Pricing Mistakes At Every Stage Of Software Growth

From free betas to discounting to confusing complexity, your software company needs to avoid these pricing mistakes regardless of what growth stage you're in.

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We didn't know anything about pricing in the late 1990s when I was running a software business because, like many founders, we spent the majority of our time and money on the product's capabilities. The challenge with early software products is that your customers ever use only 70 percent of your product and learn to deal (at least short term) with the gaps.

The real pickle no one ever tells you about is that each time you acquire a new customer, that customer uses a different 70 percent of your product, with additional gaps you didn't know about. This creates an enormous backlog of product features that needs to be addressed before the product/market fit stabilizes. And this, in turn, forces software companies to focus heavily on developing crucial product capabilities. Looking back, it's no wonder pricing was relegated out of the discussion entirely in our early years — and then, as with many items on the back burner, it never made its way to the forefront again.

I think a lot of software companies operate in this way. As we re-architected our on-premises solutions for the cloud in 2006, we really tried hard to understand this phenomenon. Why did it take us so long to address pricing? Why were we so consumed on product that we inadvertently spent so little time on constructing how we would acquire and retain customers more profitably — arguably the single most important thing we should have been focused on? We began a multiyear journey to wire the pricing discipline into our business model. It was painful and time-consuming. We made mistakes and learned how to recover quickly. But in the end, we succeeded in addressing the single most important, and often missing, element inside our business model: monetizing our intellectual property with discipline, science, rigor, and good judgment.

PRICING MISTAKES: STARTUPS & EMERGING SOFTWARE COMPANIES

One of the biggest mistakes for young software companies is unpaid betas. If we could get all of the startup founders in the world together in one room, we would tell them to try to avoid unpaid betas. If you're launching a new product and need a small handful of early adopters to help round out the product, or a small handful of success stories in a new market vertical that is challenging to penetrate, that may be reasonable. But as you progress into the beta stage, adopting a strategy of unpaid betas for too long is dangerous. If a software company begins the relationship assigning a value of zero to its software in any way, it becomes incredibly difficult to charge for it later. This approach can easily morph into a free beta or free pilot strategy on an ongoing basis even in markets where a sizable number of customers has already been acquired.

Young companies often rationalize away their leverage in charging for their software under the guise that the buyer is investing their time as well. But the reality is that if there is no money on the line, no skin in the game, the odds are higher that your free software will rarely be used, if ever, during the beta. Worse yet, startups will be cranking their developers in an all-hands-on-deck approach to close feature gaps in the hopes of a potential buyer one day, only to become disappointed. It is absolutely critical that startups spend their time as quickly as possible with paying customers. A buyer participating in an unpaid beta is not a customer.

PRICING MISTAKES: ENTERPRISE SOFTWARE COMPANIES

One of the biggest mistakes for mature software companies is having too much pricing complexity. Engineering rules the roost and has overly complicated how to license, package, and charge for its software. This is further complicated with old acquisitions of on-premises software companies and more recent acquisitions of cloud software companies. The result is often a global sales team in which there is so much friction in the sales process that not only are the salespeople confused, but their customers and prospects are confused, too. And we know confused buyers never buy.

In addition, there are usually large, systemic issues with market fairness: Two customers bought the same thing and paid two different prices. Once customers uncover that they were charged differently for the same set of products and services (which inevitably they do), the software company's brand can take an enormous trust hit, especially in today's world of social media where there really are no secrets.

PRICING MISTAKES: GROWTH-STAGE SOFTWARE COMPANIES

Growth-stage software companies can burn through large numbers of customers without adequately capturing the value they deliver. No market has an endless number of customers. It is crucial that growth-stage companies get paid full value for their software during this stage. Otherwise, they run the risk of having tons of customers and uncovering too late that they left too much money on the table. This can be the difference between having an option of going public or not. If you fail to capture the value you deliver along the way, you really kneecap the enterprise value you can achieve in the long run.

DISCOUNTING MISTAKES

Most software companies leave far too much flexibility in the hands of salespeople when it comes to discounting. There is nothing wrong with structured incentives. But discretionary discounting, beyond scheduled company discounts, for example, will always get the software company in trouble. In poker, they refer to leaks in your game: places where your strategy isn't tight enough and can be exploited in the form of your losing money. For software companies, salespeople's (including the deal desk's) flexibility on discretionary discounts is one of the largest leaks in the game of pricing.

If you've ever sold software, you know that discounts are a fact of life. Structuring incentives into your monetization approach is a critical success factor. If you fail to do this, larger companies and aggregators most likely will avoid doing business with you. Today's buyers are much more educated. They understand how costs scale in the cloud. They understand gross profit margins for software companies are often in the 80+ percent range. If they're buying a lot of your software, they're going to expect that your pricing approach addresses this. If your answer is "We don't discount," that's fine. But you have to be OK with the consequence of that decision, which is likely very few sales to larger companies.

EVALUATING & ADJUSTING PRICING

Any software pricing project that doesn't help grow revenue and profitability is a complete waste of management's time. Bottom line: Salespeople should be able to sell more and do so faster. How often should software companies evaluate and adjust their feature set? Every time a new feature is developed, there is a potential of greater value-add to the customer and therefore a potential to increase prices.

When prices are adjusted outside of standard, yearly price increases, this shouldn't affect existing customers. Instead, licensing, packaging, and pricing should come into play to attract new customers and get older customers to either increase their usage of the software or buy additional capabilities being offered. It would be a terrible mistake to tell a customer that, despite selling them on one value equation a year ago, their pricing has now changed significantly because you have a different perspective on the value you deliver. Their perspective hasn't changed in this example, and any customer who has their head on straight will simply defect to the competition or some alternative. Remember, people buy on emotion and rationalize with logic. If customers feel treated unfairly in any way, their emotional response can make them take their business elsewhere, even if it logically isn't the best option for them.

When it comes to pricing, if you're a startup, don't overthink it. If you're a growth software company, you're probably already late to the game if this is the first time you're reading about this. If you're an enterprise software company, there's no time like now to begin cleaning up the mess! S

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