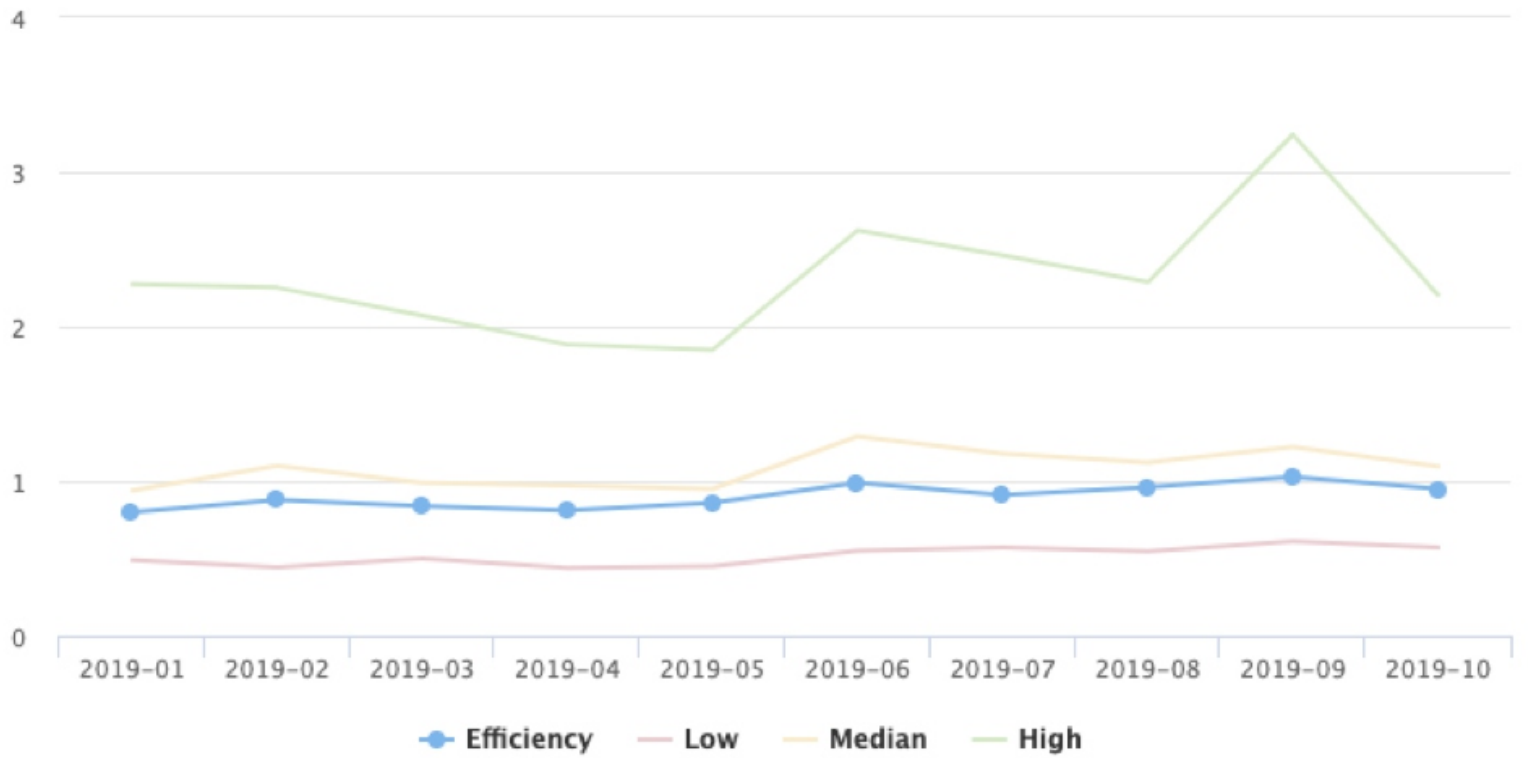
Effective Hourly Rate = labor revenue / hours covered by the agreement

Efficiency Ratio = invoiced labor / value of labor (hours x billable rate) covered by an agreement

For instance, if an engineer puts in 5 hours at \$150/hour, (\$150 being the engineer's billable rate) that's \$750 of shadow billable. (Shadow billable is a term that equates what the engineer would have charged if the client were charged hourly instead of fixed fee. We use this as a proxy for the value of the labor) If the invoiced labor amount on the agreement is \$500, the efficiency ratio is 0.67 ($\$500/\$750 = .67$). (Invoiced labor is the labor portion of your monthly recurring revenue. That is what your MSP is getting paid to do the work, taking away the agents, tools, etc.)

So what does this ratio mean? Industry experts recommend agreement efficiency between 1.2 and 1.3. That said, action should be taken when the Efficiency Ratio is below 0.8, you're getting paid too little for what you're doing. This is an indication that the agreement is not as profitable as it could be. If this ratio is above 1.5, you're not putting enough work into the client's agreement, and that client could pose a flight risk.

Efficiency



Here we can see the efficiency of clients over time, with high, median values as a benchmark.

EFFICIENCY COMPONENTS

In this example above, the Efficiency Ratio of .67 lies below the recommended ratio, so the agreement should be more closely examined. This can be accomplished with our report **Efficiency Components**, which actually breaks down each agreement in order to pinpoint the exact cause of under-performing agreements; whether it's an issue of revenue per endpoint, hours per endpoint, tickets per endpoint or hours per ticket. This chart also compares the client to the high middle and low for the partner.



Notice the Hours per Node (or Hours per machine) are high. When analyzed, you can see that the problem isn't that there are too many tickets being served per endpoint, the Tickets per Node are right at the median. The problem is the Hours per Ticket. It's off the charts, indicating that each ticket is taking too long to solve.



IMPROVING CLIENTS ONE AT A TIME

Review agreement pricing with account management and operations, and focus on improving efficiency for one client at a time, rather than trying to fix the whole business. Low-efficiency clients may require a price increase, or high-efficiency clients may need a price reduction. Another solution might include training of the clients or a different technology stack. With individual attention to each under- or over-performing client, you can substantially increase your bottom line. But you have to get there by first having strong data that will let you identify problems right away.

Here's one final equation to end this guide on:

strategy + data = solution

If you like what you've read, and you'd like to see how your own pricing is driving or creating a drag on profits, contact us today. When we meet with you, you will walk away knowing:

- Which clients are your worst performers and which are the best (and which are at risk of leaving)
- Where you might want to consider proposing a project to a client
- Which engineers are the most productive relative to their compensation
- Where gaps exist in your data (every MSP has them)

There is no obligation for this and you will gain valuable, actionable insight into your MSP. [Please schedule your time here.](#)