How to Grow SaaS Revenue, Profits and Market Share with Use-Appropriate Software Licensing and Pricing

Executive summary
The initial wave of software-as-a-service (SaaS) was characterized by “one-size-fits-all” pricing. This was largely because SaaS vendors were out to pioneer a new market—and simplicity was a cornerstone of their pitch to early adopters. The offer of extremely simple and economical pricing helped these vendors overcome whatever resistance they may have encountered to a new and unproven model for software delivery.

With increasing adoption of cloud services, the SaaS marketplace has changed dramatically. SaaS and other on-demand models have now been fully embraced as compelling alternatives to traditional on-premises software deployment for many reasons. These reasons include reduced total cost of ownership, faster time-to-benefit, greater flexibility to increase or decrease capacity, and easier delivery to remote, mobile and/or third-party users.

Unfortunately, many SaaS vendors still employ a one-price licensing model, even though customers have already demonstrated their acceptance of—and even preference for—pricing that more accurately reflects the actual value that a SaaS solution delivers.

Vendors who don’t move beyond one-price SaaS model suffer from two core problems:

1. They leave money on the table. When vendors charge a single price for their SaaS offerings, they are giving away features and functions for which customers would certainly pay a premium. This substantially reduces revenue and margins.

2. They miss sales opportunities. Vendors who don’t offer lower-cost, entry-level solutions miss out on substantial sales to both potential and existing customers. This reduces near-term revenue and market presence. It also forfeits long-term opportunities for up-sell/cross-sell revenue.

The solution for SaaS vendors is obviously to implement software licensing and pricing models that more accurately reflect the value they deliver—and that give customers greater choice with their software spend.

This use-appropriate pricing can be readily implemented without burdening developers or slowing time-to-market. Instead, proven software licensing and entitlement management tools can be used to segment access to software features, set limits on concurrent users, track the number of devices from which any individual user account accesses the software, manage transitions from free trials to paid subscriptions, and define any other use/cost parameters appropriate for a value-based pricing model.

SaaS vendors that fail to evolve past a one-price model will continue to miss out on revenue opportunities. Those that adopt use-appropriate pricing, on the other hand, will grow revenue, margins, and market share. They will also be better equipped to use pricing as a strategic competitive advantage as the global SaaS market continues to grow and mature.

Leaving money on the table
The first wave of SaaS market-makers primarily sold against incumbent on-premises software vendors. In doing so, they faced a variety of psychological barriers to adoption—not the least of which was that SaaS solutions could not match the capabilities and sophistication of conventional enterprise applications.

Against this perception, SaaS market-makers were able to offer compelling incentives of low cost, minimal risk, and great simplicity. These incentives attracted early adopters, who discovered that SaaS is more than just easier and cheaper way of implementing software. It is also great for accommodating peak workloads, supporting mobile/remote users, and provisioning business continuity. Because of how quickly and easily they can implement upgrades, SaaS vendors can even out-innovate their more conventional competition to offer differentiated features and functionality.
Unfortunately, while the superior value offered by many SaaS solutions has been widely recognized in the marketplace, the legacy of one-price SaaS remains. As a result, today’s SaaS vendors typically leave money on the table every time they make a sale.

One-price SaaS tends to shortchange SaaS vendors in three ways:

1. **The one price is too low.** Many SaaS vendors focused on highly attractive pricing in order to optimize the speed and breadth of their market penetration. Now they find themselves stuck at a price point that does not accurately reflect their solution’s real business value.

2. **One-price SaaS doesn’t reflect the added value of premium features.** SaaS vendors keep adding new capabilities to their solutions to differentiate themselves from the competition. But not every customer wants or needs these additional capabilities. So one-price SaaS vendors wind up giving them away to both the customers who use them and the customers who don’t.

3. **One-price SaaS doesn’t reflect the added value of incremental business use.** SaaS vendors tied exclusively to a price-per-concurrent-user subscription model don’t get compensated for the fact that they may be supporting three different shifts of users during a single 24-hour cycle—or that individual users may be using their software (and therefore require support) on two or three different devices. In fact, “credential sharing” among multiple users is costing some SaaS vendors 40-60 percent of their potential per-user revenue.

Of course, most SaaS vendors already charge customers for tangible “extras” such as additional data storage volume, transactions above a specified threshold, and/or data import and export. But these types of ancillary charges are tied to deliverables other than the software itself.

SaaS vendors, however, can also benefit significantly by generating additional revenue based on the additional business value their software provides to customers. If they fail to do this, the profitability of their core software subscription business will always suffer. SaaS vendors should therefore stop leaving money on the table and gain the ability to charge their customers a fair price based on their actual use of the software.

**56% of SaaS ISVs Miss Revenues Due to “One Size Fits All” Packaging and Pricing**

What is your estimate of revenues you are leaving on the table because of “one size fits all” pricing/packaging?

![Bar chart showing estimated revenue missed due to “one size fits all” pricing/packaging](chart.png)

source: Flexera Software online poll of SaaS ISVs, April 2011
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**Missing sales opportunities**

One-price SaaS doesn’t just leave money on the table by not having customers pay for the full business value they receive. It also prices SaaS vendors out of a variety of sales opportunities by making customers pay for capabilities they don’t immediately want or need.

That is, by locking themselves into a single price package, SaaS vendors limit their ability to selectively go downmarket to capture additional revenue and market share.

Three particular sales opportunities that one-price SaaS vendors miss are:

1. **Customers with limited budgets and limited requirements.** SaaS vendors can leverage their development investments by offering entry-level “lite” versions of their solutions to customers who may not need or be able to afford all the functionality—or all of the support entitlements—in the current one-price solution. In addition to representing an immediate source of incremental revenue, many of these customers will grow over time and require additional capabilities that will yield additional revenues.

2. **Customers that can be captured with free trials, discounts and other incentives.** To market their solutions effectively, SaaS vendors need to employ tactics such as free or discounted trials of limited- or full-function solutions. These kinds of sales incentives require the flexibility to create these special-use licenses—a kind of flexibility that simple one-price SaaS does not inherently provide.

3. **Customers that want to extend limited solution functionality to additional users.** Companies often find it useful to provide limited functionality—such as the ability to view data or modify specific data fields—to users other than those for whom the solution is primarily licensed. Entitlements and pricing for these additional seats have to be scaled down as appropriate.

It is important to emphasize that the inability to capture these customers results in more than just the loss of immediate revenue and market share. Customers using limited-function versions of a SaaS solution can be prime candidates for future up-selling and cross-selling. A SaaS vendor’s ability to meet a customer’s need for inexpensive, limited-function seats for an ancillary set of end-users can also be a critical factor in customer satisfaction and long-term account control.

SaaS vendors therefore don’t just need to be able to charge a premium price for premium solution functionality. They also need to be able to scale down functionality and pricing as necessary to address current and emerging market opportunities.

**Making the move to value-based SaaS software licensing and pricing**

One thing that makes one-price SaaS attractive to vendors is its simplicity. You just pick a number and try to sell your solution to as many customers as possible for that number.

SaaS vendors that want to graduate to a more rational use-appropriate pricing model, on the other hand, will need to do three new things well:

1. **Formulate a market-driven entitlement and software licensing strategy.** The first step in any move to use-appropriate SaaS pricing is to determine how to best segment the market by segmenting specific solution entitlements. This requires a reasonable understanding of how different types of customers are using the solution—as well as why prospects have chosen to not subscribe to the solution and/or go with a competitor.

   Key questions to ask in formulating a segmentation strategy include:
   - Which features of the solution can appropriately be considered “premium” features?
   - What minimum set of features would make sense for an entry-level/trial subscription?
   - Can features be segmented by functional modules (such as contract management, purchasing management and payables management)?
   - Are there subsets of features that would be appropriate for ancillary users?
   - Are customers asking for concurrent-user licensing?
   - Is user access to the solution from more than one machine usually essential or optional?
   - How are competitors pricing their solutions? What capabilities do and don’t they offer?

   The answers to these questions are obviously different for every vendor and every market. And these questions are not the only ones that SaaS vendors have to consider when it comes to pricing. As noted earlier, solution pricing can also be tied to parameters such as transaction count and storage utilization—as well as other value-adds such as premium support and vertical market content.

   SaaS vendors also have to temper their segmentation strategies to avoid making them too complex for customers. And they need to continually re-evaluate their strategies to assess their success and modify them as appropriate over time as customer expectations and requirements continue to change.
The central issue, however, is to pinpoint opportunities for better aligning SaaS packaging and licensing terms with the actual requirements of various market segments in order to ensure that pricing accurately reflects what customers want and need.

2. Acquire necessary entitlement management and software licensing mechanisms

To move beyond one-price SaaS and successfully execute a segmentation strategy, vendors have to acquire a variety of technical capabilities. These capabilities include:

- **The ability to flexibly define and deliver service “bundles” based on application features.** This allows an appropriately tiered set of solutions to be offered to customers for an appropriately tiered set of prices.
- **The ability to flexibly define and enforce license usage policies.** This includes the ability to track usage parameters such as the number of concurrent users and/or the specific devices from which any individual user is accessing the application.
- **The ability to flexibly define and manage subscription models.** This includes the ability to track the duration of free trials, to automate activation of paid subscriptions, to provide self-service renewals and upgrades, and/or control access to support resources as appropriate.
- **Full visibility into customer usage.** This is important for seeing whether customers are reaching or exceeding the limits of their entitlements, so that they can be offered the appropriate additional licensing at an appropriate cost.

It is important that these mechanisms are flexible, automated, and easy to manage—so that SaaS vendors can respond to changing market conditions with as little effort and cost as possible. In fact, these mechanisms will ideally not require SaaS vendors to make any substantive changes in their current applications or application development processes. Instead, they should be able to be “grafted” onto the existing SaaS delivery environment.

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**38% of SaaS ISVs use Spreadsheets or Homegrown Tools to Track Entitlements**

Which approach best describes how you keep track of customer entitlements?

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<th>Method</th>
<th>Percentage</th>
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<tr>
<td>Homegrown Tools</td>
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<td>Spreadsheet</td>
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<tr>
<td>Subscription</td>
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<tr>
<td>Honor System</td>
<td>0%</td>
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<tr>
<td>Other</td>
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Source: Flexera Software online poll of SaaS ISVs, April 2011
3. Implement appropriate business processes
Once the right strategy and policy management mechanisms are in place, SaaS vendors can then go to market with business processes that enable value-based customer relationships. These processes include:

**Marketing**
With tiered offerings in place—along with the ability to offer free trials—SaaS vendors can promote their solutions in more targeted ways to different markets. They can also use the web, partners, and events more extensively to promote trial and entry-level solutions. Online pricing calculators may be especially important for helping customers choose from multiple options.

**Sales**
Sales efforts can similarly be targeted to increase penetration into both entry-level and premium markets. In some cases, entry-level opportunities may warrant the starting or growing an inside sales team. Sales compensation plans may also have to be modified to incentivize up-selling of existing accounts.

**Support**
Support entitlements can vary under a tiered system. Also, customer interactions with the support team can provide good opportunities for cross- and up-selling. These factors and others may impact the tools and training that SaaS support staff need.

**Finance**
Financial metrics become increasingly important as SaaS vendors move to value-based pricing. The finance department can provide important insight into which service bundles are contributing the most to operating margins based on price, volume, and cost of sales. This insight can then be used to determine which bundles to push, which bundles should perhaps be discontinued, etc.

**The business benefits of use-appropriate SaaS software licensing and pricing**
None of the steps involved in moving to value-based SaaS pricing are especially difficult or resource-intensive. But they do require some thought and effort—and they represent a fairly significant shift in overall business strategy. So it’s important to fully understand the business benefits that make such a shift worthwhile.

These benefits include:

- **More revenue**
  With use-appropriate pricing, SaaS vendors can get more revenue from customers who are using more of their software’s features and functions. They can also get more revenue from the lower end of the market by selling limited-function, entry-level solutions.

- **More sales/market share**
  By offering entry-level solutions and/or scaled-down licenses for ancillary users at existing accounts, SaaS vendors can greatly extend their market penetration. In addition to increasing revenue, this market penetration creates significantly greater opportunities for future up-sell and cross-sell.

- **Higher customer satisfaction**
  Customers don’t like it when they have to pay for more than they need. They also don’t like it when they can’t buy the extras they want. So, by allowing customers to more closely and flexibly align software spending with business value, use-appropriate pricing drives higher long-term satisfaction and loyalty.

- **Better allocation of development spend to real market demand**
  Use-appropriate pricing enables SaaS vendors to make money from the capabilities that customers want. It also gives them clearer financial visibility into what exactly those capabilities are. As a result, they can be smarter about allocating development dollars to those capabilities that will actually drive revenue growth.

- **Better account control**
  The ability to deliver different functional packages to different types of users within any customer’s organization is essential for account control—especially since it prevents competitors from gaining a foothold at either the low end or the high end.

- **Better use of pricing/bundling as a competitive advantage**
  Pricing is a powerful competitive weapon. SaaS vendors locked into a single-price model will not be able to use pricing as necessary to against competitors that may have advantages in other areas. SaaS vendors that can price and bundle adaptively, on the other hand, can much more readily out-maneuver the competition.

- **Superior long-term adaptability (including readiness for pay-per-use models)**
  The software industry continues to evolve at a rapid pace. Pricing/licensing models continue to evolve as well. SaaS vendors that begin to develop adaptive pricing and bundling management capabilities will be much more be prepared to compete in a market that may eventually embrace pay-per-use models than their less flexible competitors.

The rules of the software game are changing rapidly. To survive and thrive in an everything-as-a-service marketplace, SaaS vendors must be able to quickly respond to shifts in customer expectations and competitive landscapes. One-price SaaS limits revenue, market...
penetration and competitive strategy. Every SaaS vendor should therefore take steps now to enable use-appropriate models for software licensing, bundling and pricing.

**About Flexera Software**

Flexera Software is the leading provider of strategic solutions for Application Usage Management. These solutions deliver continuous compliance, optimized usage and maximized value to application producers and their customers. Flexera Software is trusted by more than 80,000 customers that depend on our comprehensive solutions—from installation and licensing, entitlement and compliance management to application readiness and enterprise license optimization—to strategically manage application usage and achieve breakthrough results realized only through the systems-level approach we provide.

Flexera Software’s **FlexNet Producer Suite for Software Vendors**, a proven solution used by thousands of customers, provides both the licensing and back-office entitlement and subscription management capabilities SaaS providers need to successfully create and deploy use-appropriate pricing models that drive growth in revenue, margins and market share.

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