Cranking Up the Cash Flow—Three Key EBITDA-Generating Moves

Anybody that has ever talked to an investment banker, thought about selling their business or contemplated buying someone else's business knows that EBITDA—a proxy for operating cash flow—is one of the key multipliers that goes into an MSP's business valuation. Is your business model shaped to achieve record EBITDA as your revenue trajectory zooms?

It goes without saying that prudent expense control is key to profitable operations. So let's leave that easy one aside and focus on three less obvious operational areas that are ripe for improving your EBITDA picture. There is one common operational thread running through all the ideas: get as much cash as you can, as fast as you can.

Change the sales commission plan.

Here's a personal experience I don't want to repeat: Several years ago I was running sales and operations for a good-sized MSP. As the business unit leader, my compensation was directly tied to fiscal year EBITDA attainment. As we rounded the bend into Q4 that year I had a nasty realization: My entire sales team was going to blow through their quotas and break personal earnings records, but I was going to miss my goal. Why? Because a huge portion of our sales pipeline was set to close in Q4. So we had incurred all the costs of sales without any customer payments to generate cash and profitability during the fiscal year. Ouch! The sales guys win, but the business misses its goal.

The solution: For the next year's commission program I put timing levers in the plan to reward sales that closed earlier in the year. So deal multipliers (the percentage of total contract value) that the sales team was paid for closed business was incrementally higher in Q1 vs. Q2, Q2 vs. Q3, etc. Voila, the sales team cranked it up (being the coin operated machines that they were) and we closed more business earlier in the next year. Sales plan alignment with business EBITDA goals is low-hanging fruit for improving your cash picture.

Compress the time to billing.

This one should drive every MSP CEO crazy. You find a prospect. Unveil their IT pain. Create a vision. Propose a solution. Establish trust. Discount your pricing. Pummel your competitors. Haggle with legal. And then a miracle happens—six to nine months later, you've won the business! Then you get some bad news: Your implementation team or project office is backed up. You can't possibly get them up and running for another 60 days. Or the customer's project lead is taking three weeks off to go climb a mountain—so the customer won't be ready to roll for another month. So far, six to nine months into the relationship—all cost and no cash.

The solution: First, you can't improve what you don't measure. Add a "time to billing" (T2B) performance metric to your team's management objectives. T2B is a simple measure of elapsed time between the day the customer signs your contract and the day you send the first bill to them for monthly recurring services. Longer T2B means lousy EBITDA.

Once you start to measure T2B performance, start doing things to reduce it. Refine communication between sales, the project office, and engineering. With the types of long sales cycles that MSPs live with, there should be no surprise wins. There is zero reason that it should take weeks or months to complete an implementation and start billing a new customer. Get the engineering kick off meeting moved up to the day after the ink dries on the contract. Tighten up sales accountability for reserving and planning implementation resources.

Buy from EBITDA–friendly vendors.

I keep three simple vendor engagement rules:

1. Don't treat me like an enterprise customer, i.e. bank, hospital or manufacturer.
2. If you take the time to understand the MSP business model, then I will give you all the time you need to tell me your story.
3. Structure your partner proposition to generate EBITDA for me!

I can't tell you how many times a vendor worked through Phil's Rules #1 and #2 only to flail at Rule #3, the EBITDA finish line. We'll establish a trusted relationship, agree on a proposed solution and then the vendor/partner blows the whole thing up at the finish line with EBITDA-destroying economic terms.

The solution: Your new vendor/partner certainly has the right to make money. They don't have the right to make it all up front—especially when most of your MSP contracts are based on monthly recurring payments. Be clear with prospective vendors early on in the sales/purchasing process that the business will not incur substantial risk and negative EBITDA by paying the entire cost for a new system up front.

If you are crafting an RFP for a major expenditure, publish EBITDA-friendly economic terms as a "must perform" requirement to win the business. Share your MSP contract terms with your vendors. Expose them to the way you take in cash. Tell them to align their requested cash outflows as closely as they can with your contracted cash inflows. Again, be ready to "give to get." Accept a slightly higher per unit price in exchange for more favorable EBITDA terms. Good MSP sellers get this MSP business model. Seek them out and reward them for doing business is a way that grows your business valuation.

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