

## ***It's Hard, Complex, Problematic, and Boring, but Pricing is a Core Strategy***

A MediaAPI brief

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During a recession, companies cut expenses to create profits. Later, during an economic recovery, companies have to grow the top line, revenue. More headcount will sell more products, but what about a strategic calculation of the perfect product, license, discount, and price blend to dominate your direct and indirect channels? A calculation that includes your competitors, customers, partners, corporate strengths, and weaknesses? A calculation that execs review, recalculate, and continually improve. That calculation is your pricing model.

Pricing is one of the most strategic activities any company undertakes ...and one of the most difficult. It requires a blend of skills and commitment to pursue long-term advantages that few companies understand. Most software vendors abdicate a consistent pricing process and slowly cripple their market development, channel, and competitive strategies, and often, revenue.

Strategic pricing especially complements channel strategy because channel partners need pricing and licensing that complement the solution stack. Often price models naively grab an entire customer budget, and leave no room for the products and services to complete a "solution." Apps are half-completed, software goes unused, vendors and markets disappear. Poorly chosen price models have killed or stunted emerging markets.

Still, successful pricing requires a calculation and a process. Most companies declare a price and then move on. Most companies don't commit to the process and get run over by the companies that do commit.

For software vendors, a dollar of revenue created through strategic pricing falls directly to the bottom line as profit. Fantastic, right? Yet who owns pricing? Sales? Marketing? Product Marketing? Product Management? Finance? All have an opinion and yet all only see one piece to the puzzle.

FACT: Price is the most important communication made about a product to the most important audience, the customer. The field is well-trained, the collateral is beautiful, the software...bulletproof. But the elephant in the middle of the room is still price and it will be

**Price...**is the most important communication about a product.

- Is the software simple or complex?
- Is it a channel or direct product?
- Is there a long or short sales cycle?
- Can end-users handle this product?
- Must it be installed at the datacenter?

All of these and more can be answered by the product price alone.

And pricing is one of the most profitable activities any vendor can undertake. A dollar of software revenue falls cleanly to the bottom line.

Yet most companies never engage in pricing because it requires leadership, interdisciplinary skills and the execution of strategic decisions.

In industry after industry, the dominant companies from Wal-Mart, to Citibank, to Microsoft and Oracle, actively engage in strategic pricing.

discussed, early or late in front of the customer. At \$1K or \$100K, are you a consumer or enterprise product, a channel or direct sale? Does the price point map to the "value" of the product established in the client's mind?

Let's back-up. In *every* market, the dominant companies are the best *pricing* companies. Wal-Mart is the world's dominant retailer, and has spent tens of millions of IT dollars on complex pricing algorithms to create \$168 Billion in revenue. Again and again, superior vendors make price strategy a key part of *executive* responsibility, *across* business units and functions.

ERP, SCM, and other enterprise applications generate terabytes of data but companies rarely perform sophisticated regression on that data. Even simple algorithms based on a few data points would hint at new, profitable pricing directions.

Airline customers protest widely divergent ticket prices in the same row, but the carriers, with huge labor and capital costs and product (seats) that expire with every takeoff, have to be aggressive pricers. Airline profit margins are miniscule; they cannot leave any seat behind, on any route. American Airlines spun off its Sabre reservation system primarily because Sabre's pricing data was worth billions of dollars to other airlines far beyond a proprietary reservation system to American.

Conversely, the software industry is amongst the poorest pricing practitioners simply because gross margins are so high. Software's market growth and high margins mask many mistakes and inefficiencies in the industry. However, post-recession, the market is slower, competition is fierce and customers have tight IT budgets.

Recall the hunter's axiom of out-running each other rather than the bear. Software vendors must primarily price against competitors in consolidating markets yet remain profitable to survive. Only via pricing can vendors strike that balance.

With pricing, you can pick up stray dollars in front of a steam-roller, but you'd better be fast.

**Siebel and Salesforce.com**

Salesforce.com was founded in 1999 as a low-cost, web-based alternative to Siebel's (founded 1993) Sales Force Automation (SFA) software.

Flying under the Siebel Fortune 1000 radar, Salesforce.com attracted small and medium business customers who needed basic features for only \$65 per user per month.

Salesforce.com was "good enough" SFA for a large, underserved market. Even into Q1/2003, Tom Siebel stated that they had never competed against Salesforce.com, a disingenuous comment because recent Salesforce.com customers include Avis, TimeWarner, and Dow Jones.

By correctly balancing price, features, licensing, and its sales channels, Salesforce.com is profitable and has an estimated market capitalization on par with Siebel's.

	Siebel	Salesforce .com
<b>Customers</b>	3500	7400
<b>2003 Revenue</b>	\$1.6B	\$100M
<b>2003/2002 Growth</b>	-22%	100%
<b>Price</b>	High	Low
<b>Sales</b>	Direct	Indirect
<b>Sales Cycle</b>	Long	Short
<b>Product</b>	Complex	Simple
<b>Software</b>	License	Hosted
<b>Payment</b>	Upfront	Monthly

MediaAPI provides primary research and strategy consulting to the enterprise software industry.