eBOOK

Software Pricing PARTNERS

Burning Through Growth Potential

Why software investors should pay attention to monetization—the underexploited key to value creation.

Software Monetization Is Overlooked

OR UNDEREXPLOITED IN MOST VALUE INVESTING PLAYBOOKS

Yet it's one of the most powerful plays investors have. A focused, disciplined monetization strategy—including licensing, packaging and pricing—drives top-line growth and valuation by improving salesforce performance and revving up deal velocity. It boosts EBITDA by keeping price aligned with customer value as usage scales, enabling companies to sell deeper into accounts with bigger margins.

WHY IS **MONETIZATION** SO POWERFUL?

15 - 20%

Of software revenues are being vaporized by unnecessary discounting alone

Fixing just the discounting problem will drive growth. Imagine a $12M company (with a 5% churn rate) recaptures 50% of the money being lost through unnecessary discounting. At the end of a three-year holding period, EBITDA will be up by $1.25M. If during that time the company goes beyond the quick fix to improve overall monetization strategy, the EBITDA gain could double.

The reason so many software companies are burning through growth potential isn't usually a salesforce problem. Often, we've found, it's because the company chose the wrong software licensing model—everything is derived from there. This is causing packaging and pricing complexities, and misalignment between how the company delivers value and how customers perceive it. The salesforce can't defend value when presented with all kinds of exception use cases that seem to justify discretionary discounts.

And that's not the biggest drag on growth and EBITDA. Burdened with a poorly constructed or incorrect licensing model, the software company's executives are doomed to expend tremendous amounts of time and energy going round and round, trying to understand and solve the resulting tangle of operational problems. ***Now that's really burning potential.***

This ebook will show you how to address monetization in two steps—a huge opportunity to unleash the potential of your investments.

Any activity that burns up a company's growth potential reduces an investor's ROI over the life of that investment

"Improving sales and pricing is the most efficient short-term lever for increasing the valuation multiple and the top line." [1]

"Pricing affects profits more than any other factor…weak accountability and discipline around price setting and discount management can cripple profitability." [2]

1 "Cracking the Code in Private Equity Software Deals" Boston Consulting Group, May 2017
2 Global Private Equity Report 2017, Bain & Company

The Earlier You Improve Monetization
THE MORE VALUE IT CREATES

YOU'RE INVESTING IN SOFTWARE COMPANIES WITH STEEP GROWTH CURVES.

The question is:

Across how much of that growth curve is the company generating maximum value?

Nothing is more fundamentally important to software investors than maximizing value creation across as much of the growth curve as possible. Even when you're investing in early-to-market category leaders, you know these companies are ultimately competing for a finite number of customers. As competitors pile in, pricing and margin pressures bear down. At that point, the effects of a poorly chosen licensing model and suboptimal packaging and pricing start to be seen. They show up in slowing revenue growth, shrinking margins and missed profit targets.

"Successful software businesses often are so profitable that management teams may not aggressively optimize costs, operating efficiencies or revenue models. This leaves room for experienced investors to step in, restructure or refine and improve performance."

Global Private Equity Report 2017, Bain & Company

To generate more value across more of the growth curve and your holding period, address monetization in two steps. It's a similar approach to what you're probably already doing with operating costs: targeted cost reductions followed by sustained cost transformations.

MONTH 1

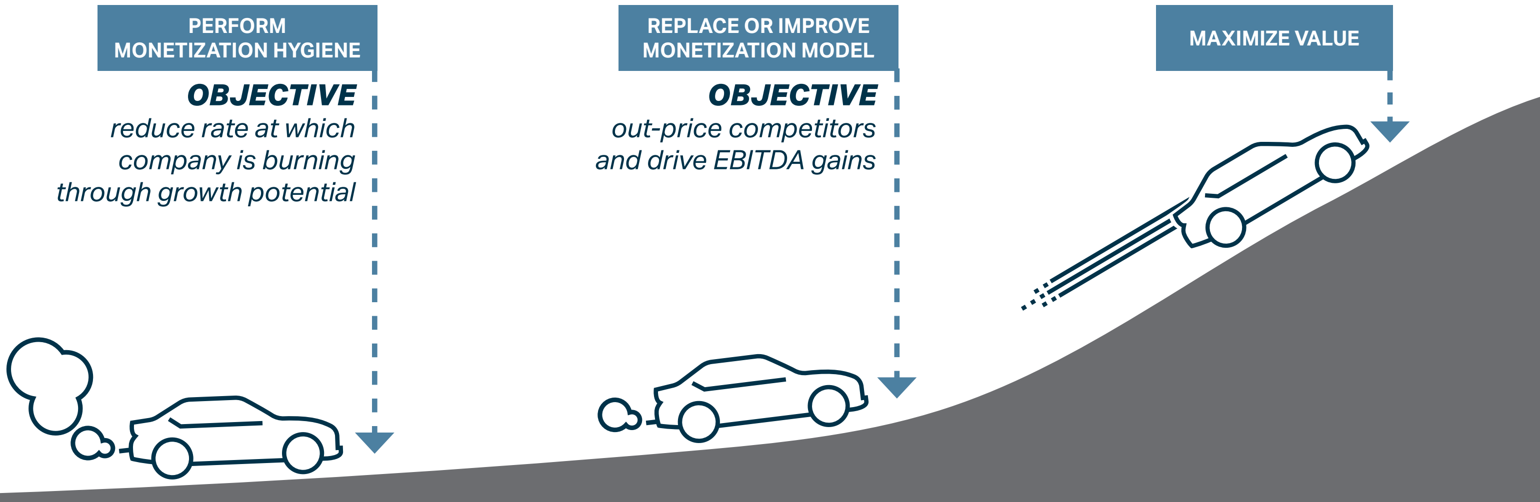
Clean Up the Growth Engine with Monetization Hygiene

Slow the rate at which the company is burning through its potential customers and revenue with a series of quick fixes to the flawed monetization model. These often include standardizing a grandfathered pricing approach for current customers, standardizing surcharging/discounting behavior and eliminating pricing discontinuities.

MONTHS 2 - 6

Replace the Current Growth Engine with a More Powerful Model

Successful monetization enables software companies to out-price competitors instead of underpricing them. It aligns licensing, packaging and pricing with how the company delivers value and its customers perceive it. The new monetization strategy equips marketing to position products effectively, and enables everyone from the executive team to the salesforce to consistently convey and defend value. It's bullet-proof against the gaming of pricing models and buyer discount strategies. It also creates a dynamic forward-looking framework to guide product roadmaps, providing earlier visibility into market and profitability fit.



Out-price Competitors

BY OUT-ANALYZING, OUT-THINKING AND OUT-EXECUTING THEM

To transform a company's monetization engine—efficiently with minimum risk—get help from monetization professionals with plenty of experience in the unique challenges of software products and markets. Most software company executives have, at most, been through two or three pricing projects. We've been through hundreds, bringing them from start to successful finish.

Here's a "satellite view" of our process:

OUT-ANALYZE

Beyond simply rolling up data, there's much to be discovered by analyzing a software company's transactions in detail. We use statistical tools to reveal patterns of value delivery and sophisticated demand models to quantify price elasticity. Through these analyses, we develop a deep understanding of how customers use products and perceive value, and what's changing. More information comes from a qualitative analysis of interviews with customers, customer-facing employees and competitors' customers—uncovering insights no algorithm could ever reveal.

OUT-THINK

There are hundreds of ways to license software, including proven patterns and yet-to-be invented approaches. Choosing one is a critical decision since it directly affects the revenue stream and steers packaging and pricing, which affect revenue as well. The right licensing choice can transform a confusing pricing strategy that adds friction in the sales process into a simpler approach that helps customers assess value and encourages them to buy. A good licensing model that scales naturally with increasing usage and value also helps customers forecast needs and costs going forward. It reduces perceived purchase risk and increases subscription renewal rates.

OUT-EXECUTE

Execution can be anywhere from one-half to two-thirds of the software monetization process. Since monetization touches nearly every area of operations, implementation prowess and a proven methodology for change management are essential. The methodology must help the executive team triage issues, arrive at consensus and exert leadership. Implementation must also take into account the changes that need to happen across multiple internal functions and how the new monetization model will affect the company's ecosystem of partners, affiliates and resellers.

Beliefs vs. Evidence

What software executives believe is happening doesn't always line up with what is really happening. Here's an example from a recent client engagement:

Belief

The management team believed that "surcharges and discounts balance each other out." This belief was superficial because it was based on aggregate data from reports and dashboards.

Evidence

Digging deeper, we found that the belief was true for the core product, but large discretionary discounts applied to an add-on product and to implementation and professional services were throwing the balance way off.

Because of this erroneous belief, the $50M company almost chose a very risky strategy (raising prices) and would have missed out on the immediate upside opportunity to recapture $250K+ per month in lost revenue (per monthly customer cohort).

Recognizing this reality, the company began to exert more control over structured incentives and discretionary discounts. As a result, they're now on target to recapture $2M+ in realized growth potential in the first 12 months.

This recapture plan has been constructed around a salesforce that previously used price negotiation as its main lever to win customers. While the company had some pricing elbow room in relation to competitors, it was going to be very tough initially for this relatively inexperienced salesforce to defend value at higher prices.

By implementing a smarter monetization model, combined with a phased roll-out approach, the company is well-positioned to raise prices later. Once the salesforce has learned how to better convey and defend value, sales promotions and discount levels can be adjusted to further increase growth, and boost EBITDA and valuation.

Monetize

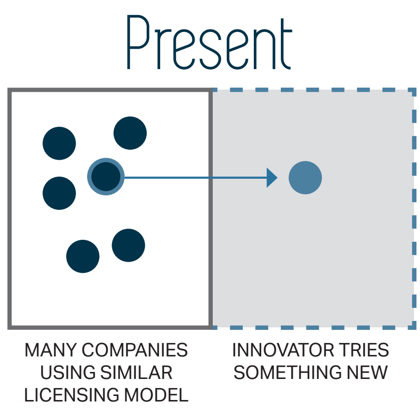
FOR WHERE THE MARKET'S GOING

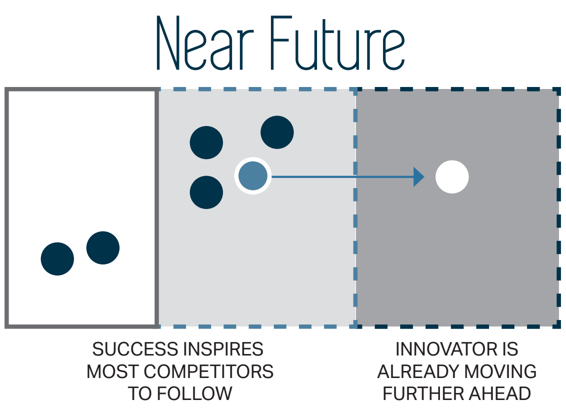
The ice hockey adage about skating to where the puck is going applies to software monetization too. Yet many software companies make licensing, packaging and pricing decisions based on what's been done in the past. Execs default to their previous experiences. Choices are often heavily influenced by, if not copied from, competitors.

But since tech and tech users are always changing, making monetization decisions based largely on what's been used in the past may not be a winning approach.

When Software Pricing Partners takes on a new project, we have hundreds of licensing/packaging/pricing patterns to draw on. We know what works in different market, usage and customer purchasing contexts. But our monetization methodology—especially the interviews we conduct—also elicits new ideas. Our approach is both a rigorous analytical process and a creative one. It enables us to uncover hidden relationships in quantitative and qualitative data, and play with metrics, packaging, and possibilities across software product portfolios until we find, or invent, the best solution.

WHAT IF COMPETITORS COPY YOUR MOVE?





YOU SHOULD BE SO LUCKY

Software companies that successfully innovate monetization always have followers. Word travels from delighted customers, forcing competitors to respond. But wholesale copying never works well because a good monetization model is developed around how the innovator delivers value and other details of its business model. By the time competitors figure out how to make the model fit their own circumstances, the innovator is miles ahead, evolving monetization to where the market is going next.

We've Been Doing This for Decades

As the software industry evolved from unpredictable capital expenditure models through floating licenses, concurrent user models and SaaS, we've been a consistent voice for progress. Our pricing strategies have helped open vast possibilities for software companies to create and charge for value.

Today we're still coming up with new ways to monetize. We helped one of the largest telecom companies make the first move in their market from hardware pricing to charging for software ("servers are free"). For another client, we helped them shift pricing away from the mobile industry norm of charging for clicks to user engagement ("clicks are free"). Right now we're engaged in a highly confidential project to help a client reorganize around a new licensing model so simple and powerful, it's bound to delight customers (and derange competitors), fueling the company's next surge of growth.

Ride the Growth Curve Like Rails

With the implementation of a strong monetization strategy, software companies have an advanced propulsion system for not only driving growth, but creating more value all along the growth curve. As an investor, you can help companies upshift to this more powerful growth engine.

Well-conceived and executed monetization unifies organizations and investors around how the company is delivering value and how customers are perceiving it. Everyone understands how the next release or product fits into the strategy for driving revenue and profit.

Friction between the software company, its salesforce and its customers and prospects vanishes, so more deals get done faster. The revenue engine really cranks. Potential turns into more revenue, stronger EBITDA and higher valuation.

Software Pricing
PARTNERS

To start realizing the full growth potential of your investments, contact Software Pricing Partners at **704.765.2399** or visit **softwarepricing.com.**