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EFFECTIVE SOFTWARE PRICING STRATEGY



SWIFT STRATEGIES

Insight From Jason Foodman

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fundamental aspects of researching, assigning and testing prices for products in the software space. While the lines between consumer and business software have gotten fairly blurry, for the purposes of this article I'll be focusing primarily on software that is designed to sell to consumers and small businesses (as opposed to Enterprise software, for example, which has its own unique sales, marketing and pricing challenges).

Understanding the Fundamentals

Before you can even begin thinking about specific pricing

Developing effective pricing strategies and models for software products is a complex and challenging task. Much has been written about pricing models (and their strategies and testing), however the process remains a difficult one — and is ultimately often purely subjective. The right price can have a significant effect on sales, while the wrong price can destroy entire products — and companies.

Therefore, I thought it might be valuable to review and discuss some of the fun-

damental aspects of researching, assigning and testing prices for products in the software space. While the lines between consumer and business software have gotten fairly blurry, for the purposes of this article I'll be focusing primarily on software that is designed to sell to consumers and small businesses (as opposed to Enterprise software, for example, which has its own unique sales, marketing and pricing challenges).

strategies, it's vital to understand and define some fundamental things about your product and its audience:

- Who is your customer, and what are their expectations, motivations and needs?
- Is your typical customer a small business or a consumer, or something in between?
- Will your product be fulfilling a critical need, or is this entertainment, a core utility or something else?

If you're selling primarily to consumers, assemble as much knowledge as possible about your potential typical customer (the Internet is a powerful research tool for this kind of task). Ask yourself what is driving the consumer's potential purchase of your product, and what their specific needs, desires and requirements might be.

A profile of your perfect customer will begin to emerge. Then ask yourself what, based on the marketplace, they would be willing to pay for your type of product. In many cases, your product's location within a specific type will very nearly determine your price for you. For instance, consumers are accustomed to paying for security utilities but equate music sharing utilities as free, so if you plan to compete in that space you better have a revenue model other than an up-front purchase.

Before you know exactly how to market and sell a software product (or service), you've got to understand the market you're selling into. The best of all scenarios is if you like, enjoy, or understand your product's niche you'll not only have a good feel for who your customers are, but you'll have a head start on marketing — and selling — to them as well.

Researching Your Competition

Understanding the best sales methods, and the pricing of competing products and services, is vital to correctly setting your own price. What's your value proposition, and how do you fall into the field of potential solutions? What's driving someone to make this purchase and how can you play into their fears, needs and desires?

Your price should match, to some extent, your standing in the competitive solution pool. For example, if you have the most robust, complete solution anywhere, it would be understandable for your product to have the highest price. Likewise, if your product or service is the least feature-rich and complete, you should probably be considering the lowest price. Meanwhile, if you are in a crowded field with numerous options similar to yours, probably being the most expensive isn't a good idea, even if you are the best.

As a first step in this type of scenario, develop a matrix or spreadsheet identifying and describing all of your product's competing products, along with each of their pricing models. The matrix would additionally include such valuable aspects as Features, Presentation (GUI, Website, etc.), Ease of Use and more. This method will prove invaluable to you as you assess the value of your product, providing a 'big picture' view of the data at your fingertips and allowing you to draw the best conclusions on where you fit in the marketplace.

Even with exhaustive research and a thorough matrix, however, keep in mind that in the consumer space, as long as you have a viable product with features consumers are looking for, selling is often more about marketing than pricing. Consumers are getting more savvy and may certainly comparison shop, but the vast majority still buy the first reasonably priced product they see that really solves their problem or excites them.

And Finally: The Price

Once you understand your customer and have researched the market and competition, you're ready to develop a pricing model. I use the word 'model' because a good revenue strategy for a software product often involves (and should entail!) far more than a single, one-time purchase. Savvy companies look at the entire revenue spectrum associated with a sale, rather than simply how much someone pays at that moment in time for that specific product. In the hardware space, for example, it's not uncommon to find manufacturers who make more on accessories and up-sells than they do on the core piece of hardware (usually the case for items like printers and desk-top computers, for instance). Keep that line of thinking in mind as you develop your pricing model.

In the software space, there are numerous and specific revenue-associated potential benefits to selling to and acquiring a customer:

- Future upgrades: Once a customer is using a product, you have the opportunity to sell them upgrades to that product. A single customer could account for numerous sales over numerous years as you extend the functionality of your product. It's great to maximize that first sale, but it can — and should — be only the beginning.

- Mailing lists: Savvy companies keep in contact with their customers, and use that customer relationship to sell related products and services. In fact, there are software businesses that generate more than half their revenue from their existing client base!

- Upsells/Cross-sells: During the sale, take the opportunity to offer the customer related products and services. For example, on a

piece of consumer software you should always offer physical delivery (CD/DVD) as an option. Some customers find it essential, and will pay more to have the product in hand, and once again it's a chance to capture an otherwise lost bit of incremental revenue (while enhancing your offering). Likewise, find related products issued by you or your partners to offer someone buying one of your products. Once a customer trusts and respects your products and company, they are much more likely to buy a different product from you than from an unknown company.

- Word of Mouth: Building a large customer base has the effect of free marketing, and assuming you have a good product or service, this normally works to your distinct advantage. Happy customers tell other potential customers about you and your products and services, which generates further sales. So there is an advantage to be considered when developing a price, in

that a key objective is often simply to maximize the size of the user base.

- Add-ons, Modules & Plugins: Some software lends itself to offering various revenue generating add-on and plug-in sales. In these cases, it may make sense to sell something simple and affordable with the intent of selling additional modules either at the time of sale or into the future.

Again, it's something to consider when developing the initial pricing strategy.

- Bundles: If someone is looking at purchasing product A, offer them a bundle consisting of products A & B (or A, B & C) for a discounted price.

Some of this can get a bit complicated, especially when weighing so many factors against one another in search of your final price. But it's also exciting to know that you're making progress, and that you're on the road to setting a viable price for your product.

Other Considerations

Now that you've outlined the information and done the research, you should have a pretty good idea of the price range you may be looking for.

Which brings us to the next steps, and some further considerations. First off, there are many possible ways a product can be licensed. Most software in the consumer space is a simple per-user flat fee. While some like to keep the fee a simple round number, many studies have shown that the .99 phenomenon really is more effective (as several further interesting studies have shown, .99 is evidently perceived as a severely discounted item, while .95 is said to imply a more moderately discounted price) — and let's face it, \$19.99 just sounds cheaper than \$20. If your product is under \$7 or so, you could also try to reverse the model, pricing it as "FREE + Shipping and Handling (S&H)" — then building the cost into the S&H. So, instead of someone paying \$3.95 + \$1.95 S&H for a product, you may find more success offering them that same product for FREE + S&H (\$5.95).

And keep your up-sells and cross-sells in perspective in terms of their relative prices to your product's price. If your product is \$69.95, for example, you probably won't have much success trying to up-sell a product costing \$299. The best bet is therefore to price your product competitively, and then to offer similar products and services that are cheaper than your product itself (i.e. 'add-ons').

The Big Questions

The right price can have a significant effect on sales, while the wrong price can destroy entire products — and companies.

And as you zero in on a pricing model, don't forget to ask this key question: "Can we run our business profitably while selling software at these prices?"

It sounds obvious, but it's a mistake many have made — especially those new to the industry. If you can't justify a higher price but can't run your business at the lower price, perhaps you need to add more features and presentation into your product so that you can justify a higher price. That's better than overpricing, as some interesting things happen when a product is overpriced (one of which is a singular lack of sales). Because no matter how good the market and sales effort has been, a product that is considerably overpriced probably won't sell well — consumers and businesses are simply more savvy than that nowadays, and won't make the leap to making a purchase without a clear feeling that they're getting what they paid for.

On the other hand, a product that is significantly under-priced can have its own problems (not least of which is simply the effort to operate profitably). First and foremost is the fact that an under-priced product may actually cause a lack of confidence on behalf of the purchaser. So, for example, if your competitors are all selling at \$495, you should not be selling at \$29.95 - the customer looks at this and simply assumes yours to be the inferior product. Ultimately, you need to first understand the range (as described in the Research section) of available prices, where you fit in, and to find your 'sweet spot'. And be careful, as even in the consumer space (and certainly in the business space), there is some element of the 'first impression' that can potentially haunt you.

It All Comes Down to Effectiveness

I am often asked, "How much will people pay for this product?" The answer isn't as simple as pricing it correctly, as a whole host of other factors come into play when a consumer or business makes a purchase decision. The presentation, explanation, company history/experience, pitch, reputation, support and more all play major roles.

Two products priced identically can sell very differently based on who is selling them, how they're selling them, where they're selling them, how well they are explaining and defining the product, as well as the graphics, the box, the coupon, the presentation, and so on. So, while price is important, it isn't everything - a product that sells well is usually priced well, presented and pitched well, marketed well, and achieves at least some good word of mouth on its effectiveness.

Evaluating, Testing, Watching

Once pricing and surrounding collateral has been defined, you should test it out often. How many people buy at \$24.95 as opposed to \$19.95, for instance? With creative coding you can give consumers different pricing based on various criteria (for example, when they first visited your site).

Also consider experimenting with coupon offers to see how price-sensitive your buyers are. But don't lose sight of the fact that in some cases having fewer customers paying a higher price is to your benefit (fewer customers to support, yet for the same revenue). I've been told at least a half dozen times "If you guys cut your prices in half you would sell twice as much product" - true, maybe, but the revenues would be identical and we would have twice the customer base to support.

On the other hand, more customers mean more potential for up-selling, cross-selling, upgrades and future revenue. There are many aspects to achieving a successful pricing strategy, and each company must evaluate their offerings and where they fit into the spectrum to decide which strategy and model is best for them.

Clearly, a good strategy involves understanding your market, researching prices, setting good pricing and then monitoring, evaluating and fine-tuning that pricing (and potentially the marketing and sales that accompany the product).

So perhaps the entire experience can be best summed up with, "If at first you don't succeed" Good luck!