
SVPMA Workshop: Pricing, Business Models, and What Are Things Worth

*Rich Mironov
CMO, Enthiosys
April 25, 2009*

Agenda

- Introductions
- Basics of Pricing
- Case Study #1: Consulting
- Case Study #2: iPass
- Exercise #1: Teleportation
- More About Software Pricing
- Exercise #2: SaaS
(Innovation Games Online)



Objectives



-
- See where pricing fits
 - Work a few exercises
 - Appreciate the scope of issues
 - Laugh a little
-
- Not a deep dive on financial modeling

Agenda

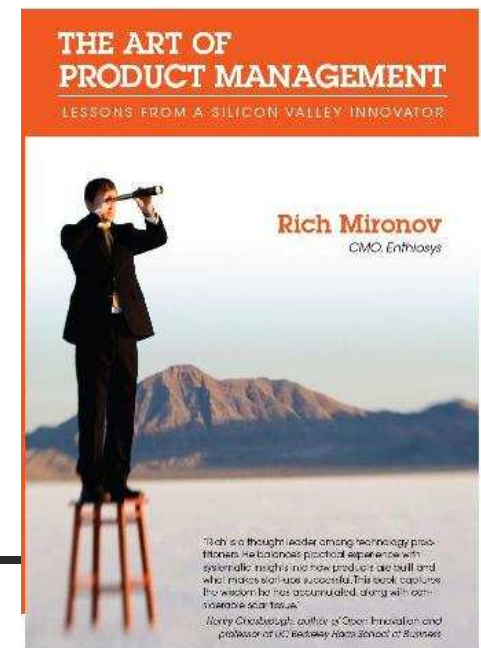
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An Unapologetic Product Guy



- CMO at Enthiosys, agile product mgmt consultancy
 - Business models/pricing, roadmaps
 - Innovation Games[®] and customer needs
 - Agile transformation, interim PM executive
- Repeat offender at software prod mgmt
 - Tandem, Sybase, four start-ups
- *“The Art of Product Management”* and Product Bytes
- Haas executive education faculty



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Where Does Product Mgmt Fit?



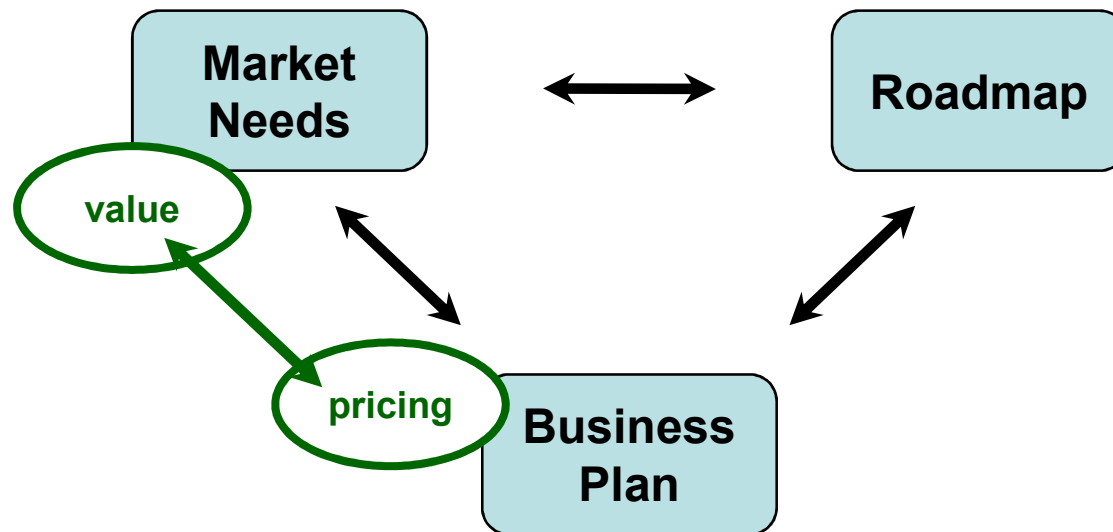
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*“Pricing is almost never
about the number.
It’s about the model.”*

Context



Bottoms-Up or Top-Down?



- We'll be focused on market pricing (bottoms-up)
 - *“What the market will bear”*
 - Considering pricing models and specific prices
- Companies also need top-down
 - Justifying R&D investments, projecting revenue
 - *“We need higher prices to hit break-even sooner”*

- Iterative
 - Intersection of market, business model, costs...

A screenshot of a Microsoft Excel spreadsheet titled "Microsoft Excel - Book1". The spreadsheet displays a financial model with the following data:

	A	B	C	D	E
1		<i>FY-10</i>	<i>FY-11</i>	<i>FY-12</i>	
2	Units	250	750	2,250	
3	Price	\$50,000	\$50,000	\$50,000	
4	Revenue	\$12,500,000	\$37,500,000	\$112,500,000	
5					
6					

Where Does Pricing Fit?



- Rarely the headline
- Part of the business model
 - How do we make money? How much?
 - Revenue/profit/shipment forecasts
- Supports core value proposition
 - *“Our product/service saves you \$\$\$\$...*
 - *...and we want 15% of the savings.”*
- Often an obstacle to buying
 - Too complex
 - Much too high (sticker shock) or too low (desperate)
 - Free (no reason to trade up)

Company Models



-
- Big companies that do serious pricing analysis
 - General Mills, Goldman Sachs, United Airlines, Toyota
 - Small companies built on a pricing strategy
 - Salesforce.com, Netflix, ZipCar
 - Companies that don't handle pricing strategically
 - Nearly everyone else

Philosophies and Approaches



-
- *We have the data, resources and commitment to do serious pricing analysis*
 - Patient and scientific
 - *The market defines pricing models and prices*
 - Small fish, big pond
 - *We have an explicit pricing strategy*
 - But little data
 - *Our costs and ROI requirements define prices*
 - Cost-plus
 - *We can't ship until someone picks a price*

New and Mature Markets



Mature markets	<i>Outside threats, late-comers</i>	<i>Compete on price</i>
New markets	<i>Let 1000 Flowers Bloom</i>	
	New pricing models	Dominant pricing model

Start with Customer View



-
- Customers buy most products to make money or save money
 - How do *they* describe value?
 - Quantify it for them
 - They won't spend the time to analyze this fully
 - Assume you can capture a fraction of value
 - B2B: often 5% to 15%
 - Consumers often driven by fashion, not analytics

Pricing Your Start-Up



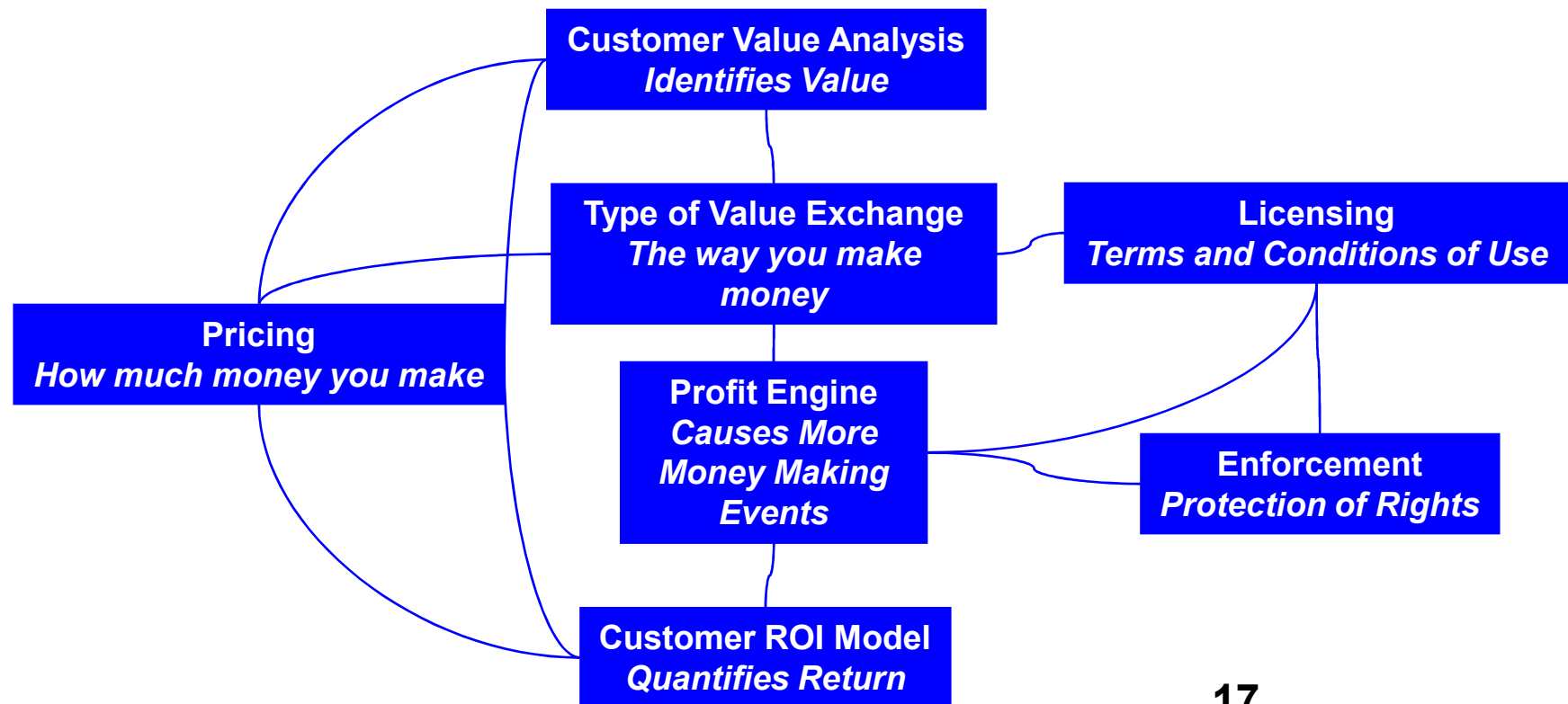
- **Why** will customers buy?
 - Tell a story in customer's own language
- **What's** the natural unit of exchange?
 - How do they derive value? What does the competition do?
 - Can you split off a profitable segment?
- How much of customer value can you capture?
- Test, trial-close, get your hands dirty



Business Model Framework



A framework of interrelated choices that help you create offerings that provide maximum value.



Software Value Exchange Models



1. Time-based access (e.g. unlimited/month)
2. Transaction (stock trade)
3. Metered (seats, CPUs, named users)
4. Hardware (appliances, dongles)
5. Service (virus updates, support)
6. Percentage of incremental revenue/savings
7. Data-driven insights

A jagged, starburst-shaped graphic with a black outline, containing the word "Charity?" in bold black text.

Charity?

Avoid Creating Pricing Problems



-
- DON'T...
 - Make price the primary issue (usually)
 - Over-complicate the sale
 - Require customers to be smart
 - Change prices too often

 - DO...
 - Support the business model/plan
 - Reinforce (charge for) key benefits
 - Pick natural units
 - Make correct ordering easier

Support the Business Model!



- Pricing drives customer behavior
- What do you want core customers to **do**?
 - No-brainer renewals (small monthly fees)
 - Big up-front license (lock up marketplace)
 - Lust for upgrades (cool features are extra)
 - Freemium model (1% upsold into paid services)
 - Install latest version (free updates, increasing service fees)

How Will People Cheat?



- If I want to rip you off, how could I do it?
 - Licensed software...
 - Per-Seat SaaS...
 - Hardware token...
- Licensing versus enforcement
- Who are the cheaters?
- How much are we willing to spend?
 - Diminishing returns
- Easier to exploit complex pricing models



Customer Commitments



"by the drink"



"by the month"



No commitment
High variable costs

Lower volume
Uncertain usage
Optional
Actively manage costs

NEED CONTINUOUS MARKETING

Big commitment
Low/no variable costs

Higher volume
Predictable usage
Required (cost of business)
Low cost control effort

HARD INITIAL SELL

Everyday Commitments



-
- Things we commit to...
 - Things we buy “by the drink”...
 - Why?

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Exercise: Consulting Services



- Your last start-up just closed, so you are suddenly a consultant. A prospective client needs market analysis, MRD, a pricing model.
- What are your pricing objectives?
- How to structure a project?
- Risks for you? For client?



Possible Objectives



-
- **Work at any price**
 - Food on the table
 - **Loss leader**
 - Underprice first assignment, get follow-on work
 - Good reference for other clients
 - **Become indispensable**
 - Push for a full-time position later
 - **Gain pricing experience**
 - What will the market bear? OK to lose assignment

Some Consulting Pricing Models



-
- Per hour, no limits
 - Per project
 - Per hour with project ceiling
 - Fixed price for initial sizing (“pay me to estimate”)
 - Milestones (progress payments)
 - Equity (pre-IPO stock)
 - Customer sets value at end
 - Shared savings (portion of ROI)
 - Free (experience, reference, try & buy)

Risks in Consulting Models



	Client's Risk	Consultant's Risk
Straight Hourly	Unlimited cost, quality, completion	None
Fixed project price (pay on completion)	Timely completion	Unlimited effort, defining "done"
Fixed price milestones	Partial work not valuable, how to inspect work?	Upfront analysis
Equity, portion of ROI	May overpay later	No immediate cash value

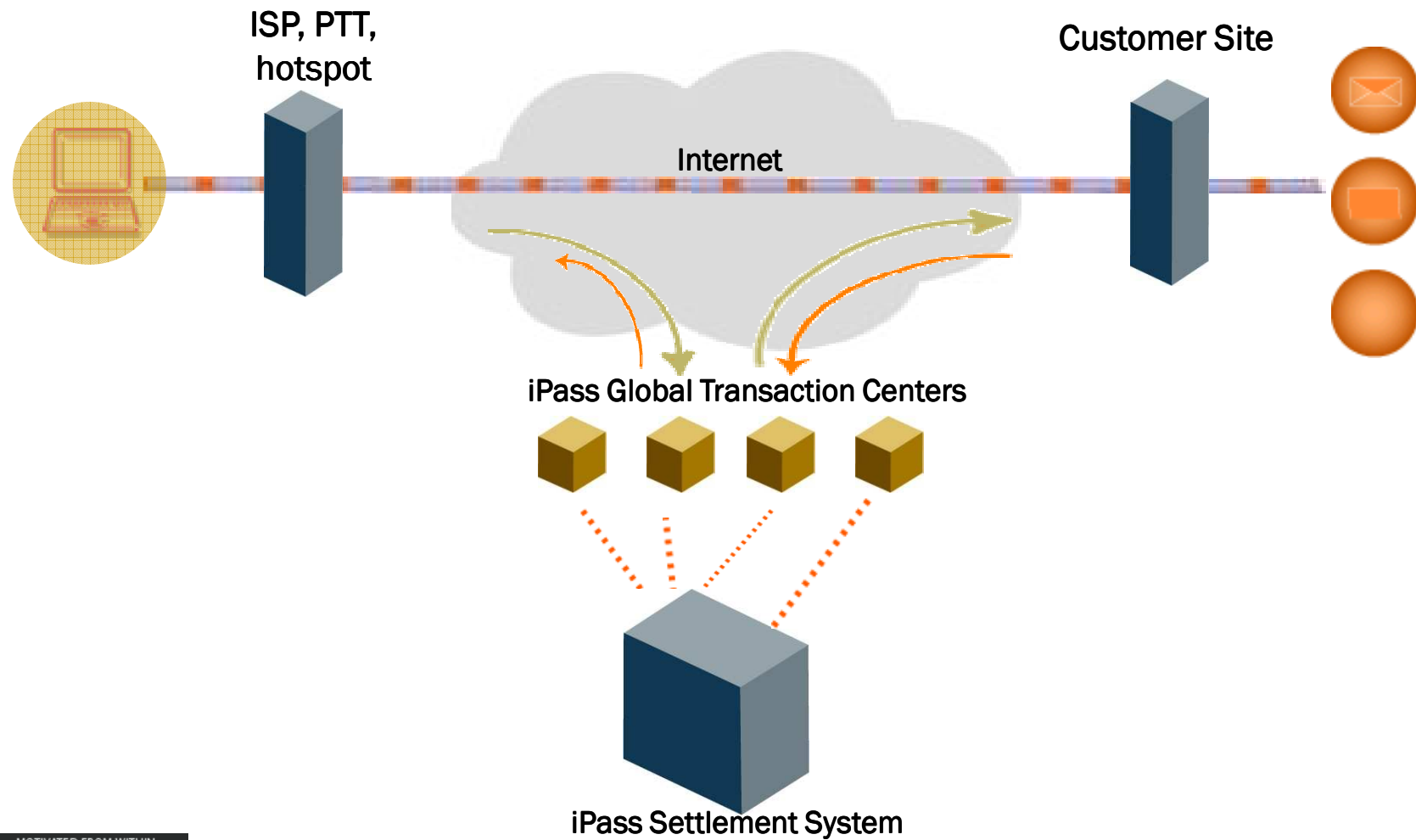
Case study: iPass



- Founded 1996: new market, new application
 - Falling asleep in Tokyo hotel
- Early clearinghouse for Internet “roaming”
 - How do I dial into the ‘net when far from home?
- Target: corporate travelers, “road warriors”
- By 2004, covered 170 countries
 - 20,000 dial-up numbers, 5000 hot spots...
- IPO July '03, \$1B market cap



iPass Transaction Model



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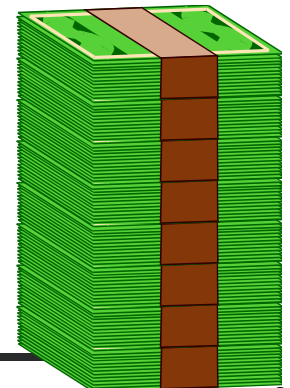
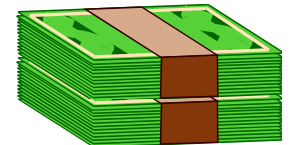
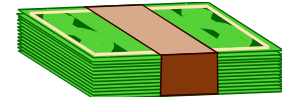
Evolution of iPass Pricing Model



-
1. Cost-plus pricing (mark up each POP 40%)
 - Buy-side prices are visible
 2. Flattened by country (then continent)
 - Simpler
 - Customers indifferent to suppliers
 3. Overlay Home/Roam model
 - Charge less at “home” but more to “roam”
 - Lots of “home” substitutes but few “roam” alternatives

Network Effect: Strategic Leverage

- Early: low volumes, high supplier prices, difficult purchasing
 - Grow user base, add more networks...
- Mid-cycle: can substitute suppliers, improve quality, simplify end user experience
 - Companies want biggest network
 - Networks want most roaming users
- Maturing: dominant player
 - All major dial-up networks (BT, FT, DT, AT&T...)
 - All major hotspots (T-Mobile...)
 - Who wants to join the second-largest ATM network?



Selling Value-Added Data



- iPass was monitoring quality data
 - For each dial-up attempt: POP, result, initial speed
- Aggregated and resold this to...
- ***Customers***
- ***Prospects***
- ***Network operators***
- Hybrid model



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Workshop Exercise: Teleportation



- Founders: Stanford physicists with local VC
- Software plus expensive custom hardware
- Some arbitrary product limitations
 - Inanimate objects only (no people)
 - Under 40 pounds, under 18" diameter
 - 2000 mile limit, arrival +/- 3 inches
 - High power requirement (15 kW)
 - 15 second recharge time
 - Non-military, non-government



Not *Yet* a Product or Service...



-
- No target application or audience
 - No go-to-market strategy
 - No pricing model (*how we will make money*)
 - No infrastructure/operations/support plan
 - No marketing or sales staff

 - Lots of blue sky discussions

Team Exercise: 20 minutes



-
- Break into groups of 4-6
 - Pick a target application
 - Tell a specific user story
 - How does customer define value?
 - Competing offerings?
 - Adoption challenges, infrastructure needs?
 - Build a value proposition
 - Justify a list price (quantity one)?
 - Dimensions of discounting/bundling/tiers?

Teleportation Presentation



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Software Models: The Real Fun



-
- No natural cost-plus approach
 - SaaS is how it's delivered, not how it's priced

Possibilities:

- One-time license
- Recurring/rental
- Bundled with hardware
- Per transaction
- Prepaid usage...

Recurring vs. One-Time License



-
- Not (really) about how you deliver it
 - One-Time Licensing
 - Perpetual or long-term license plus support
 - Pre-empt competition
 - Some upgrade fees on major releases
 - “Selling the future”
 - Good because...
 - Bad because...

Recurring vs. One-Time License



-
- Not (really) about how you deliver it
 - Recurring / SaaS
 - Monthly or annual fees
 - No separate support or upgrades
 - Upsell packages of capabilities
 - Theoretically easy to cancel
 - Good because...
 - Bad because...

Mixed Models



- Most software solutions use multiple models
 - Tiered capabilities (entry, standard, expert) per user per month
 - Different units for bigger customers
 - Software support levels (work hours, 7*24)
 - Separately priced “connectors”
 - Additional price for data import or conversion

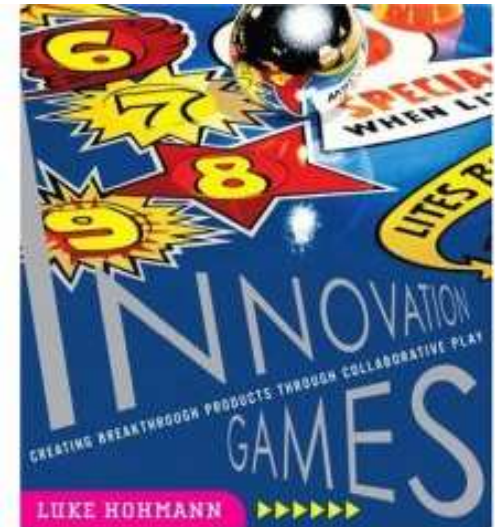
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(Innovation Games Online)**



Exercise: SaaS Pricing

- Innovation Games[®] Online
 - Extension of Luke Hohmann's Innovation Games[®]
 - Originally conceived as face-to-face collaborative market research tools
- Target audiences
 - Product managers/marketers
 - In-house market researchers, paid consultants
 - Companies (divisions) that do frequent customer collaboration/needs-finding
 - Not-for-profit groups, open source projects



Buy A Feature



- An Innovation Game® where customers/prospects collaborate with a vendor to prioritize a backlog
 - Vendor gets information about the features customers **want first**, and reasons for their preferences
 - Product manager "**prices**" a list of potential features. Customers are given "**money**" and asked to collaborate with group to decide which features will be "**purchased.**"
 - The group has only enough money for a subset of features. They negotiate for the most important items, while explaining their decisions.

Buy A Feature Online - Backlog



Buy a Feature - An Innovation Game - Mozilla Firefox

File Edit View History Bookmarks Yahoo! Tools Help

buy a feature
AN INNOVATION GAME

- Home
- Logout
- Edit User
- Change Password
- Client Mgt
- Project Administration

Overview Results Summary G1 G2 G3 G4 G5

Overview


Feature	Benefit	Price
Find Nearby Friends Provides you with a list of friends that are near you based on a configurable list of friends and a distance that you specify.	Enables you to find the friends you want — and avoid the people you don't like!	\$107
Unscratchable Lens Specially hardened lenses that can only be scratched by a material as hard as a diamond.	Improves durability and safety of the classes.	\$18
Integrated Headphones Headphones integrated into the sunglasses.	Enables you to listen to music, the radio, and/or other information, such as driving directions, through your sunglasses.	\$59
Unbreakable Frames Frames that are strong enough to withstand 50psi.	Lasts longer.	\$57
Voice Command Allows you to control all ieSunglass programs through voice commands.	Enables you to easily control the device while your driving, providing much higher degrees of safety.	\$182
Landmark Lessons Provides detailed information on nearby landmarks.	Enables you to learn about and therefore more fully enjoy cities that you're visiting.	\$61

Stock Ticker Stream

Find: user Next Previous Highlight all Match case Reached end of page, continued from top

Buy A Feature Online - Underway





STOP BUYING PRINTABLE FEATURE LIST

			Nancy	Don	Eloise	Linda	Luke
	BUDGET		\$50	\$50	\$50	\$50	\$50
	BALANCE		\$15	\$12	\$35	\$10	\$38
Find Nearby Friends	\$107	\$95					\$12
Unscratchable Lens	\$18	PURCHASED		\$18			
Integrated Headphones	\$59	\$59					
Unbreakable Frames	\$57	\$22		\$20	\$15		
Voice Command	\$182	\$147	\$35				
Landmark Lessons	\$61	\$61					
Stock Ticker Stream	\$157	\$157					
Darkness Controls	\$21	\$21					
Traffic Directions	\$105	\$65				\$40	
Streaming Music	\$60	\$60					
RSS Streaming	\$11	\$11					
Wind Blocks	\$12	\$12					

System	Welcome
System	Let's start the game... you can bid now
Nancy	I think voice command is important. anyone agree?
Don	biggest issue for me is scratches/sitting on glasses. Unbreakable?
Eloise	agree... I've bought 3 pair of reading glasses so far this year
Eloise	\$15 for me against unbreakable frames
Linda	traffic direction first: I hate paying extra for GPS when I'm traveling. \$40 for me there


Don
▼

Buy A Feature Online - Results



Buy a Feature - An Innovation Game - Mozilla Firefox

File Edit View History Bookmarks Yahoo! Tools Help

 **buy a feature**
AN INNOVATION GAME

- Home
- Logout
- Edit User
- Change Password
- Client Mgt
- Project Administration

Overview **Results Summary** G1 G2 G3 G4 G5

ie-sunglasses

	Purchases	Bids	Chats View...
Unscratchable Lens	<div style="width: 40%;"></div>	<div style="width: 10%;"></div>	
Unbreakable Frames	<div style="width: 30%;"></div>	<div style="width: 10%;"></div>	
Darkness Controls	<div style="width: 35%;"></div>		
Find Nearby Friends	<div style="width: 25%;"></div>	<div style="width: 25%;"></div>	
Integrated Headphones	<div style="width: 25%;"></div>		
Traffic Directions	<div style="width: 25%;"></div>		
Wind Blocks	<div style="width: 25%;"></div>		
RSS Streaming	<div style="width: 10%;"></div>	<div style="width: 30%;"></div>	
Voice Command	<div style="width: 10%;"></div>	<div style="width: 10%;"></div>	
Landmark Lessons	<div style="width: 10%;"></div>		
Stock Ticker Stream		<div style="width: 10%;"></div>	
Streaming Music			

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Find: user Match case

Break into teams...

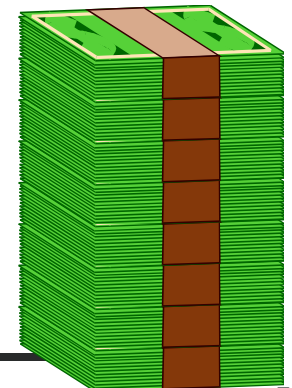


-
- Describe a persona and use case
 - How will customer value this service?
 - Competitive options
 - Natural unit of value exchange?
 - “Quantity one” price?
 - Levels, tiers or bundles?
 - ***Present your recommendations***

Take-Aways



- Market pricing starts with audience's pain
- Pricing model aligned with pain
 - Units make sense
 - Savings >> price
 - KISS
- Must support business model
- Complex pricing plans impede sales process
- Invest in research if you can
 - Competition, interviews, historical databases



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