eBOOK

SoftwarePricing PARTNERS

How To Price Software

THE FUNDAMENTAL ELEMENTS TO EFFECTIVE SOFTWARE PRICING

Figuring out how to price your software is often considered the root canal of business because both are painful and can lead to downstream complications. However, both the pain and the complications of either procedure can be mitigated – if not avoided altogether.

We won't lie and tell you software pricing is easy and painless. It isn't. How to price your software takes work, but many companies make it harder than it has to be.

Software pricing can also be painful because it requires change, explicit decisions, and often exposes an organization's weaknesses. But easy or hard, software pricing has to be done if you want to get paid. Do pricing well and you will be paid well, too.

What Role Does Price Play?

Price plays many roles. On the face of it, price allows a prospect who is in the information-gathering phase of your sales process to decide if your offering will fit within budget and should be considered. In the later stages of your sales process, price is just one of the many elements a prospect uses to select a vendor.

THE AMOUNT YOU CHARGE CAPTURES EVERYTHING A PARTICULAR OFFER REPRESENTS, INCLUDING YOUR PRODUCT'S IMPACT ON REVENUE, ASSOCIATED RISKS AND COSTS.

How you decide to package your products and/or services for different kinds of customers is called your Offering Model. The amount you charge captures everything a particular offer (i.e. Basic, Professional, or Enterprise) represents, including your product's impact on revenue, associated risks and costs.

Therein lays the challenge. If you want people to consider the amount you want them to pay for your offer, then you must make sure they understand what they are getting for their money. That's why it is important to highlight differences that are significant to the customer including: product features, service delivery, quality, reliability, future capabilities on the product roadmap and more.

Many customers also take into account intangibles such as your company's reputation, business practices, people involved pre- and post-sale, references, and your website experience.

PRICE SENDS A POWERFUL MESSAGE

Since the amount you charge for a particular offer, in other words the price, captures "everything", it also sends a message. If a prospect thinks the price is too high on the value you deliver, your price and company may be perceived as unreasonable. Similarly if your prices are too low, people may wonder what's wrong with your product or whether your company will survive.

When your offers and the amount you charge fit together, and your prospect understands the value delivered, you will probably hear feedback on the sales front that include "reasonably priced", "good value for the money", or even "it's a little on the high side".

Getting the price you want is more likely when you support it with information about the value of your offers and the critical differences between your offers and the competition.

Clarifying Terminology

To avoid confusion about list vs. net price, we use the term "Pricing Model". This allows us to deal with the setting of list prices separate from creating various types of discount incentives. In other words, a **Pricing Model** has both the amounts you charge and the incentives you create to encourage prospects to buy your solutions.

A PRICING MODEL INCLUDES HOW LIST PRICES AND DISCOUNTS ARE COMMUNICATED AND PRESENTED TO PROSPECTS.

In addition to the tactical activities that establish list prices and discounts, the Pricing Model also includes the rationale behind how prices scale with volume, why promotional discounts are offered, and how to implement and administer prices and discounts.

Beyond the tactical, a Pricing Model also includes how list prices and discounts are communicated and presented to prospects – from initial consideration to purchase through upgrades and purchase of additional offers.

WHERE NOT TO FOCUS, INITIALLY

Since many pricing consultants confuse the setting of list prices with a Pricing Model, they tend to focus too heavily on answering the "how much" question. An effective Pricing Model starts instead with a clear understanding of the end user, the buyer, and the buying process.

Some of the first questions that should be answered before fiddling around with prices are:

- How will your products and services be used and by whom?
- What else needs to be in place to realize the benefits of your offering?
- Who else needs to understand the value delivered whether they approve or participate in the purchase?

In summary, don't just look for "the number" because other systemic issues may need to be addressed. Your objective is to first explore all aspects of how your customers achieve value with your solutions so you can fully communicate the right message to the right audience. This will help them understand how their economic lives will be better and why the prices you develop later in the process make sense.

Where Does a Pricing Model Fit?

Companies have problems when they try and develop a Pricing Model because it is complex and intertwined with other activities. Furthermore, today's Pricing Model needs to continue to work well over time as the company and its offerings evolve.

This is especially problematic with software companies because most of the Pricing Models they develop work for only a short time.

To make sure the Pricing Model works over time, integrate it into a more comprehensive **Monetization Model.** Such a model separately addresses how products are licensed and what is being delivered before getting into pricing.

If you haven't defined the offering or how you are going to charge for it, how can you determine the amount a customer should pay?

Note: If the firm you are thinking of hiring isn't familiar with more mature monetization concepts, you're most likely going to be paying for a short term fix to your pricing problems.

ONE SMALL PIECE TO THE PUZZLE

A PRICING MODEL IS ONLY AS EFFECTIVE AS THE OTHER PARTS OF A MONETIZATION MODEL: THE LICENSE MODEL AND THE OFFERING MODEL.

The **License Model** is the most fundamental structural part of a Monetization Model and consists of two elements:

1. Value metric: what captures value and how value scales.
2. License terms: usage and deployment rights, what's included in the price, and payment terms and timing.

The other structural element of the Monetization Model is the **Offering Model** that deals with how products and services are configured and offered to your customers. Different levels of product functionality may be offered separately or bundled in with different levels of services.

Once you have built the License and Offering Models, you can tend to the Pricing Model where list prices are set along with promotional or volume discounts. Done properly, your overall Monetization Model will be unique since your company is unique in its offerings, people, and available resources.

WHY MONETIZATION MODELS ARE IMPORTANT

The components of a Monetization Model determine the number and types of customers and the size and volume of sales transactions. The Pricing Model primarily affects the sort of customers you attract and will therefore influence the cost to serve these customers. The License Model and Offering Model affects customer acquisition and retention, cashflow, and the sales effort – including getting the prospect to understand the value your offering delivers.

Because a Monetization Model affects both revenues and costs, it will also affect the amount of capital needed to fund the time delay between when cash is spent and when it is received.

An effective Monetization Model also makes it easier to raise capital since you are more likely to hit higher levels of revenue more quickly.

Should Cloud, SaaS & Mobile Affect How You Price Software?

New delivery mechanisms and platforms affect how value is delivered and should have an effect on different parts of the Monetization Model. SaaS and Cloud delivered applications offer the cost advantages of a shared-cost data center. Mobile applications provide added value because there is easier and convenient access to applications. Mobile applications also enable an application to communicate with the mobile user.

With respect to payment terms in the License Model, many cloud-based and mobile applications are licensed on a subscription basis. Subscription payments also include updates and often some level of support.

When a License Model changes so customers can pay over time – as a subscription or as a pay-as-you-go/pay-per-use basis – you are likely to attract different types of customers. Some customers who were turned off by a large up-front payment may be attracted to the lower price points of periodic payments. These customers are willing to trade up-front payments for costs that are greater as smaller ongoing payments accumulate over time.

THINK CHUNKS

Often cloud-based products are packaged in smaller "chunks." This may be in the form of bundles of functionality that better meet customer needs or purchase increments that are more granular (e.g. buying "seats"). In addition to the smaller-sized cash outlays, customers are more willing to pay for functionality or units they think they need now or in the near future. In effect this also eliminates customer resistance to paying for what they don't need.

While a Monetization Model still needs to be developed carefully, the Offering Model and the Pricing Model need to be adjusted to reflect the added value of subscription payments and an offering consisting of smaller packages that can be purchased in smaller quantities.

Do You Really Have a Pricing Problem?

Indeed poor pricing can cause many sorts of problems, but a change in price level or pricing page may not address the root cause. In fact, changing these may aggravate the problem.

Software companies succeed when their Monetization Model does a good job of aligning:

1. Product and services
2. Target customers
3. Distinct competitive advantage
4. Costs

Misalign any of these elements and you will generate less revenue in aggregate or on a per-customer basis and spend an inappropriate amount of money doing so.

BE CAREFUL OF JUMPING TO CONCLUSIONS

If you are experiencing a pricing problem, don't jump to the conclusion that your price levels are wrong. If you use a Monetization Methodology to diagnose your problem, you may find the root cause of your problem is something other than the amount you ask customers to pay.

For example:

- ***Low revenues*** may be caused by too few customers because your License Model or your offering doesn't fit the way customers want to license, use or pay for an application. As a result, your price levels may by high relative to the value customers see or the available alternatives they have.
- ***Long sales cycles*** may reflect packages that are confusing, hard to understand, or do not seem to offer a strong competitive advantage. When you clearly understand what customers value and have a framework for making packaging decisions, your offers will make more sense and it will be easier to communicate the unique value your application delivers.
- ***Low customer lifetime value*** can be caused by low upgrade, upsell, or attach rates. If the functionality in higher priced offerings is out of whack, customers may not want to trade up. If your entry-level product is free and too rich with features, you may attract a lot of users but they may never convert to users that pay you money (a.k.a. customers).

In the classic (i.e. old) movie, Cool Hand Luke, one memorable line was "What we have here is a failure to communicate". With few exceptions, companies that experience these symptoms have a failure to communicate value to the right prospects or customers.

In other words, their Monetization Model is incomplete or broken — somehow the license metric, terms and conditions in the License Model combined with the packaging in the Offering Model doesn't fit with list prices and discounts inside the Pricing Model.

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