

# Software Pricing: Getting Back to Growth

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# Software Pricing: Getting Back to Growth

Software vendors are rapidly running out of room to grow organically. Enterprise software players are boxed in by increasingly budget-conscious buyers and by their own entrenched culture of deep discounting. Vendors of packaged software are battling runaway SKU complexity and channel partners' demands. And both groups are still grappling with the software-as-a-service model—as both threat and opportunity. What's needed now is a disciplined approach to pricing that combines rules-based process standardization and controls with the flexibility to offer different prices to different customer segments.

Somewhere in the world right now, it's very likely that a salesperson is closing a multimillion dollar deal for an enterprise software bundle. That's good—except that it's also very likely that the deal is being clinched largely on the strength of off-list discounts of up to 70 percent.

The company's executives really won't know until the end of the next closing period what the actual sales price was, how deeply any part of the bundle was discounted or what other concessions were made to close the sale. They will certainly not be able to answer critical questions such as "Are we leaving money on the table?" or "Are we really in danger of losing this deal on price?" And they may pause for just a moment to ponder whether it's worth having a list price at all.

There's also a good chance that a packaged software vendor is launching a new product right about now. But the product is almost certainly being

introduced in a way that will make things harder for the vendor. It is being offered in an array of bundles for different customers, countries and channels so there are literally thousands—perhaps tens of thousands—of SKUs for what is really one product. It makes for more price points than the channel can digest—and a more complex channel management problem than is good for any software vendor. This will only get worse in the months ahead, with new releases, new versions and new channel partners.

Both sector scenarios are approaching critical points and both are pointing to potential crisis. Top-line growth has never been harder for software vendors—or more necessary. Research firm Forrester Research projects that software investments will grow much more slowly in 2008.<sup>1</sup> Vendors such as Oracle are relying heavily on acquisitions for growth. And venture capital is no longer flowing strongly toward the software sector.

The heart of the problem is that organic growth will never again be what it was in the software industry's "go-go" years. Growth through mergers and acquisitions will only exacerbate the problem of tepid organic growth. New online software delivery models such as software-as-a-service (SaaS) are adding to the overall complexity. (See sidebar: "How to price SaaS?") "Knowledge workers want products that work like Google," noted one attendee at Accenture's 2007 CIO Council Forum. Overall, capturing value will become even more critical as the breadth of products, customers and channels continues to expand.

Yet, software vendors are proving to be their own worst enemies. It is impossible to overstate how much they have trained their customers to buy at the last moment—when products are "on sale" and the sales rep can be counted on to over-discount and is likely to include

1 "Forrester Revises 2008 Outlook for US and Global IT Purchases," Forrester Research press release, Feb 11, 2008 <http://www.forrester.com/ER/Press/Release/0,1769,1195,00.html>

**Figure 1: A host of factors is conspiring to make software vendors' challenges much more difficult to resolve**



Source: Accenture

lots of “free” software and services such as support and training to sweeten the deal. Vendors bring very little discipline to discounting; analyses of transaction data consistently reveal enormous, unmanaged variance in deal economics.

Growth should be all about getting the most valuable price, with price strategy and execution as the software sector’s key enablers of profitable growth.<sup>2</sup> Independent studies confirm a widening gap between what software vendors offer in terms of licensing and pricing and what enterprise customers actually want. Vendors with more flexible and advanced pricing and licensing strategies typically experience better relations with their customers as well as greater revenue and faster sales cycles.<sup>3</sup> (See sidebar: “The benefits of pricing right.”)

This document will dissect the challenges facing business leaders in enterprise software and packaged (“desktop”) software (we will not discuss

embedded software or other software that is closely tied to specific hardware platforms). Many of these challenges may seem familiar to readers.<sup>4</sup> But the mandate now is to move from analyzing the problem to taking specific steps to return to profitable growth using the right kinds of pricing capabilities.

### Roots of the problem

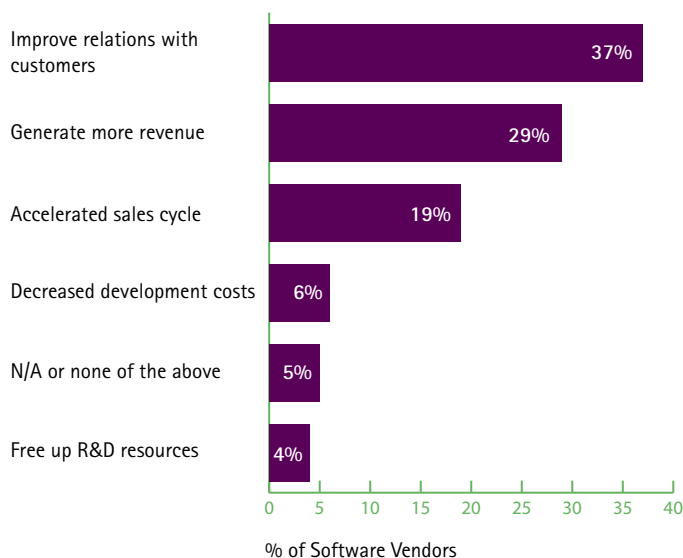
There is no single cause behind the software sector’s pricing difficulties (See Figure 1). For a start, the software industry is maturing and customers are leaning harder on vendors, due to the overall slowdown in IT investments. More and more enterprise customers are dedicating purchasing professionals to the task of evaluating and negotiating with IT vendors. So even when the sale has been made to the business leader on the basis of ROI and when the CIO is happy that the solution can be implemented, integrated and managed, it is increasingly necessary to confront

those with whom the contract must be signed. Typically, price comes to the fore again. Tell those professional buyers that their business-side leaders have blessed the deal—that they think the solution adds value—and the response may well be something like “Great, but my job is to make sure it adds even more value.”

Competition isn’t easing up, and acquisitions continue to reverberate around the industry. Consolidation affects packaged and enterprise software sectors; both are seeing the axis of competition shifting from products to product suites and integration, adding SKU complexity. Leaders in both categories are pushing rapidly into emerging markets, provoking a new set of challenges—issues such as new channels, go-to-market partners,

<sup>2</sup> “How to build a powerful pricing capability,” *Outlook*, 2007, Number 1, Accenture  
<sup>3</sup> “Key Trends in Software Pricing and Licensing: A Survey of Software Industry Executives and Their Enterprise Customers,” ECPweb, Macrovision, SoftSummit, CELUG, and EDA Consortium, November 2007, [http://www.softsummit.com/pdfs\\_registered/SW\\_Pricing\\_Licensing\\_Report\\_2007.pdf](http://www.softsummit.com/pdfs_registered/SW_Pricing_Licensing_Report_2007.pdf)  
<sup>4</sup> “Staying power,” *Outlook*, 2007, Number 3, Accenture

**Figure 2: Reasons why software vendors change pricing and licensing policies**



Sources: SoftSummit et al

piracy, localization and competition. And enterprise software providers are starting to target small- to mid-sized businesses, a move that adds enormous complication to existing pricing strategies.

New business models are also having an impact: SaaS online delivery models in particular are attracting plenty of attention. Participants at Accenture's 2007 CIO Council Forum noted that the growing costs and complexity of legacy enterprise applications would help facilitate a solid future for subscription-based software. Open source is steadily making inroads and technology developments are moving apace: service-oriented architecture (SOA) frameworks are gaining ground, encouraging IT leaders to rethink their long-held beliefs about software development.

### The importance of better pricing

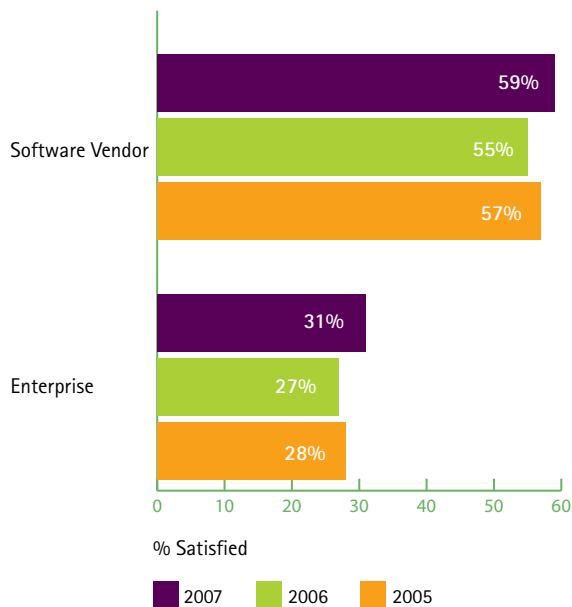
Accenture's analysis points to substantial opportunities for pricing to drive top-line growth in a post-boom software market. Well-planned price strategy and execution are integral to profitable growth. The software vendors that are proactively reworking their pricing and licensing policies are doing so with such business goals in mind (See Figure 2).

Discrete efforts to date have yielded good results. Many software providers from both camps have made greater use of segmentation. For example, Microsoft has multiple portfolio offerings to allow it to hone in on slightly different needs; its new Vista operating software comes in five packages—Home Basic, Home Premium, Business, Ultimate and Enterprise.

At the same time, on the enterprise side, SAP is adding mid-market offerings and pricing structures that are quite different from its traditional large enterprise licensing model. Providers have also segmented their markets tightly by region—for instance, most software companies vary their desktop software pricing by geography (North America, Europe, etc.); by vertical segment such as "government" or "education" and by bundles, which provide users with lower costs per product while vendors get stronger lock-in.

However, software providers now need to demonstrate that they can take their pricing capabilities up several notches. Third-party research indicates that many vendors are still not listening to their customers: more than twice as many vendors as enterprise customers are satisfied with their pricing and licensing strategies (See Figure 3).

Figure 3: Average satisfaction with pricing and licensing strategy



Sources: SoftSummit et al

Specifically, Accenture believes that vendors have to start thinking and acting in terms of a broad set of on-demand services rather than just segmenting their customers ever more finely. Also needed: enhanced price-setting capabilities that allow software providers to better manage complexities and cope with the SKU explosion that the move to segmentation has created.

### Challenges to stronger pricing capability

There are three main areas where software vendors are struggling with pricing. First, product managers and marketing managers are hard-pressed to make smart decisions about price setting. Then there is the soaring difficulty of price administration and publishing—how to capture, code and communicate pricing decisions to internal sales teams and to the channel—and in ways that are comprehensible to customers too. And there are formidable challenges to the mechanics of sales

activities—understanding customers' changing requirements in order to sell on value, identifying and planning for conversations with new economic buyers, and much more.

In packaged software, the fundamental issue is SKU proliferation. Vendors treat every SKU and offering differently from a pricing standpoint, leading to far too many price points. Large software vendors today are facing millions, if not tens of millions, of price points with only a small percentage of them being used in actual transactions. One of the first knock-on effects of creating unique price points for each item is that it takes longer to bring an offering to market. It's more difficult to change prices quickly. It also makes pricing activities harder to manage; too much time is spent on pricing administration, publication, communication and approval.

The problems with price-point proliferation don't stop there. It exacerbates errors in order entry and order management, inflates maintenance

overhead and encourages gray-market activity. Channel partners struggle to figure out which price is applicable for which SKU in which situation. And customers continually see pricing inconsistencies among offerings.

At the same time, price setting and analysis are more difficult to execute. Spreadsheet tools and ad hoc analyses can't keep up with the soaring volume of prices and customer/channel partner demands. For the same reason, it is increasingly difficult for sales reps or channel partners to get timely, accurate pricing information when preparing bids. It's no wonder that managers and sales reps have little time to focus on understanding customer needs.

The story is not dissimilar in enterprise software. There, the core problem is undisciplined deal management, where different customers end up paying widely varied prices for the same solution, either due to the sales relationship or to legacy behaviors such

# How to price SaaS?

Software as a service is getting the attention of IT leaders. According to Gartner, it will make up a quarter of the \$220 billion-a-year software industry by 2011. One attendee at Accenture's 2007 CIO Forum was bullish on the SaaS model because of the cost and complexity of upgrades needed for enterprise applications. "It's almost more reinstall than upgrade," he said.

The problem is that SaaS pricing is still very much in its infancy. Most providers don't yet know whether to price by user, minute, month or some other metric. SLAs, help desk policies and upgrade schedules can vary widely. And it is not clear how business users perceive the pricing position. Already, many customers are starting to feel "nickel-and-dimed"—which will stiffen their resistance to any additional fees for services and upgrades.

It's important to note that SaaS is more than just an "online" version of existing software. Along with its new delivery model, SaaS introduces fundamental changes in core features, packaging, integration and associated services. As a result, SaaS pricing needs to follow the practices associated with the launch of completely new products rather than just slight modifications of existing pricing schemes.

One potential solution involves pricing the solution, not just the software, to a single standard. Providers already have access to the tools and techniques needed for "solution-based" pricing. For example, sophisticated market research techniques can test different price points and standards to see how buyers perceive the value of different add-ons.

as waiting until the end of the quarter to make purchases. Software vendors often don't know when they are over-discounting, or when they are losing sales by keeping prices too high.

Purchasing of enterprise software is increasingly driven by the CIO's budget, not by the user's needs or value potential. Meanwhile, salespeople continue to discount late-quarter deals to make their quotas. Deals are won at lower prices than necessary, and some may not even be worth it. Yet while very small transactions may be discounted very steeply, large and important deals can be lost due to the lack of a satisfactory discount, with high-revenue customers sometimes receiving smaller discounts than very low-revenue customers. Part of that problem is that sales managers and executives do not have clear, accurate guidelines for negotiations. And in enterprise software applications, loose and fragmented pricing processes can make it tough to manage pricing.

A few examples from Accenture's client work illustrate the range of challenges that software companies are wrestling with—and the opportunities they can expect:

A software provider with a broad suite of enterprise applications is trying to transform itself for growth by shifting from all-direct sales to making greater use of channels and from negotiating a single "umbrella" master agreement covering all products to implementing more transactional, solution-specific pricing. Its efforts to transform along both dimensions simultaneously are requiring significant changes in pricing architecture, business processes, sales strategy and CRM/pricing systems infrastructure.

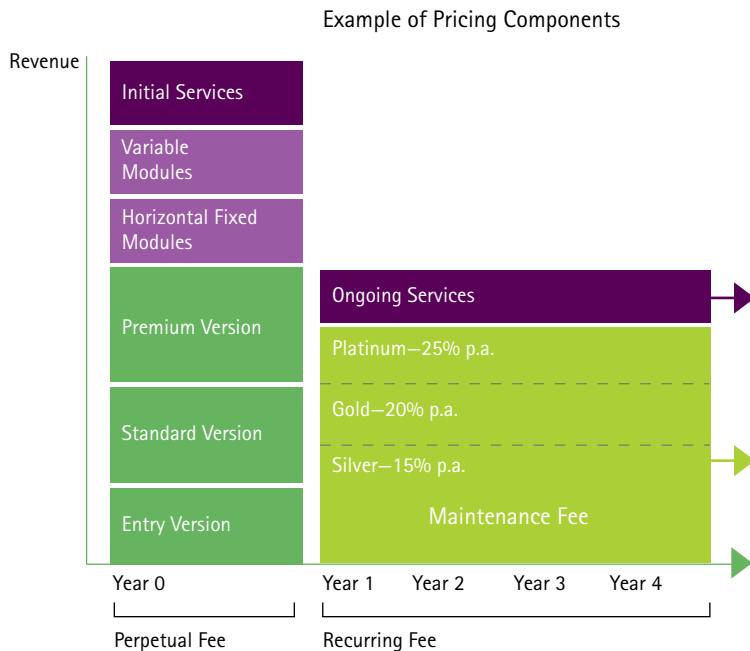
A similar company with an even broader portfolio of enterprise applications is striving to boost its profit margins by improving the quote preparation process. Its current capabilities are limited: the interface of the quoting system is awkward, response times are slow, the price and discount guidelines it provides to the sales force are often out of date,

and there is no workflow process to help confirm that sales reps stick to discounting guidelines. To lower costs, improve response times and increase customer satisfaction, the company is requiring a combination of systems improvement and change management to drive more disciplined sales force behavior.

Another large enterprise software organization has never had good price analytic capabilities for understanding its deal economics. To increase its margins, the company is working with Accenture to identify and understand systematic over-discounting practices by solution, industry, region and customer class. A key objective is to identify and leverage those products and accounts where the company really has differentiated pricing power.

A large software company with a broad set of packaged products is struggling with the scalability of its pricing systems. Pricing involves extensive reliance on manual tasks and it typically takes several months to set new product

**Figure 4: Software companies need to think about all their sources of revenue**



Source: Accenture

pricing. As a result, the company loses out on many promotion opportunities. It is implementing new pricing systems to streamline and automate price setting and administration processes.

A large software company is running into challenges with scaling up and managing the job of publishing its prices to its thousands of channel partners. The company already has millions of price points, and is expecting many more with the arrival of new SaaS offerings. It is not practical to continue with its traditional approaches of publishing long price lists every month. The company is investigating rule-based, dynamic price publication capabilities.

### Action stations

Some solutions are emerging. Accenture's work with a range of software companies reveals several key best practices which companies can begin to develop immediately:

#### 1. Review the core business model in light of the potential impact of new offerings, term licenses and SaaS components

Companies need to think about all the sources of revenue—not just the initial licensing sale but the associated sales of optional components, services, online offerings and ongoing service components (See Figure 4). In some cases, management may need to completely rethink the company's packaging, bundling and pricing schemes.

#### 2. Standardize pricing approaches (not necessarily pricing strategies) across product lines

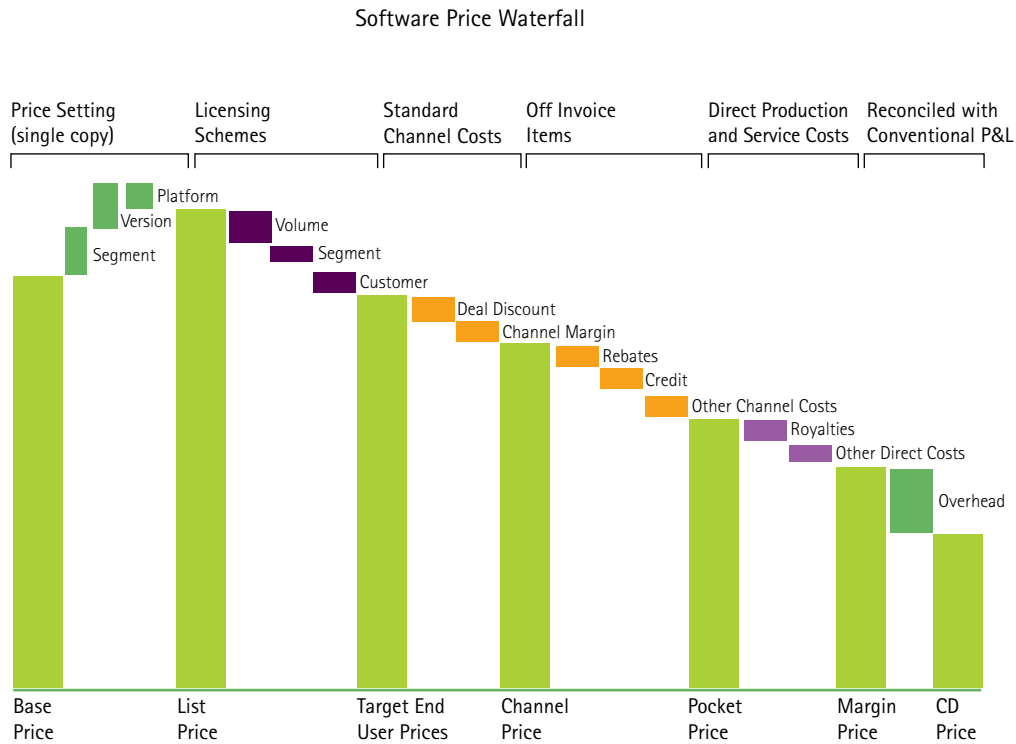
Today, some leading software firms can speak to only their list prices and the discounts associated with particular deals. But those that have mastered pricing practices organize their price setting, licensing and

transactional processes to clearly reveal each discrete pricing and discounting action that leads either to the final or pocket price. Leading-edge companies have standardized their price-setting frameworks and variables across product groups and business units (See Figure 5). The standardization helps with scalability and development of insights into when and how much to charge and to discount.

#### 3. Implement "formula" or rules-based pricing to help salespeople construct deals

For a long time, industrial companies have set pricing rules, supported by analytic and business process automation tools, to structure their varied deals. Software companies should do the same now that they are finding themselves with many more SKUs than before.

Figure 5: Price-setting factors



Source: Accenture

## The benefits of pricing right

Software companies that are highly focused on building their pricing capabilities are realizing significant benefits in the form of sustainable revenue and margin growth by:

### Systematically reducing discounting among existing customers

- Less variance in deal setting—very small transactions, if not worth it, get flushed out while very important deals are appropriately priced
- More consistent pricing throughout the quarter, thanks to better sales force control

### Better pricing of net-new business

- Better responsiveness to individual customer deals
- Increasing average transaction price at the segment level
- Accurate quoting and disciplined sales behavior

### Greater efficiency of pricing processes

- Improved sales force productivity—clear guidelines for negotiations streamline the process and free up time for more valuable activities
- Improved time to market
- Reduction in administration and transaction errors

- Less costly and less manual quote-to-fulfillment processes

### Greater scalability

- Greater visibility, integration and automation for pricing capabilities
- New pricing systems are easily scalable to accommodate new SKUs and models

# In our experience, pricing initiatives that stop at the strategy level are neither scalable nor sustainable.

## 4. Use pricing applications to enable best-practice pricing

In the last few years, several technology solutions have emerged that provide critical analytic insights to support segmented price setting by improving understanding of the provider's pricing power. These solutions also help standardize and control pricing activity. Price management solution companies—for example, Vendavo, PROS, Zilliant, and Vistaar—are rapidly implementing capabilities in their solutions to make them suitable for software/high-tech markets. Enterprise software companies SAP and Oracle have shown keen interest in pricing and are actively strengthening their offerings in this area through partnerships, acquisitions and internal development.

## 5. Focus on organizational improvement

Pricing is a deeply cross-functional business process, with partial ownership in product management, product marketing, finance and sales—and therefore, no

central point with total ownership. To grow top-line revenue organically, software firms will need to address core issues of pricing governance and accountability. For large companies, a central "pricing group" can coordinate several pricing activities and help implement leading pricing practices.

In our experience, pricing initiatives that stop at the strategy level are neither scalable nor sustainable; a true pricing transformation has to incorporate an implementation plan if it is to have any chance of succeeding. A pricing makeover will take time, investment and commitment at all levels to elevate these new pricing capabilities; there will assuredly be pain, roadblocks and missteps—none of which can be an excuse for doing nothing.

## Wrap-up

As things stand now, both enterprise software providers and vendors of packaged applications are headed for significant problems. There can be no question of the urgency to take pricing capabilities to the next level; the costs of doing nothing are

prohibitive. If they do not change course on pricing soon, they will find profits sinking, opportunity costs soaring and lower returns from the acquisitions on which they already rely on for growth.

What's needed now is a break with traditional approaches to pricing. It is time for less gut reactions and more facts—time to develop and apply superior pricing capabilities using "scientific" approaches that marry rules-based pricing, pricing discipline and standardization with more effective customer segmentation and a better understanding of how to put scale to work.

Those fact-based approaches are entirely practical today. The software providers that are quickest to adopt them wholeheartedly will be the first to unlock new growth opportunities and to build the capabilities necessary for facilitating sustainable business platforms. And the vendors that continue to act as if today's pricing policies will be effective ad infinitum? Their CEOs can expect sharper questions from shareholders before too long.

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