



3rd Annual ISA Management Division
Marketing & Sales Summit

Advanced Workshop
**Increase Hardware Margins
with Better Software Pricing**

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Today's Pricing Challenges

- Understanding and creating value for customer becoming a key success factor
- Customers want technology that adds revenue or subtracts costs -- sooner rather than later
- Knowledge of customer and business execution often more important than technology
- Pricing and packaging key to extending product life and recovering costs
- Solid pricing practices essential for dealing with intense competitive environment

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Workshop Topic Areas

- Pricing Foundation
- Software Pricing
- “System” Products

Introduction MarketShare

- Unique focus since 1987
 - Pricing software and systems
- Address client problems
 - Slow sales cycles
 - Money left on table
 - Chaotic/confusing pricing
 - Need to enter new markets / segments
- Results
 - Improve financial performance
 - Strengthen competitive position
 - Foundation for future growth

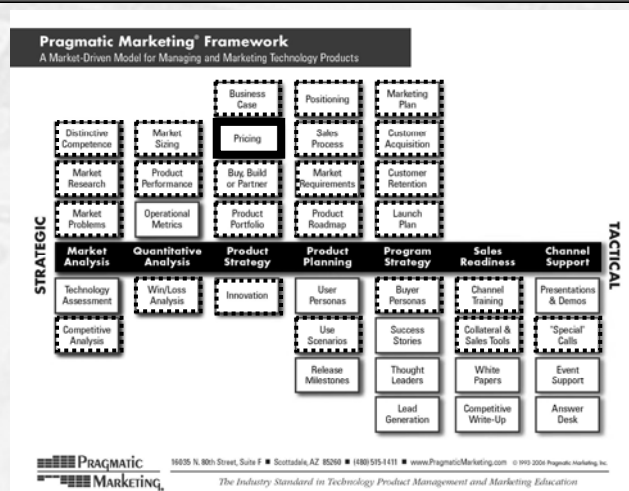
Introduction

Pricing Software vs. Other Products

- Business goals same
 - Revenue, cashflow
- Standard pricing fundamentals apply...
 - Customer value
 - Value relative to competition / substitutes
 - List prices, scheduled and negotiated discounts
 - Payment terms
- But software is different
 - Complex, highly differentiated
 - Scalable, configurable
 - Licensed not sold
 - Low / no COGS – high discounts!

Introduction

Pricing Is Pervasive



Introduction

Common Pricing Mistakes

- Follow the leaderless crowd
 - Everyone watches what the others are doing
- Cost-plus pricing
 - Not linked to customer value
- "Fruit-salad" pricing
 - Too many pricing exceptions
- "One-size-fits-all" pricing
 - Overly-simple, inflexible pricing
- Channel mismatch
 - Channel skills vs. vendor needs vs. economics
- Pricing for share
 - Not enough margin from low prices
- Product-centric pricing
 - Ignoring role of services

Introduction

Pricing Is Not Just A Number

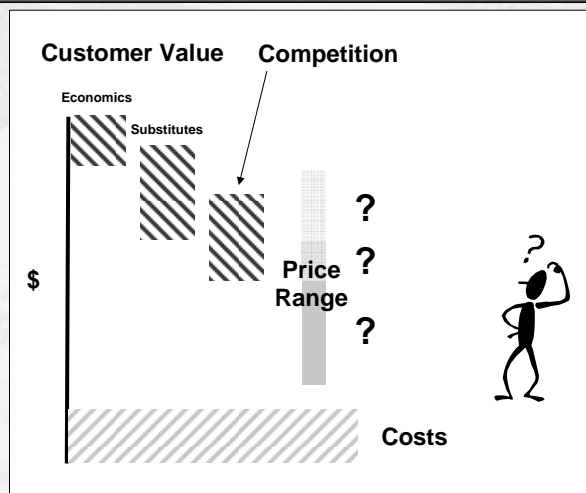


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Workshop Topic Areas

- Pricing foundation
 - Software Pricing
 - "System" Products

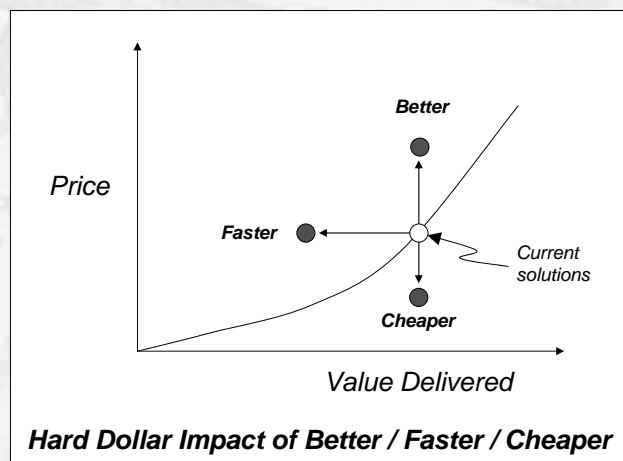
Setting Price Level



Pricing Foundation

- Customer Value
- Competition
- Costs

Customer Value Monetize Value Delivered



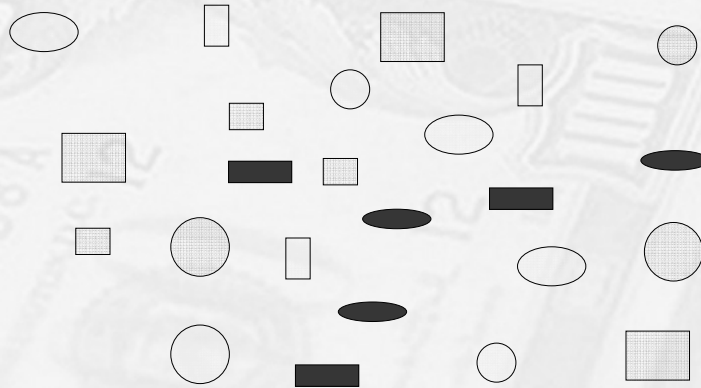
Customer Value **Engage Customer**

- **Customer view of their business**
 - Revenues, growth, profits
 - Customer acquisition, retention
 - People, product, production
- **Problems that need to be solved**
 - Means, methods, processes
 - Where product fits
 - Different segments
- **How product will be used**
 - Personal vs. group use
 - Transaction vs. continuous use
 - Sporadic use vs. frequent use

Customer Value **Key Questions**

- **Design**
 - What problem are you trying to solve?
 - Who has the problem?
 - Is the problem growing or shrinking?
- **Pricing**
 - Who will pay to solve the problem?
 - How much will they pay?
 - How much will go into the bank?

Customer Value
Sort / Match Features, Use, Usage



Customer Value
Benefits and Costs

- **Benefits of product use**
 - Faster time to market
 - Increase number of customers
 - Decreased downtime
 - Labor, material savings
 - Fewer product rejects
 - Less training
- **Costs of realizing benefit**
 - Management time
 - Conversion time, costs
 - Facility changes
 - Training
 - Lost time
 - Product acquisition
 - One-time vs. ongoing

Customer Value

Economic Impact – High Level

Supply Chain Execution solutions from <co. name> boost efficiency, cut costs, and delivers extremely rapid return on investment. Using the our products, specific savings and benefits include:

- * Reduced labor costs for data entry.
- * Reduced material handling costs and increased productivity.
- * Increased inventory accuracy.
- * Reduced standing inventory.
- * Elimination of product loss from expiration.
- * Real-time ERP integration.
- * Improved customer service.

Additional benefits include extensive lot tracking, reduced training time for new employees, and the ability to optimize warehouse space.

Customer Value

Economic Impact - Quantified

Engine Manufacturer saves nearly \$3 million in test cells
Industrial Component Manufacturer produces \$1,000,000 net benefit
Major Engine Manufacturer increases uptime saving \$12 million
Bearing Manufacturer saves \$335,000 in parts spending
Foundry Operation sees 50% decrease in downtime
Component manufacturer reduces machine downtime by 50% saving over \$160,000 In first year
25% increase in Overall Equipment Effectiveness delivers consumer durables on-time
Major Remanufacturing Business saves over \$1.5 million annually
Manufacturer saves over \$1 million a year
Engine manufacturer saves \$126,720
Electrical distribution operation saves \$92,265
Manufacturer of household durables doubles output

Customer Value Economic Impact - Timeframe

- **More development output**
 - 1-2% more output
 - Typical project 12 FTEs @ \$100K/developer x 18 mos
 - \$12-24K/year
 - **Shorter time-to-benefit**
 - Shave 2-4 weeks off 18 month project
 - Typical project (above) \$1.8M
 - \$30-65K/year
 - 3-5% more revenues or cost savings
 - ROI of 2X in 3-5 years
 - \$25-40K/year (=3-5% x \$3.6M/4 yrs.)
 - **Start further down "learning curve"**
 - More mature code
 - 5-10% less debugging effort
 - Debugging = 5% project costs = \$90K (\$60K/year)
 - \$3-6K/year
-
- **\$70 – 135K Annual benefits**
 - \$12 – 24K Development output
 - \$55 – 105K Shorter time-to-benefit
 - \$3 – 6K Debugging
 - **\$100K One-time costs**
 - Technology insertion

Customer Value Economic Impact - Calculator

INPUT

STEP 1: Workplace and email environment

Number of employees with email

Number of workdays per year per employee

Average hourly salary per employee United States - Dollar

STEP 2: eMail usage

Ave. number of spam emails per day per employee

Number of seconds wasted with each spam message

STEP 3: Calculate the cost of spam

RESULTS

Total Corporate Cost of Spam		Cost of Spam for Each Employee	
LOST SALARY Yearly	<input type="text" value="6680.36 USD"/>	LOST SALARY Yearly	<input type="text" value="173.61 USD"/>
Daily	<input type="text" value="43.40 USD"/>	Daily	<input type="text" value="0.87 USD"/>
LOST PRODUCTIVITY Yearly	<input type="text" value="26.40 Days"/>	LOST PRODUCTIVITY Yearly	<input type="text" value="12.67 Hours per Employee"/>

Your ROI with Praetor

Your license pays for itself in 38 days or less

Pricing Foundation

- Customer value
- Competition
- Costs

Competition How Important?

- Inertia toughest competitor
 - Cost and impact of change
 - Incumbent always has edge
- Change creates opportunity
 - Need significant advantage
- Competitive considerations
 - Company
 - Product
 - Strategy
 - Resources
 - Pricing competence
- Be mindful of competition

Competition

Pricing Information

- **Good for understanding what customer sees**
 - Customary practices
- **Value of information**
 - Accuracy, timeliness
 - Different business objectives, resources
- **Ideal: Actual prices**
 - List – small customers
 - Net – published discounts
 - Negotiated – Hardly ever to never
- **Sources of price lists and discount schedules**
 - Published on web (e.g. educational, GSA)
 - “Phantom shoppers”
 - Consultants
 - Former sales reps

Competition

Sales Rep Information

- **Use with care**
 - Tactical perspective
 - Most recent deal
- **Biased**
 - Lower prices always better
 - Product deficiencies
- **Does have value**
 - Broad insights
 - One piece of puzzle
 - Help form view of competition
 - Understand customer behavior

Competition

Invoice Information

- Useful for repricing and add-ons
 - May be indicator for new product
- Actual price paid = street price
 - What neighborhood?
- Sales view of fair price
- Drill down for insights
 - Broad sampling
 - Account types, size
 - End of quarter spikes

Competition

Customer Information

- Understand value delivered
 - What are substitutes
 - What is good / not about competition
- Pricing perceptions
 - Competition
 - Comparables
- Don't ask direct questions
 - "Fair" price to pay for delivered value

Pricing Foundation

- Customer value
- Competition
- Costs

Costs / Cost Structure The Starting Point

Believe It or Not!

Your Costs Don't Matter
Except to You

Costs / Cost Structure

Cost Validation – Process

- **Estimate number of sales transactions**
 - Net price to make product revenues
 - Gross margin / contribution to overhead
- **Estimate associated costs**
 - R&D, promo, sales
 - Allow for profit and downstream investments
- **Do sanity check...**
 - Realistic? How achieved?
 - First time customers vs. switchers
- **Make numbers consistent**
 - Test (and adjust) price levels
 - Make sure revenues > costs

Costs / Cost Structure

Cost Validation – Example

- **Estimate number of sales transactions**
 - \$1M from 40 transactions @\$25K
 - Generates \$600K contribution
- **Estimate associated costs**
 - \$300K sales, \$100K R&D, \$100K promo
 - \$50K G&A, \$50K profit allowance?
- **Do sanity check...**
 - \$300K enough to generate 40 sales?
 - \$100K promo to generate 10 prospects per order?
 - \$25K net per order? Average? New customers?
- **Transaction detail later**
 - Product and modules
 - Number, type

Workshop Topic Areas

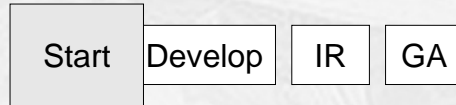
- Pricing foundation
- Software Pricing
- "System" Products

Software Pricing

- Pricing process
- Price metric
- Packaging
- Price levels

Pricing Process

Pricing from the Start

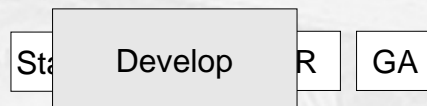


- **How product creates economic difference for customer**
 - Nature of value, order of magnitude
- **Transaction volume**
 - Customer segment(s)?
- **Business case* driven by transaction value (net)**
 - Transaction driven by mix of product “chunks”

* Reminder: Your costs / ROI don't matter to your customers

Pricing Process

Develop Pricing in Stages



- **Configure product**
 - What “it” is (main, options, modules)
- **Determine metric**
 - Choose what to control / measure (and charge for)
 - Charge for what you control / measure
- **Determine offering structure**
 - Chunks, bundles, upgrade paths
 - Drive pricing structure
- **Starting price levels (e.g. Qty 1)**

Pricing Process

Introduce Pricing to Sales



- **Economic value to customer**
 - Base + *differential* value
 - Quantify value of uniqueness
- **Volume-driven (scheduled) discount schedule**
 - Rationale
 - Roll-off, maximum
- **Set deal expectations**
 - Value, mix of product “chunks”

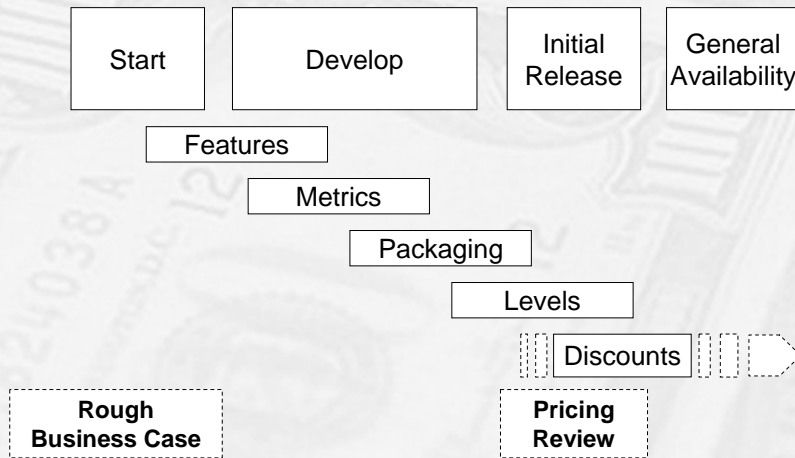
Pricing Process

Introduce and Monitor Pricing



- **Initial discounts**
 - One time, promotional
 - Segment focused
- **Price realization**
 - Watch scheduled vs. negotiated discounts
 - Market / customer feedback

Pricing Process Do Pricing in Stages



Software Pricing

- Pricing Process
- Price Metric
- Packaging
- Price Levels

Price Metric

Description and Importance

- **Grouping of features**
 - Packaging possibilities
- **How to charge**
 - Select from candidates
- **Strategic decision**
 - Determines flexibility
 - Long-lived

Price Metric

Selection Guidelines

- **Aligned with customer's business**
 - Path to revenue
 - Financial-enhancing usage
 - Revenue-generating users
- **Scales with value delivered**
- **Can be estimated for budgeting**
 - Accuracy less important
- **Should be "wired" into application**
 - License servers, keys
 - Transaction counters

Price Metric Business Alignment Crucial

per loan	+++	per user	+++
per patient	+++	per user	+++
per user	++	per user	+++
per user	++	per user	++
per user	+++	per user	++
per property	+++	per user	++
Per user	+	per user	++
per student	+++	per user	++
per user	++	per user	+
per customer	+++	per user	+
per user	+++	Per user	+
per user	+++	per user	+
per patient	+++	per user	+
per employee	+++	per user	+
per user	+	per user	+
per user	++	per ad	+++
per claim	+++	per bill	+++
per bill	+++	per claim	+++
Per gallon of fuel	+++	per customer	+++
per patient	+++	per employee	+++
per shareholder	+++	per employee	+++
per user	+++	Per gallon of fuel	+++
per employee	+++	per loan	+++
per user	+	per patient	+++
per user	+	per patient	+++
per ad	+++	per reservation	+++
per property	+++	per property	+++
per user	+++	per reservation	+++
per reservation	+++	per member	++
per employee	+++	per user	+
per member	++	per user	+
per user	+	per user	++
per user	+	per user	++

- Horizontal and vertical markets
- Sometimes aligned

- Vertical markets
- Aligned w/ customer's business

Price Metric Common Software Price Metrics

- “Client”
 - Person, device, connection
 - Copy (only one copy per user?)
- Use / transaction / record
- Location or entity
 - Unlimited use doesn't scale!

Price Metric

Hardware-Based Software Metrics



- Generally undesirable
 - Moore's law vs. Bloat's law
- "Computer"
 - CPU vs. Core
 - Server box vs. CPU in box
- CPU capacity tier
 - MIPS, MHz
- Special purpose HW
 - Instrument / controller / device
 - Maybe OK?

Price Metric

Other Price Metrics

- Salesforce (RightNow) – per rep per month
- Check scanning (Kodak) – per check
- Insurance (Allenbrook) – per policy
- Survey (Zoomerang) – per survey
- E-mailing (Constant Contact) – size of mail list
- Stock trading (Archipelago) – per trade / share
- Credit processing (Verisign) – % transaction
- Rights mgmt (Macrovision) - % revenue

Price Metric Use Easy-to-Estimate Metrics

	User-Based	Usage-Based	Time-Based	Location-Based
<p>Hard</p>  <p>ABILITY TO PREDICT LICENSE USE / COST</p>  <p>Easy</p>	Sessions	# Records Viewed	Day Pass Licenses	Project Team
	Concurrent User/Client	# Records Created	Monthly Licenses	Workgroup
	Named User	# of Transactions	Short-Term License	Department
	CPU locked	# Active Processes	Multi - Year Renewable	Site
	Seat-based	# Projects Stored	Perpetual	Enterprise

Software Pricing

- Pricing Process
- Price Metric
- Packaging
- Price Levels

Packaging and Value

Must Understand Use

- **What problem is being solved?**
 - Customer types
 - User types
 - Company types
 - Usage patterns
- **What are growth paths?**
 - More usage
 - New features

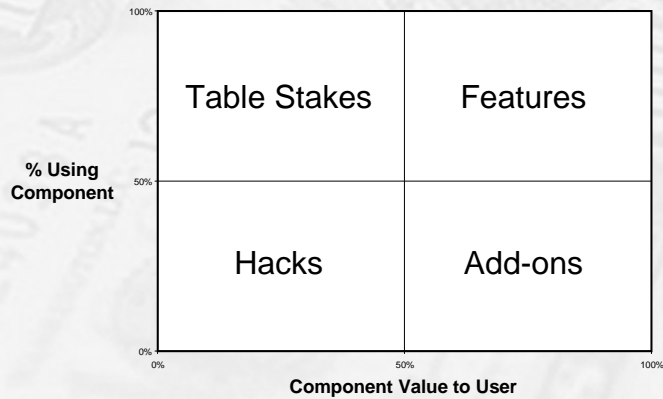
Packaging and Value

Assembling the Package

- **Basic issues**
 - What use cases are being addressed?
 - How are functions related?
 - What functions are popular?
 - Which functions will customers pay more for?
- **Narrowing the choices**
 - Broad vs. narrow appeal
 - Basic vs. premium offering
 - Add-ons and options

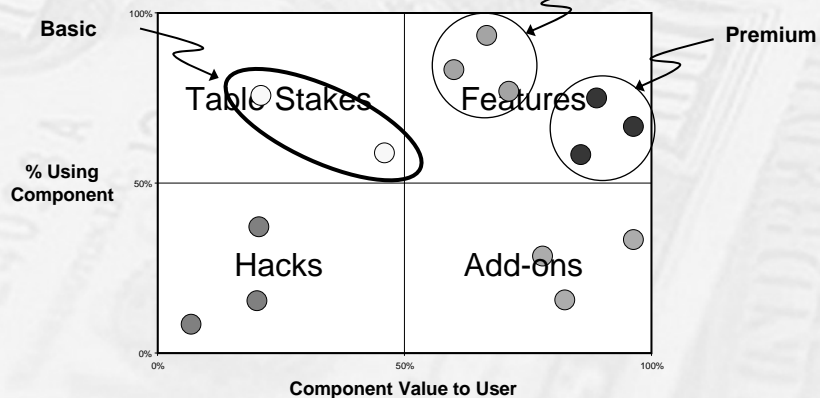
Packaging and Value Evaluation Framework

Usage versus Value



Evaluation Framework Define Products, Add-Ons

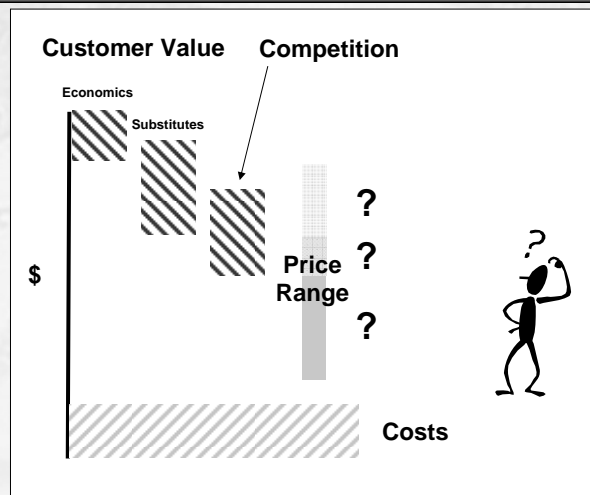
Usage versus Value



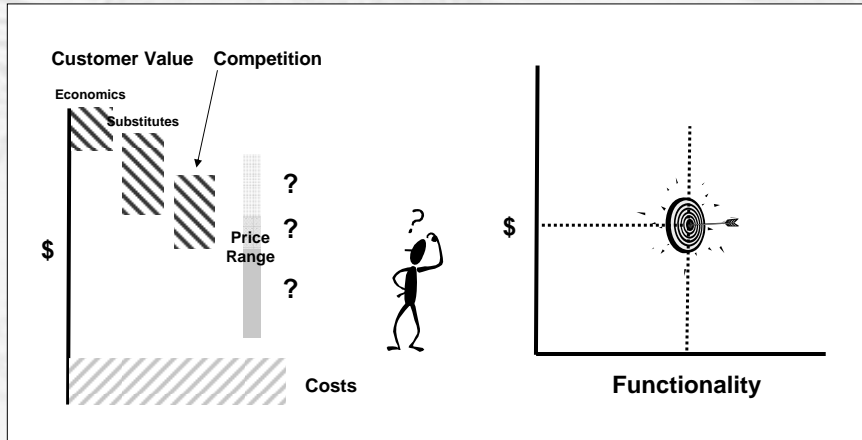
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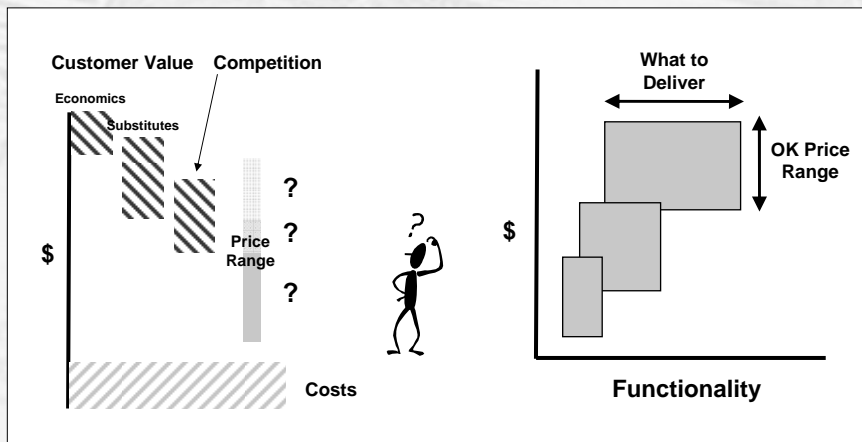
Setting Price Level



Price Levels Single Product Pricing



Price Levels Anticipate Product Family



Price Levels

Vector in on Price

- **Approach**
 - Set price for base / anchor product
- **Establish price for base / anchor product**
 - Single unit at list
- **Carefully set price level based on...**
 - Customer value
 - Competition
 - Costs
- **Set relative prices**
 - Members of product family
 - Modules
- **Adjust prices**
 - Strategy
 - Scheduled discounts

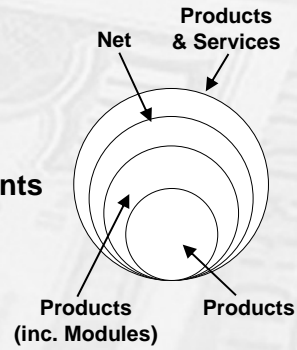
Price Levels

Get One Price Right

- **Approach**
 - Establish base / anchor product price
 - Set relative prices for other products
 - Module prices set relative to “their” products
 - Adjust prices based on market, strategy
- **Base / anchor product**
 - Single unit at list
- **Set price level based on...**
 - Customer value
 - Competition
 - Costs

Value to Customer
Set Price Based on Deals

- Few customers buy single products
 - Part of a deal
- Start with transaction
 - Net price received
- Separate transaction elements
 - Product vs. services
- Set levels for transaction elements
 - Share of transaction
 - Product(s)
 - Modules



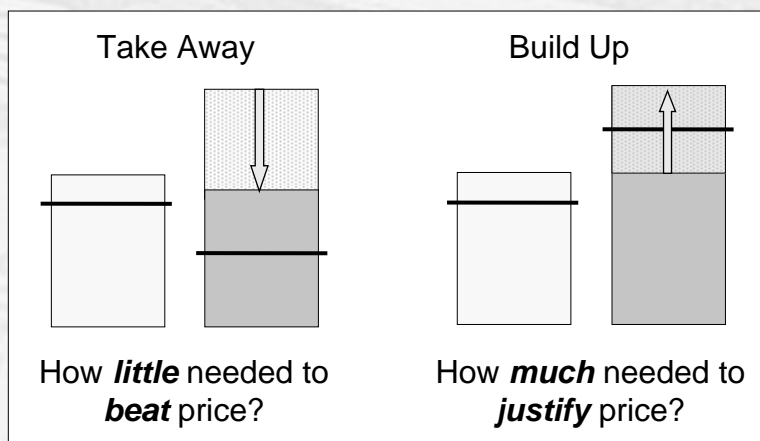
Value to Customer
Prices From Deal Scenarios

Deal Value Net	\$100K	\$200K	\$62.5K
Product % Deal Value	60%	50%	90%
Item X % Product Total	66%	80%	50%
Net Revenues - Item X	\$40K	\$80K	\$25K
Units - Item X	3 - 5	7 - 8	2 - 3
Net Price - Item X	\$8 - 13K	\$10 - 11K	\$8-12K

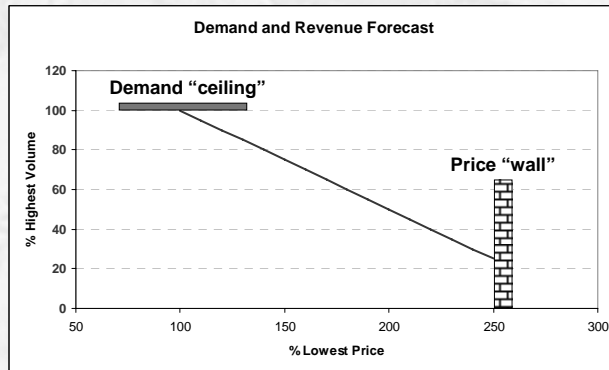
Value to Customer Economic Value Pricing

		<i>Notes</i>
1-year net value	\$200K	
Fast payback period	\$100K	Six month return
Target return	10X	Allow for mis-estimate
Value-driven price	\$10K	PV of product features
.....		
Lifetime net value	\$450K	Present value
Target return	10X	Allow for mis-estimate
Value-driven total	\$45K	PV of price
Annual price	\$15.0K	3 yrs. @ \$15K
Price for faster payback	\$7.5K	More sales?

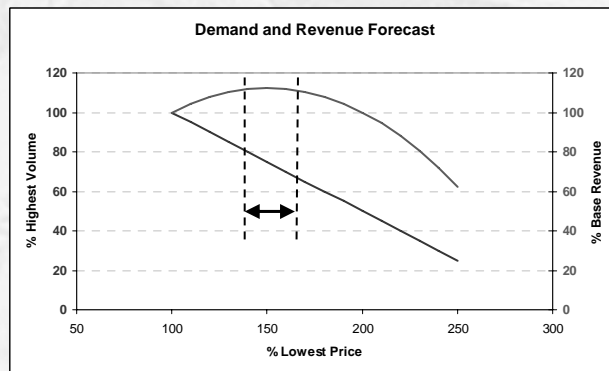
Competition Meet Price Using Packaging



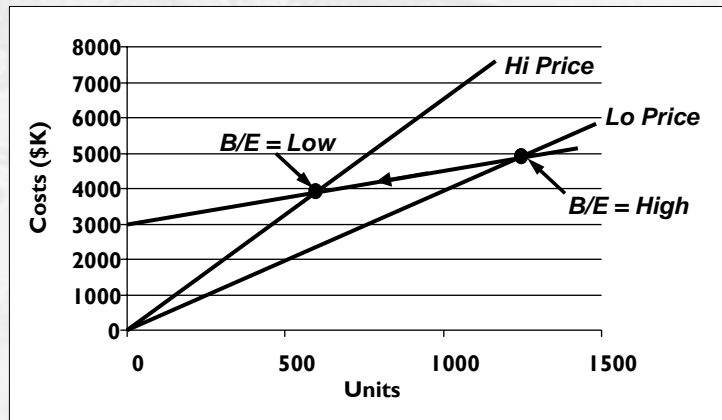
Costs / Cost Structure Estimate Demand and Revenue



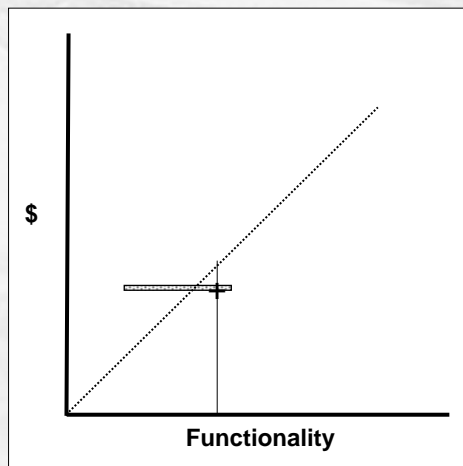
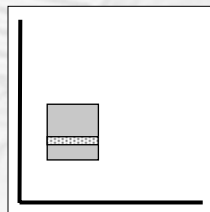
Costs / Cost Structure Estimate Demand and Revenue



Price Levels
Watch Breakeven Point

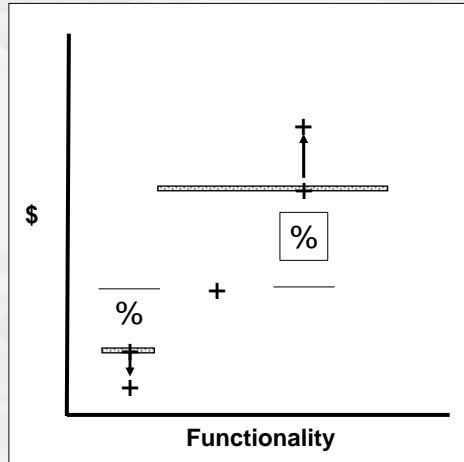
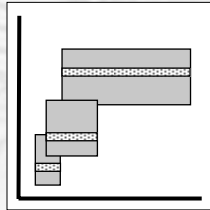


Price Levels
Finalize Base Features, Pricing



Price Levels

Set Relative Price Levels



Workshop Topic Areas

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System Products

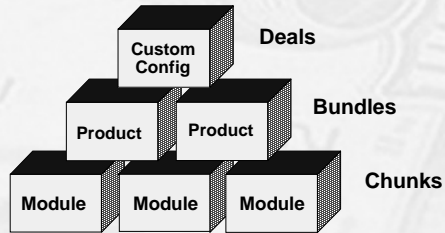
- **Avoid Complexity**
- **Set Discount Schedules**
- **Manage Discounts**

Avoid Complexity

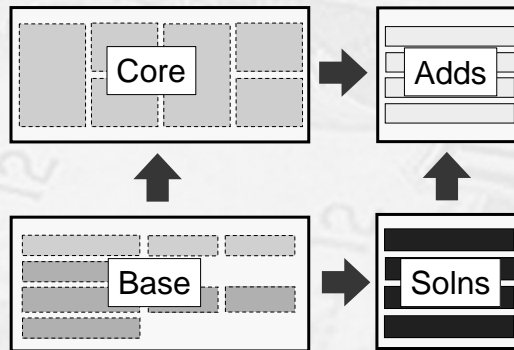
System Product Sale Is Complex

- **Hard to configure, quote**
 - **Sophisticated use**
- **Complex sales process**
 - **Drawn out decision-making**
 - **Highly competitive**
 - **Long sales cycles**
- **Complex transaction**
 - **Multi-element**
 - **Service intensive**
 - **Long-term**

Avoid Complexity
Packaging Is Key

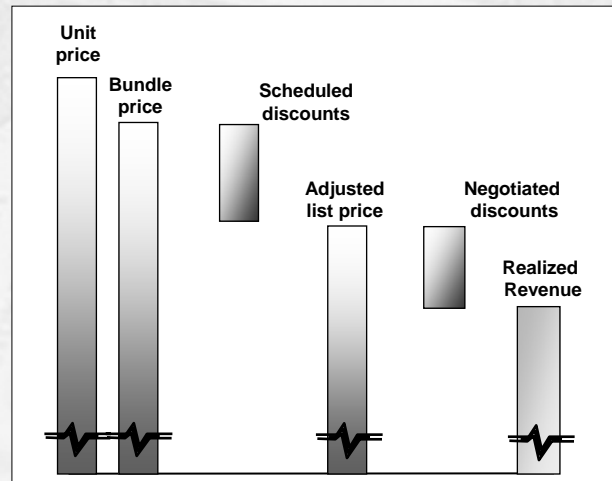


Avoid Complexity
Make Deals Easy to Configure



System Products

Focus on Realized Revenue

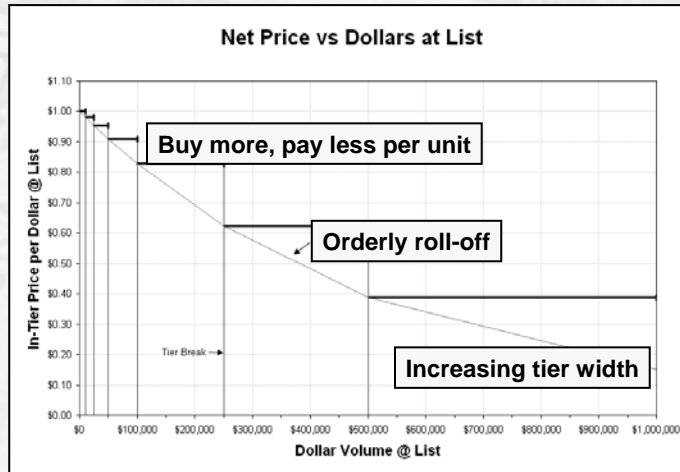


Set Discount Schedules

Basic Discounting

- Discounts are incentives
- Scheduled discounts
 - Customer must qualify
- Purpose of scheduled discount incentives
 - Standardized
 - Broadly applied
 - Easy to administer
 - Encourage specific buying behavior
- Volume discounts most common

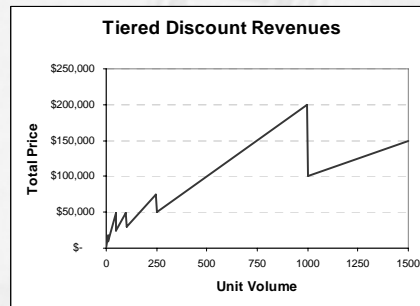
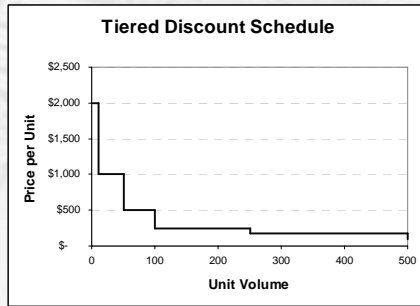
Volume Discounts Make Discounts Continuous



Volume Discounts Keep Revenues Continuous



Volume Discounts Typical Discount Schedule



Volume Discounts A Better Version

Tax-Table Discount Schedule

# Units	\$ Payment	+ \$/Unit
1 - 9	-0-	2000
10 - 49	18,000	1000
50 - 99	58,500	500
100 - 249	83,300	300
250 - 999	128,000	200
1000 +	278,000*	100

* Avg. price = \$278 (= \$278K/1000) which is 13.9% of \$2K list

Set Discount Schedules

Other Discounts

- **Introductory**
 - Focus on new product
- **Bundle**
 - Increase transaction value
- **Upgrade**
 - Trade-up, upsell
- **Segment focused**
 - Industry, customer type
- **Can be creative but...**
 - Discounts must be targeted
 - Clear business objectives
 - Fixed boundary markers
 - Policy driven

System Products

- **Avoid Complexity**
- **Set Discount Schedules**
- **Manage Discounts**

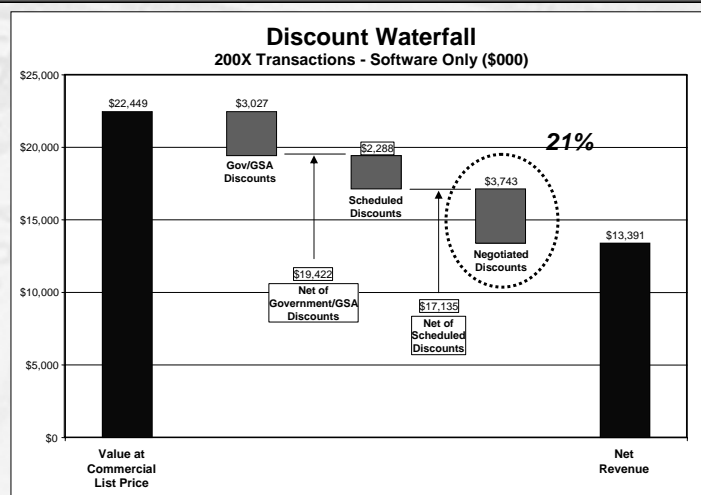
Negotiated Discounts Can't Manage "Discretionary"

... When it comes to the prices we pay, we study them, we map them, we work them. But with the prices we charge, we're too sloppy.

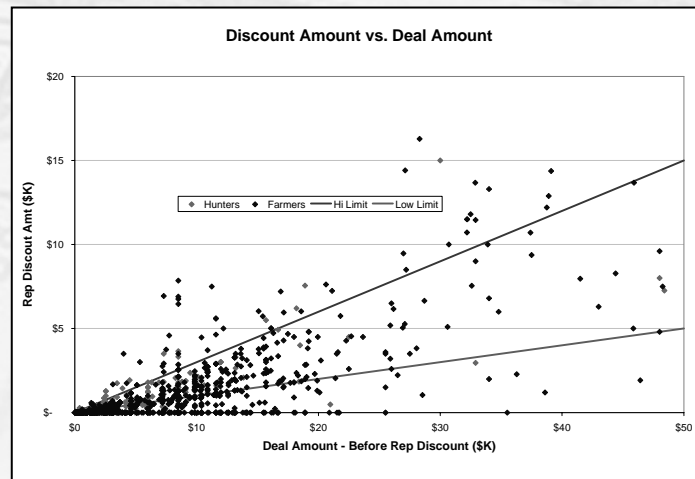
An analysis of [appliance pricing] found out that about \$5 billion of it is discretionary. ... there may be \$50 billion [total] that few people are tracking or accountable for.

Jeff Imelt, CEO, GE
Interview, Harvard Business Review June 2006

Negotiated Discounts Often Significant – Rarely Tracked



Negotiated Discounts Inconsistent (Unfair?) Deals



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Negotiated Discounts Necessary But Hard to Control

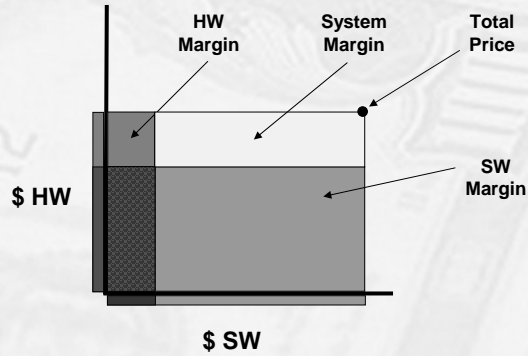
- Well trained customers and sales reps
 - Timing is everything
 - Hit the numbers
- Highly variable (by definition)
- Giving away more than needed
 - No information
 - No framework
 - No discipline?
- Erodes margins
 - Software giveaways

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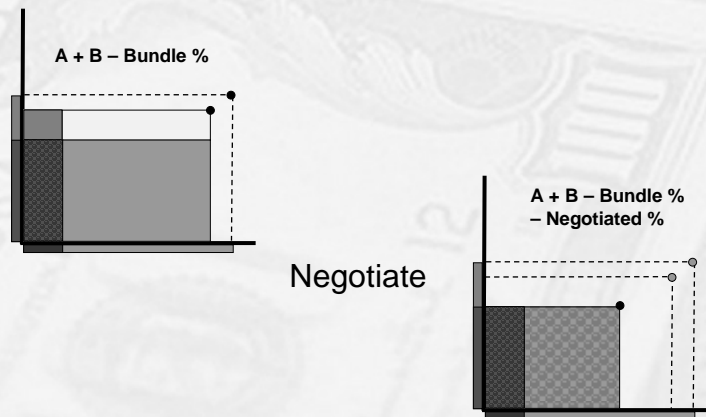
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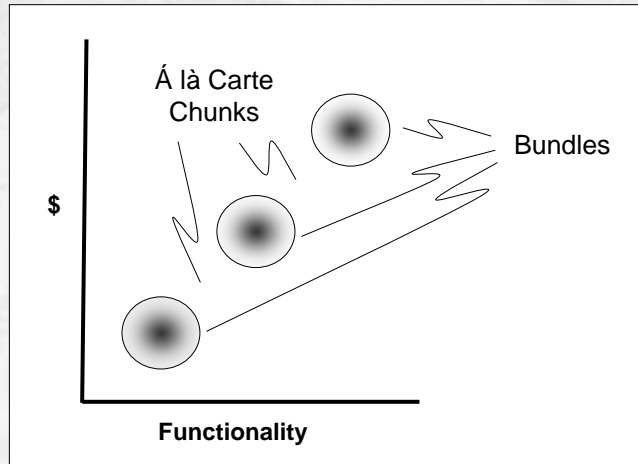
Manage Discounts System Product Margin



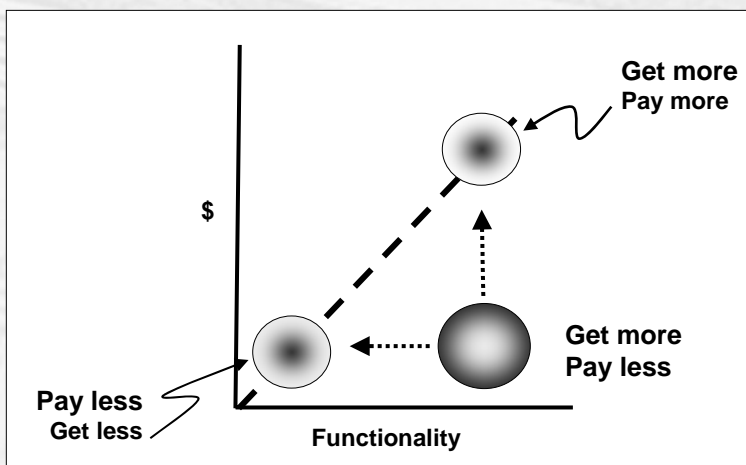
Manage Discounts From Bundle to Net Price



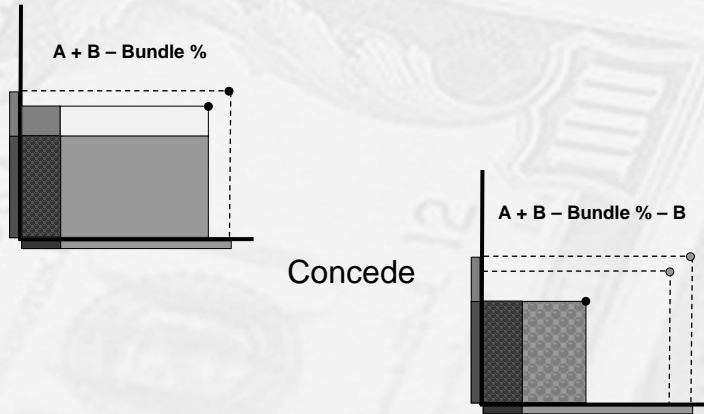
Manage Discounts
Packaging Helps Negotiation



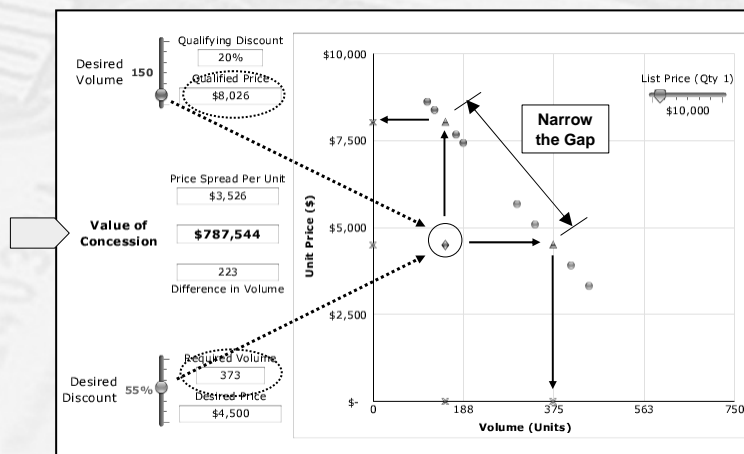
Manage Discounts
Negotiate Value Not Price



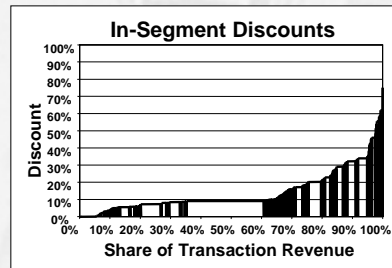
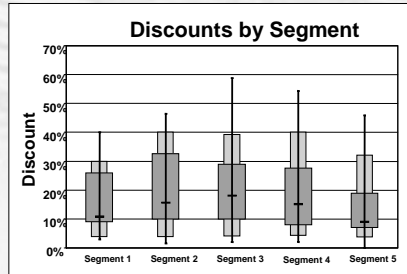
Manage Discounts From Bundle to Giveaway



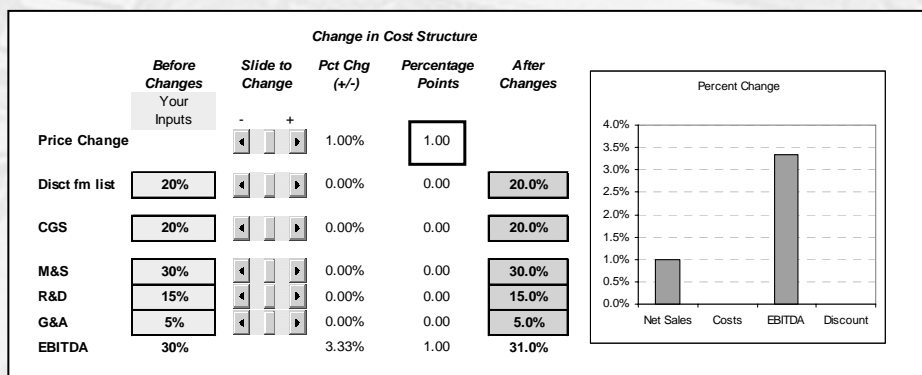
Manage Discounts Better Tools; Concede Less



Manage Discounts Track Where Discounts Go

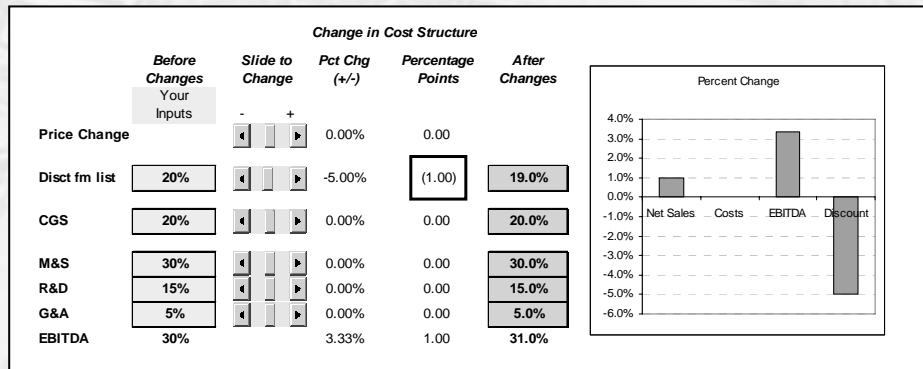


Wrap-Up Hard to Raise Price



3.3 % ↑ in EBITDA from 1 % price ↑

Manage Discounts Use Hidden Price Increase



3.3 % ↑ in EBITDA from 1 % discount ↓

WRAP - UP

Wrap-Up

Pricing Often Blamed

- Pricing alone doesn't cause product failures
- One of many mismatches
 - Package
 - Value
 - Customer
 - Price level
 - Metric
- This is a process failure
 - Development and customer loosely coupled
 - Pricing not in sync with development
 - Pricing reviews too few, shallow
 - Too little time, experience, information

Wrap-Up

Pricing Needs a Context

- Company objectives
- Company capabilities
- Product category and maturity
- Customer targets
- Competitive frame
-
- Can't be done in a vacuum

Wrap Up

Fundamentals Are Simple

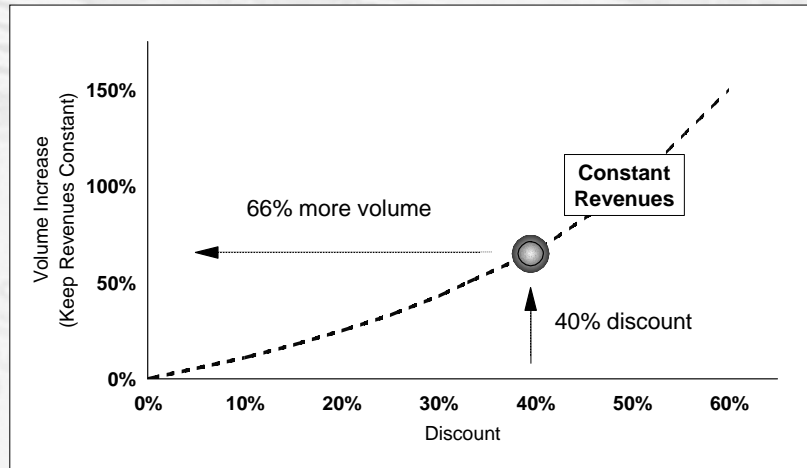
- Understand customer
- Watch competition
- Respond to market conditions
- Leverage your strengths
- Watch cashflow
- Don't leave money on the table
- Avoid suicidal markets

Wrap-Up

Keep Pricing On Track

- Align with customer value
 - Clarify value prop
 - Relate value to business drivers
- Improve decision quality
 - Price in stages
 - Tie into development cycle
- Make pricing easy-to-understand
 - Logical, consistent
- Ensure disciplined execution
 - Provide sales tools, training
 - Make pricing easy to administer
- Strengthen pricing process
 - New products and pricing updates

Wrap-Up Price Cutting Is Often Foolish



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Wrap-Up Pricing Is Worth Doing Right

- Increases revenue opportunities
- Reinforces value communications
- Shortens sales cycles
- Leverages development resources
- Decreases special pricing requests
- Lessens administrative burden

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Wrap Up Pricing Takes Skill, Effort

“Best guess”



“Best guess”
+ Process + Data
+ Experience



Lose Sales

Leave Money



“Scientific price” from demand curve, 1000's of transactions, price tests, other research

Thanks!

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