



How to Succeed with Managed Services

Perspective by
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For technology companies, traditional services businesses have played an important role in revenue generation. These days, however, the shift to subscription and as-a-Service business models has put pressure on these revenues. In search of new revenue streams with better growth rates, many technology companies are increasing their focus on Managed Services (MS).

We define Managed Services as the proactive management of a technology product by the vendor on behalf of their customer. We also include broader outsourced services that are related to and/or adjacent to the vendor's products (e.g., workflow outsourcing).

Based on our experience working with clients across a wide range of technology products (enterprise software, IT hardware, communications equipment, ATMs, laboratory instruments, to name a few), getting the MS operating model properly aligned is as important to success as selecting the right services to provide.

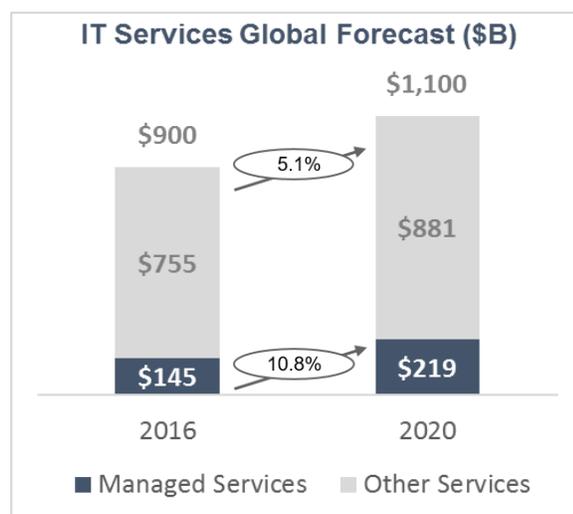
In this paper, we explore the factors driving the opportunities around Managed Services, outline a framework for the MS operating model, and touch upon the maturity continuum that providers must traverse to build a successful and profitable MS business.

Why Interest in Managed Services Is Growing

There are three main factors driving technology providers' interest in Managed Services – financial opportunity, customer demand, and Managed Services' role as a stepping stone to Software-as-a-Service (SaaS) and other as-a-Service (X-as-a-Service, or XaaS) offerings and business models.

1. Financial Opportunity

In a time when traditional services, primarily Professional Services and Maintenance, are experiencing slowing growth, Managed Services are particularly attractive due to their current and projected growth. The MS market is currently estimated at \$145 billion, representing approximately 16% of the \$900 billion overall IT services market.¹ However, whereas the overall IT services market is growing at approximately 5.1%, the MS segment is projected to grow at approximately 0.8% annually to \$219 billion in 2020.¹



Source: Waterstone analysis based on Gartner & MarketsandMarkets data

With gross margins that can be 30% or greater (depending on the specific market) and often with a lower asset/investment base than the core product business, Managed Services can absolutely contribute to overall company profits. For Managed Services that have strong underlying technology automation for delivery, margins can be even higher. It is not surprising that many tech companies seeking to boost their services revenue and profit are actively creating or expanding their Managed Services.

2. Increasing Customer Demand

Customer requirements are constantly evolving, and vendors must monitor new customer demands and adapt swiftly. There is a clear and growing demand for both XaaS and Managed Services across most technology segments. Industry surveys demonstrate that technology executives have both an increased awareness of and greater willingness to pay for these types of offerings.ⁱⁱ

Without suitable MS offerings, providers risk losing new business as prospects seek these services elsewhere. More harmful is the risk of losing business from existing customers. When customers want to shift some of their spend to Managed Services or XaaS and their existing vendor has no compelling offerings, this could be the catalyst for them to move their business to a competitor.

3. Stepping Stone to XaaS

One undeniable trend over the past decade has been the shift from product and license sales to XaaS. Industry reports on XaaS and its various components suggest that the overall market is growing at a minimum of 20% year-over-year.ⁱⁱⁱ The operating flexibility that XaaS provides has proven very attractive for technology buyers, along with converting CAPEX into OPEX. For technology providers, an XaaS business model can be attractive due to its predictable recurring revenue.

While XaaS is often the desired future business model, undertaking the dramatic shift in a company's operations can be very difficult and doesn't happen overnight, particularly for established players that have a traditional license or product sales model. Managed Services can serve as a vital stepping stone in the shift from a traditional product and maintenance model to a true XaaS offering. For example, for software companies, developing remote management and hosting for existing products and services is an effective first step towards migrating towards a SaaS portfolio. Providing these offerings to clients through a subscription helps build the internal processes and controls around managing an XaaS model, as well as building management understanding and signaling to investors the benefits of a recurring revenue model. As the MS arm of the company grows, it can provide an excellent foundation to move to a full-blown multi-tenant XaaS business.

Given these three factors, the case for focusing on Managed Services is clear. In responding to the opportunity and imperative, technology companies often focus attention on developing and launching new MS offerings. In our experience though, ensuring that there is an effective MS operating model is critical to successful growth.

A Framework for the Managed Services Operating Model

Waterstone categorizes the MS operating model across four dimensions:

- **Dimension 1: Services Selling Model** – alignment of the company’s sales and marketing approaches to effectively sell services
- **Dimension 2: Services Offerings** – an effective services offering development process, in addition to a compelling current offering portfolio
- **Dimension 3: Services Delivery** – necessary capabilities to efficiently deliver the service offerings, with particular focus on automation
- **Dimension 4: Governance and Support** – the tracking and management of key performance measures, along with support from company functions, that reflect the specific needs of a services business (which are different than a products business)

In our framework, these dimensions are grouped by go-to-market and delivery:

Managed Services Operating Model Framework

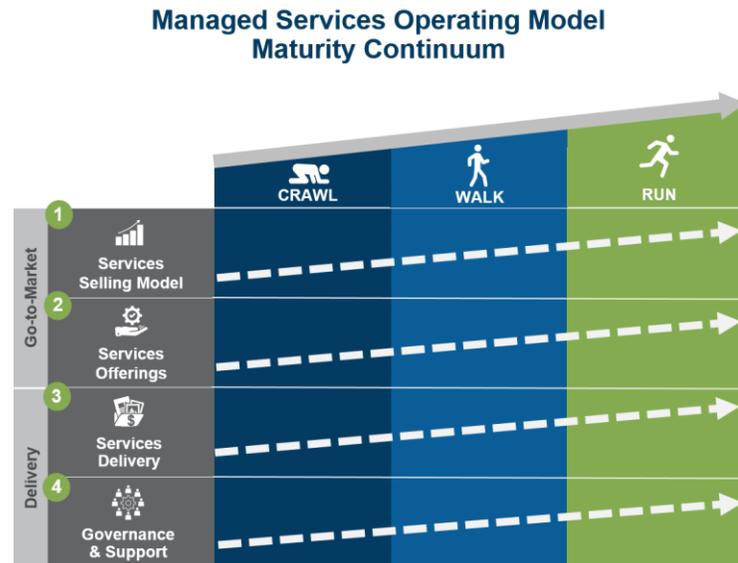


The Managed Services Operating Model Maturity Continuum

In our work helping numerous technology companies improve their services businesses, we have seen a clear continuum of maturity emerge across the four MS operating model dimensions. For example, within the services selling model dimension, an immature company often has an extremely product-centric sales force with little to no compensation incentive to sell services. A mature company would typically have a highly consultative selling process and team with compensation plans rewarding recurring services and solutions.

At Waterstone, we have taken this notion of the maturity continuum and applied it across the MS Operating Model Framework to create a “crawl-walk-run” MS Operating Model Maturity Continuum.

Moving up the maturity continuum on each of the dimensions is critical to growing a successful and profitable MS business. Companies aspiring to grow their MS business should benchmark their current operating model against this framework and identify and prioritize the elements critical to achieving successful growth.



In a series of upcoming papers, we will delve into each of the MS operating model dimensions to provide granularity on the key elements and our perspective on crawl-walk-run levels of maturity. To ensure that you receive them, be sure to [subscribe to our quarterly newsletter, Waterstone Currents](#).

Waterstone Management Group helps technology companies and investors create measurable value by identifying and capitalizing on disruptive growth opportunities and driving excellence in Services, Cloud, and Customer Success performance. Should you have any questions on this topic or wish to explore how Managed Services can help your company unlock new revenue streams, please contact:

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ⁱ Waterstone analysis based on “[IT Services, Worldwide, 2014-2020, 3Q16 Update](#),” Gartner, 2016, and “[Managed Services Market by Data Center \(Hosting, Colocation, and Storage\), Infrastructure \(Print Services, Desktop, Inventory\), Networking \(Remote Monitoring, MPLS, VPNS\), Information, Mobility, Communications, and Security - Global Forecast to 2021](#),” MarketsandMarkets, 2016.

ⁱⁱ “[4th Annual Trends in Managed Services](#),” CompTIA, 2015.

ⁱⁱⁱ Waterstone analysis based on “[Global Anything-as-a-Service Market 2016-2020](#),” Technavio, 2016, and “[Worldwide Public Cloud Infrastructure as a Service Forecast, 2016-2020](#),” IDC, 2016, and “[Worldwide Competitive Public Cloud Platform as a Service Forecast, 2016–2020](#),” IDC, 2016.