

Best Practices in Pricing B2B Software & Digital Hardware Solutions

Offer Design in the Subscription Era

Enter the Digital Era

From an age of on-premise desktops, servers, and mainframes, to an era of connected devices, cloud computing, big data, and digital transformation; the world and technologies around us are changing at a seemingly rapid pace. These technological changes not only provide hardware and software vendors the ability to create new value and ultimately improve their products and services, but also in how such companies deliver, price, and monetize those products and services.

The Complexity of Pricing in Today's B2B World

There can be a high degree of complexity around pricing, monetization, and offer design in the world of business-to-business (B2B) software and software-enabled hardware. From managing large-sized multi-year deal opportunities, to selling into procurement arms, to developing complex product portfolios that includes new innovation (such as AI, or IoT), to supporting clients on a variety of differing software versions and delivery models (including on-premise and SaaS). It's no wonder B2B pricing and offer design can be a confusing undertaking for product management and pricing teams. Enter a need for best practices in B2B pricing in the Digital Era.

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Article Highlights

- **B2B "DIGITAL PRICING 101" FUNDAMENTALS.** Key pricing concepts, revenue models, and pricing schedules (contracting)
- **OVERVIEW OF THE DIGITAL PRICING FRAMEWORK.** Pricing processes for developing and implementing new price structures
- **OFFER DESIGN.** Tactics, pricing tools, and examples to deliver value-based segmented commercial offers

INTRODUCTION

THE JOURNEY TO BETTER PRICING IN THE DIGITAL ERA

Achieving best practices in B2B solution pricing can be a journey for one's organization. Product teams will need to be realistic about what can be achieved in the short, medium, and long-term. Much larger pricing transformation initiatives, for example, such as migrating the portfolio from on-premise to SaaS requires company-wide co-ordination and major changes across cross-department processes, systems, training, policies, and client contracting. Even more so for those organizations that are transitioning from legacy one-time capital-based sales, or CAPEX, to "Everything-as-a-Service" (XaaS) and "Hardware-as-a-Service" (HaaS) sales under operating expense, or OPEX, models. That being said, there are always opportunities for quick wins that can deliver more immediate benefits. Key to a successful pricing improvement journey is to plan, prioritize, and establish realistic expectations.

The Digital Pricing Framework

Frameworks and processes are not uncommon in the world of software. Consider the likes of Agile, Waterfall, Scrum, and vmodel (Eriksson, 2016). Even the product management discipline itself is governed by frameworks such as the Software Product Management (SPM) Framework (ISPMA, 2019). Such processes and methodologies are the cornerstone for delivering digital project success and positive outcomes; B2B digital solutions and XaaS pricing processes are no exception.

Pricing processes help to establish best practices, consistency, and improved end-to-end pricing delivery across an organization that surpasses, from a growth and financial perspective, outcomes that would otherwise be achieved under more ad hoc pricing approaches. Successfully developing a value-based segmented pricing approach involves using the right design inputs, the right company-wide price-value training, and the right approaches to executing pricing within B2B deals. It's this full company-wide process of developing and delivering new value-based strategies in the marketplace that truly makes pricing a strategic capability for one's organization.



CONTINUOUS CYCLE OF PRICING IMPROVEMENT

- » **OFFER DESIGN.** Develop the right value-based offers, to the right clients, at the right price.
- » **ENABLEMENT.** Drive the desired pricing strategy outcomes with enabled Sales and channel teams.
- » **EXECUTION.** Best practice implementation of pricing strategies to deliver profitable deal wins and drive client growth.

Figure 1: The Digital Pricing Framework ©

The Digital Pricing Framework

OFFER DESIGN

From strategy, to value analysis, to price structure development (packaging, metrics, tiers), to financial analysis and price stress testing – the offer design phase ensures product and pricing teams bring in the right inputs and analysis to drive the most favorable value-based segmented pricing and offer structures. A stress-tested commercial price list is the final output of this phase that ensures both Sales and Product teams are armed with the right pricing tools that drive a successful commercial offer strategy.

ENABLEMENT

Whether its internal Sales teams, channel partners, customer success representatives, and even technical support staff - enablement is a critical activity for understanding how one's software is packaged, priced, and linked to one's "value story". New pricing strategies and business models are accompanied with "all-on-board" organizational alignment programs and effective communications that bring transparency to new pricing structures, deliver new monetization opportunities, as well as awareness and compliance with respect to new guidelines and policies.

EXECUTION

Applying an effective bid-evaluation process, assigning pricing negotiation policies, and applying pricing approval matrices avoids a "race to bottom" price approach when submitting best-and-final-offer (BAFO) in bids. As well, consistently monitoring win/loss outcomes, optimal key performance indicators (KPIs), and insights from post-bid award reports are critical to act as an Early Warning System for on-going re-adjustment to pricing and offer structures.

THE PRICING ECOSYSTEM ("PECO")

At the center of the framework is the Pricing Ecosystem (termed PECO); this includes all other people, processes, systems, incentive structures, and policies within an organization that are impacted by changes to revenue models, pricing, and offer structures. Cross-functional teams need to be consulted and informed throughout the Offer Design phase to fully understand the company-wide PECO implications and ensure a well coordinated plan drives to the desired milestones and outcomes.



“World class organizations excel at making pricing, offer design, and commercialization a strategic capability.”

Scott Miller, Founder
Miller Advisors Inc

The Digital Pricing Framework (con'd)

FRAMEWORK SUB-PROCESSES

Each major process within the Digital Pricing Framework (Offer Design, Enablement, & Execution) is supported by underlying sub-processes (Figure 2) that brings rigor to the new pricing evaluation and decision processes, as well as ensuring an “all on board” company alignment when implementing new pricing strategies.

It is not uncommon when developing new pricing strategies to manage and co-ordinate a variety of sub-tasks and inter-connected mini-projects across cross-functional teams. Co-ordinating company efforts is key to success when implementing new pricing strategies, and the sub-processes below can serve as a both a “next steps” checklist and planning tool for product and pricing teams.

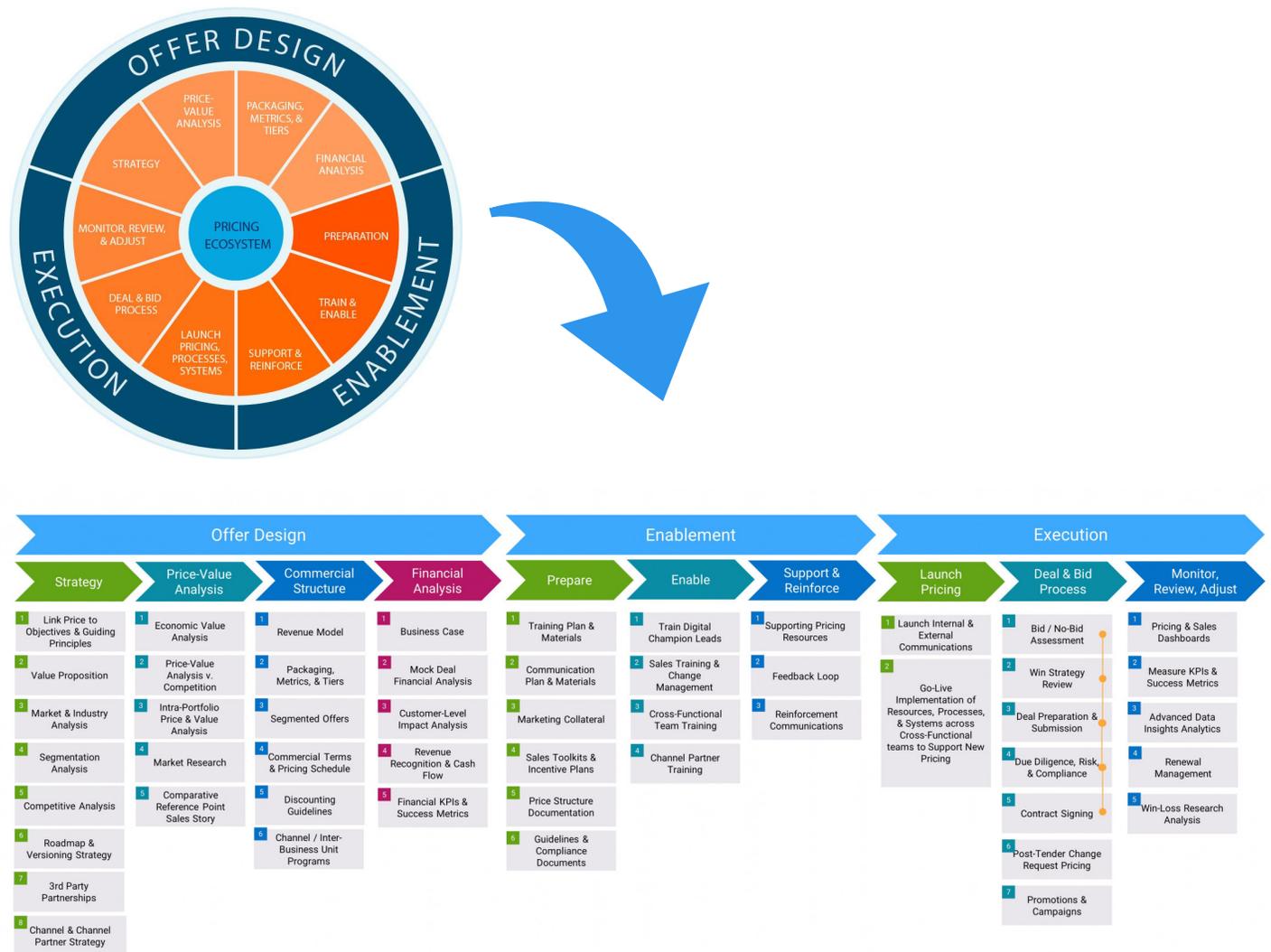


Figure 2: The Digital Pricing Framework Sub-Processes

B2B Digital Pricing 101: The Basics

Understanding the fundamentals for B2B software pricing helps to create a foundation for pricing best practices and sets the stage for the Offer Design phase within The Digital Pricing Framework. In this section, we will discuss B2B revenue models as well as an overview of industry practices around contracting B2B pricing.

Revenue Models

Revenue models serve as the basis for how clients pay for, and use, one's software solution. The most commonly used B2B software revenue models include the following:

PERPETUAL LICENSE

A type of software license that authorizes a business or government entity to use a particular version of a software indefinitely. Most often, a perpetual license is applied towards on-premise deployments (whereas subscriptions are used for cloud environments). From a pricing perspective, clients will pay a one-time software fee that, in many cases, also includes a recurring annual maintenance and support (M&S) fee portion (see 'Maintenance and Support').

TERM-BASED LICENSE

Somewhat similar to a perpetual license, though instead of a one-time upfront fee, there is a lump-sum fee alongside a recurring annual M&S fee; this lump-sum fee is payable at each time of the term renewal. Clients are entitled to use the software only during the term of the contract. Term-based license pricing can be quite lucrative from the software vendor standpoint compared to perpetual licenses, benefiting from the lump-sum payments at each time of renewal; however, this license approach is known to create client "sticker shock" during the renewal process with higher risks of a renewing client issuing a new tender.

MAINTENANCE AND SUPPORT ("M&S")

M&S involves the modification of the software product to address faults via bug fixes and patches or improve performance to ensure a software solution operates seamlessly 24/7 without any failures that can cause workflow disruptions and potential economic loss for one's client (ISO, 2006). M&S is traditionally calculated as a percentage (%) relative to the one-time perpetual or lump-sum term-based license. For example, 25% M&S fee of \$1M one-time fee = \$250,000 M&S per annum. M&S in the case of perpetual or term-based licenses is charged as a separate recurring fee, whereas activities relating to M&S would be inherently priced within subscription fee and not charged as a separate invoice line-item price structure.

SUBSCRIPTION

Typically a recurring monthly or annual license fee that entitles a business or government entity to use the software or XaaS only during the subscription term (unlike perpetual that allows them to use it indefinitely). Subscription fees also inherently bundle the M&S fee (not priced separately as in the case of perpetual or term-based licenses), application management, hosting, and compute power, in addition to the software value itself.

Though subscriptions are more commonly used for XaaS (whereby the subscription fee also includes hosting and application management), this is now becoming more widespread for on-premise solutions as well. The total annual subscription fee for B2B contracts are often calculated as a roll-up of underlying metric fees (see Metrics section).

Revenue Models (con'd)

PER USAGE FEES

This revenue model works well for services that are more transactional in nature, such as the number of transactions processed, or number of reports accessed, to name a few. A downside in the B2B setting with per usage is the creation of variability in fees from one time period to the next for the client; this variability can prove to be challenging for business clients or government entities that want to operate under a more predictable fixed budget approach. In these cases, a per usage metric fee can be used as an underlying calculation to derive a larger tiered on-going subscription fee (eg., \$0.25 per transaction x 300,000 average transactions per year = \$75,000 per year). An overage fee can be included to account for any outlier usages beyond an agreed to threshold volume amount.

OUTCOME-BASED PRICING

This revenue model links a fee reward to measurable outcomes that can either include (a) a desired financial outcome incurred by the client as a result of using the digital solution, or (b) a desired operational performance that is measured by a success metric. As an example, a 20% share fee applied against a realized \$1.5M financial cost savings a client incurs by using a productivity improvement software solution. This fee-to-financial-outcome approach has more recently been used heavily by artificial intelligence (AI) software firms (Bean, Leoni, & Blezat, 2018).

Or alternatively, in the case of relating to a fee to a performance success metric, Ellie Mae mortgage software's Success-Based Pricing model applies a fee charged to users only in those cases where loans processed with their software are converted to closed (won) loans; an advantageous approach as it provides unlimited use with payments timed to their client's own cash flows.

REVENUE SHARE PRICING

Revenue share ("Rev Share") can be an effective pricing strategy in those cases where one's software is (a) part of a client's revenue-generating transactional processes, or (b) a major component of a client's overall operations. For example, video capture technology firm SafeFleet is able to price as a percentage (%) of total ticket revenue generated for a city by capturing license plates and issuing violation packages for vehicles failing to stop for school buses.

In other cases, perhaps one's software is mission-critical for backend operations and company workflows, and could price as, say, 3% of the client's total annual revenues. Under the right circumstances, these pricing models can be extremely lucrative compared to traditional licensing or subscription models, and can also scale nicely over time as client revenues grow.



Figure 3: Common Software/Digital Revenue Models

Which Revenue Model(s) is/are Right for Business?

Although subscription pricing is leading the charge in many cases, every B2B business is different, and there is no silver bullet option that works for all B2B software and software-enabled hardware firms. Each revenue model option needs to be adequately assessed with respective pros and cons in order to determine the most favorable go-to market revenue model that best supports one's overall objectives. It should be noted, that in many cases for enterprise B2B vendors, there could also be potential to apply multiple revenue models.

For example, an opening sales offer position could include a new SaaS or XaaS subscription model, while adopting a fall-back term-based license on-premise offer in those cases where demanded on the part of the client – this is particularly common with vendors selling into government agencies who may not be ready to implement SaaS solutions, nor have the operational budget (OPEX) to support annual subscriptions. Although managing two revenue models (and possibly delivery platforms) can be much more costly, it may help to risk mitigate against a market that has not yet fully adopted one particular revenue model or delivery platform of choice. For example, launching a new SaaS software product with both SaaS and term-based licensing models is seen as more favorably by investors than launching a new product only with SaaS model (Nurkka, Waihl, & Alexy, 2017).

As highlighted in **The Digital Pricing Framework**, if your organization adopts a new revenue model, it will be critical to fully understand the company-wide and client implementation considerations: from Offer Design, to Enablement (including change management), to Execution (including RFP responses and new performance metrics), as well as other activities defined within the Pricing Ecosystem (new contract agreements, new revenue recognition, new sales incentives, etc). Selecting a new revenue model is but the first step in much wider set of activities including cross-departmental internal projects before being in a market-ready position with your new commercial offer.



Monetizing your Digital Solution

Pricing and monetization are often used as two interchangeable terms, though they are quite distinct by definition. "Pricing", for example, can refer to specific price points of a particular product offer, whereas "monetization" is more about strategy and tactics used to grow revenue across new, existing, and lost (winback) clients.

MONETIZATION STRATEGIES

Monetizing your software can be classified into the following strategies:

- New Acquisitions
- Upsell
- Cross-sell
- Renewals/Retention
- Winback

Each of these key monetization categories can include a variety of tactics that ultimately strive to drive new and incremental growth (and potentially defend against lost revenue). It's important to highlight that **different pricing and offer structures are often required for different monetization tactics**. A one-size-fits-all pricing strategy, for example, will likely drive suboptimal outcomes. For example, in the case of B2B SaaS, one pricing strategy will be required to onboard new clients, whereas a different pricing strategy may be required to migrate/upgrade clients that have already made an investment in your platform.

WHERE TO FOCUS

Key for a successful monetization strategy is growth... growth... and more growth. This growth needs to be strongly linked with the right value, to the right segments, at the right price & offer structure. A co-ordinated effort needs to happen between product teams (ie., what to develop) and sales teams (ie., where should we focus our monetization efforts). Monetization strategy focus can also shift over the course of the product lifecycle (eg., focus more on upsells when in a mature market stage), or even market conditions (eg., focus on acquisitions in an upturn).

MAXIMIZING CUSTOMER LIFETIME VALUE (CLV)

Monetization can also be thought of as a means to maximize the total amount of money a client is expected to spend in your business (software, hardware, and services) during their lifetime. From new acquisition, to upselling, to cross-selling, to renewals, and winback of lost clients - different monetization tactics and selling priorities are an important part of an ongoing client growth strategy throughout different stages of the vendor-client engagement. One thing is for certain - **delivering value is always "the" key ingredient to maximizing CLV**, and understanding the relationship between price and value across segments will be critical to design a successful and optimal monetization strategy.



Figure 4: B2B Monetization Category Examples: Pricing and Offer Structures Can Differ Across each Category

Pricing Schedule Components

ONE-TIME FEES

Implementation, consulting, and data migrations are typically the largest of the one-time fees. These are often calculated based on time and material (T&M) pricing that should, in theory, be similar in amount for similar sized clients, purchasing similar solutions, with similar deployments. Costs beyond this can vary based on factors such as integration costs with other systems, customizations, and process changes. Localized implementations and regional differences in labor rates and regulations can also impact variation in implementation fees.

In some cases, hardware is sold as a one-time fee alongside a recurring subscription bundle fee. For example, Axon, maker of body-worn cameras, charges a one-time hardware purchase fee upfront with their recurring annual subscription fee. The recurring subscription fee acts more as an upgrade assurance program over the course of the contract term that includes hardware refreshes every 2.5 years.

RECURRING FEES

B2B and B2G is now seeing a shift to subscription models from what was once dominated by perpetual licenses. A benefit to highlighting an annual fee schedule over the contract term is that it creates awareness with a client around receiving on-going value from the software, as well as setting the stage for pre-determined price increases and renewal options.

One myth in applying subscription pricing in B2B is that "customers can cancel after the first year" – an undesirable outcome, especially where implementations can be highly complex and costly. However, B2B software vendors can successfully apply subscription pricing models without this fear of initial year cancelation by including a non-cancelation clause across a fixed term commitment. B2B subscription term commitments for complex implementations now run an average of three (3) years to five (5) years. Compare this to some legacy B2B perpetual license contracts that were traditionally 10, 15, and sometimes 20 years in length (Note: Subscription contracts can indirectly be extended to 10+ years. See section 'Renewal Options').

Other key points to highlight for B2B subscription pricing include: (a) annual subscription fees are typically held constant each year during the term commitment, (b) fees are increased at time of renewal, (c) subscription totals can be linked to underlying metrics – identify these within the pricing agreement, and (d) overages are included to factor increased volumes or usage above the contracted baseline volume/usage threshold amount.

Transitioning to Recurring Revenue (aka Subscription) Models?

Adopting subscription over one-time sales models requires a mindset change around product, sales, and service teams. For example, traditional hardware sales may have included a one-time sale with a specified warranty period. But in the world of XaaS subscriptions, the approach may instead inherently include costs of hardware (eg., \$1999/year) spread out over the course of the contract, as well as on-going hardware servicing, replacement of broken units (warranty period becomes irrelevant), and/or even a refresh of the hardware itself at a specific point in time within the contract period.

Ultimately, the key ingredient to a successful B2B subscription bundle model is that **recurring fees coincide with recurring value** (vs. one-time sales mentality) as well as **a solution-based mindset** that integrates on-going value from hardware, software, and services bundles.

Pricing Schedule Components (con'd)

OVERAGE / TRUE-UP FEES

Clients can grow in size (volumes, usage, and users) either organically or through mergers and acquisitions over the course of a contract, and this growth above a baseline contractual volume can be further monetized through overage fees. Overage fees typically reflect the underlying metric(s) that are used to calculate the total annual subscription fee, and are paid above and beyond an agreed to threshold permitted volume amount that was used to calculate the original subscription totals. Typically with overage fees, the baseline subscription amount will increase permanently based on new volumes purchased.

In some cases, volumes from one year to the next can unpredictably increase or decrease relative to a baseline subscription amount. In these cases, one may want to consider a true-up fee approach whereby additional fees are added to a billing period invoice based on actual volume amounts that exceed a minimum order amount (MOA) as agreed to within the subscription. The baseline subscription remains unchanged, but invoice amounts may vary from one billing cycle to the next based on actual volumes.

RENEWAL OPTIONS

B2B contracts, in particular those with subscription offers, should include renewal option(s) within the agreement. This is a clause that outlines the terms of renewing or extending the original agreement and, from a pricing perspective, pre-determines a renewal price increase calculated in two additive parts: (a) a standard percentage increase, plus (b) a Cost-of-Living Adjustment (COLA). Renewal options help to indirectly extend the contract length, simplifies the renewal negotiation process, and lessens the likelihood of cancelation or re-issuance of a new RFP.

OTHER ANCILLARY FEES

Ancillary fees such as one-time training and training materials may seem insignificant, but can be used to drive incremental monetization opportunities increasing Total Contract Value (TCV) by as much as 1% to 5%. Avoid where possible bundling these components for free as they can provide incremental value to clients.

Examples of ancillary fees include: user group fees, on-going training and training material fees, and premium customer success fees. WorkDay (a cloud-based ERP platform) for example, charges an annual premium customer success fee for those clients who want a direct contact for customer support enquiries.



Offer Design

The Road to Value-Based Segmented Pricing & Offer Structures

With an understanding of the foundation and examples of contractualization of B2B software pricing, an organization is now ready to ask the key question: "how do we go about pricing our software solution?" Enter the Offer Design process within The Digital Pricing Framework. This process focuses heavily on applying value-based pricing concepts and tools to develop optimal and segmented pricing and offer structures. This stage consists of four sub-processes: (a) Strategy, (b) Price-Value Analysis, (c) Packaging, Metrics, & Tiers, and (d) Financial Analysis.



In many ways, the four **Offer Design** sub-processes can be analogues to skydiving:



Strategy (10,000 foot pricing view) starts by gathering key inputs - strategic, industry, and competitive analysis - that determines pricing guidance principles, product, and customer segmentation strategies.



Price-Value Analysis (2,000 foot pricing view) seeks to determine approximate price positioning based on perceived value, requirements, use cases, and willingness-to-pay across key segments.



Packaging, Metrics, & Tiers (500 foot pricing view) seeks to create segmented price lists (packages, price metrics, and tiers) as well as discounting guidelines and approval matrices.



Financial Analysis (ground-level pricing view) is the final phase that involves conducting price stress testing as well as profitability and cash flow analysis that contributes to final decisions around commercial offers and pricing policies.

Following these four sub-processes within the Offer Design phase will ensure your organization has conducted a rigorous and well thought out assessment of pricing strategies and tactics that sets the stage for your final go-to market commercial offers.

“ Offer Design is similar to skydiving: From strategy, to price-value analysis, to offer structures, to financial analysis. Each sub-process brings you from a 10,000 foot strategic pricing view, down to a ground-level, value-based, segmented commercial offer.

Offer Design

STRATEGY (The 10,000-foot view)

Strategy is a first step to gathering the right inputs that determine the go-forward short and long-term pricing and offer a design approach. Not only does a strategic assessment help to guide offer design, but it helps to drive product strategy decisions, including product positioning, new product introductions, product marketing, value selling, as well as value innovation and portfolio investments (Gale & Swire, 2012). The software strategy review process involves integrating and interpreting the implications of a variety of inputs from the following strategy-related categories:

- Link Price to Objectives and Guiding Principles
- Value Proposition (including Differentiation, SWOT analysis)
- Market & Industry Analysis
- Segmentation Analysis
- Competitive Analysis
- Roadmap and Versioning Strategy
- 3rd Party Partnership Strategy
- Channel & Channel Partner Strategy

Product management teams will need to spend an adequate amount of time to gather, discuss, and interpret strategic insights and determine how this impacts the short, medium, and long-term go-to-market pricing, customer, and product strategies. From a pricing and offer design perspective, this strategic analysis should be documented into a set of guiding principles that acts as a vision when designing and selecting optimal offer structures.

The importance of strategic analysis can never be underestimated: It is the pre-cursor to building sound pricing strategies, structures, and tactics. Ensure your team reviews these on a quarterly basis to identify new opportunities and changes within a fast-moving market. A more in-depth strategic assessment should be kicked off 2-3 months prior to Annual Strategic Planning Reviews that allows adequate time spent to assess and extract major insights that will influence pricing improvement initiatives.



Offer Design

PRICE-VALUE ANALYSIS (The 2,000-foot view)

Value-based pricing is defined as setting prices primarily to the perceived or estimated value of a product/service to the customer, rather than according to the cost of the product or historical prices. Linking price with value can be achieved using two useful software pricing tools: (a) Economic Value Analysis, and (b) Price-Value Trade-Off Analysis. These tools will help to establish the higher-level price positioning views that will serve as the price targets for the underlying roll-up of the price structure (packaging, metrics, and tiers).

i. Pricing Tool#1: Economic Value Analysis

This analysis articulates value in terms of client financial improvements as a result of using the software solution – this can include revenue growth, cost savings, cash flow improvement, and/or mitigation of financial risk. Software is then priced in the context of those financial benefits: “Similar sized clients with similar challenges have achieved savings of over \$1M per year using our software. At our price of \$150,000 per year, you’re still getting an 85% discount off the worth of the product.”

The more likely a client feels they can achieve these financial benefits, the more likely they are going to believe in your pricing strategy. B2B software and digital hardware vendors can typically price between 15 - 25% where there exists a high-confidence in the economic value for using the software. Guaranteed outcomes (eg., outcome-based pricing) can sometimes be as high as 50% - 60%. Economic value should be backed by case studies as well as trustworthy client references. Where there exists little data in terms of proof points, use conservative estimates for how you expect key performance indicators (KPIs) on the client side can be improved with your solution, and how that ultimately drives to economic benefits.

ii. Pricing Tool#2: Price-Value Trade-Off Analysis

This tool is particularly useful to not only link the price and value relationship, but to understand the client buying decision drivers and how your software offering compares against next best alternatives (ie., competition and/or other products within your portfolio (cannibalization), or even a client deciding to develop an in-house solution). This analysis seeks to quantify both price and value using a weighted scoring approach, factoring the trade-off a client segment makes between price and value. One major advantage of using this tool for larger B2B and B2G client opportunities is that it also mirrors the commonly used scoring approach used by procurement arms as part of their RFP assessment to determine a vendor contract award.

	Price	Value	Price Score	Value Score	Price Sensitivity (Price:Value Weighting)			
					Low 20:80	Moderate 30:70	High 40:60	LPTA ¹ 100:0
					Total Score	Total Score	Total Score	Total Score
Software Company A	\$1,530,000	Good	6.2	6.4	6.4	6.3	6.3	6.2
Software Company B	\$1,210,000	Acceptable	6.7	5.0	5.3	5.5	5.7	6.7
Software Company C	\$943,000	Marginal	7.5	4.8	5.3	5.6	5.9	7.5
Software Company D	\$2,450,000	Outstanding	5.2	6.9	6.6	6.4	6.2	5.2

 = most likely selected vendor (highest total score)

¹ LPTA = Low Priced, Technically Acceptable bid contract. So long as vendors meet a minimum technical requirement, a decision is based solely on price.

Total Score calculated as Price Score x Price Weighting + Value Score x Value Weighting (eg., 7.5 x 0.20 + 8.0 x 0.80 = 7.9 Total Score)

Figure 7: Price-Value Trade-Off Analysis (Scorecard)

Final scores are determined based on the trade off between price and value (a reflection of price sensitivity, which can differ across segments). For example: Software Company D (Figure 6) can command a price premium of \$2.45M for those segments where price:value trade-off is <= than 30:70. Higher price sensitive segments above 30:70 will start to see purchase decisions going to lower priced competitive offerings. On average, most B2B clients purchasing a B2B software solution have around a 30% decision based on price, and 70% based on value.

Offer Design

PACKAGING, METRICS, AND TIERS (The 500-foot view)

This process focuses on creating well-defined pricing and offer structures that integrate the 2,000-foot view price positioning findings from our previous Price-Value Analysis. During this process, teams will need to assess (a) optimal **packaging** formats that support pricing and monetization objectives, (b) ideal **metrics** that address differing use cases & requirements across segments, and (c) **tiering** that takes into consideration volume discounting and price levels. The goal of this phase is to develop an indicative commercial price list alongside guidelines and policies to manage allowable negotiation and price floors.

i. Packaging

Similar to restaurant menus, software can be sold as an a-la carte approach, or more as a bundling approach – these bundles can be used to target different segments with differing needs (value) and differing price sensitivities.

It will be important to assess which package best aligns to the original guiding principles as defined with the Strategy phase. Functional packages, for example, may be more preferred in those cases where clients integrate a mixture of different vendors into a larger system – a common occurrence with large ERPs with differing functions including Finance, Payroll, HR, and Cash Management. In this case, applying a modular approach where a client must first purchase a baseline core system before purchasing the ERP module could put a software firm at a disadvantage over a firm that sells a software component as a functional standalone offer. Alternatively, modular packages may prove to be more beneficial during a mature lifecycle phase that enables monetizing a legacy client base with new innovations and feature sets.

Types of software packaging include:

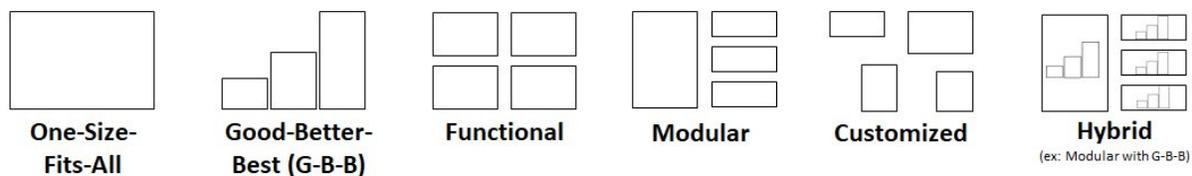


Figure 8: Software Packaging Types

Key questions to ask when evaluating software packaging structures:

- Can your new packaging approach be supported/available in the short, medium, and long-term roadmap?
- Does the packaging support desired target segments? How will your offer differ from one segment to the next?
- How does your competition package their offering? Any advantages/disadvantages to their approach?
- Does your pricing and packaging optimize product mix and enable new monetization (upsell) opportunities?
- Does your packaging allow you to highlight your key market differentiators? Or do you need to consider "un-bundling" these differentiators that might otherwise be muted in the larger bundle?
- Are your systems (billing, contracting) ready to support the desired package format?
- To what extent will you allow for bespoke/customization vs. configuration in your packages?

Decisions around packaging types is key for maximizing revenue and growth. **All too often, software vendors will "build it first" and then realize after-the-fact they are under-monetizing as a result of using a suboptimal packaging format.** It will be critical for product and pricing teams to assess how best to price and package their software offering at the beginning of the product development stage to ensure all roadmap efforts are closely aligned with an optimized pricing strategy.

Offer Design

ii. Metrics

A software metric is a standard unit of measure that links a fee structure to six possible software dimensions: access-based (who is accessing), architecture-based (resources being accessed), content-based (what is being accessed), usage-based (how much and how often it is being accessed), as well as outcome & revenue-based metrics. In a more simplistic software pricing environment such as B2C, one metric can serve as the basis for determining the pricing strategy (eg., per user fee). However, where B2B solutions are concerned, a greater degree of solution complexity and client use cases often calls for the use of multiple underlying metrics that roll-up to determine the overall license or subscription fee.

Commonly used licensing and subscription metrics include:

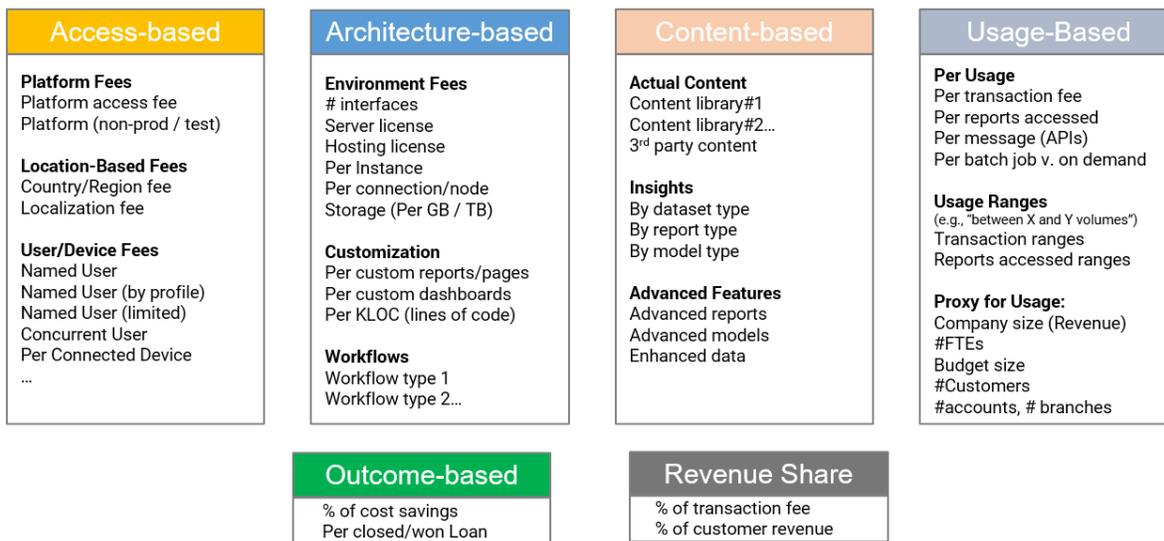


Figure 9: Common Software Metric Types and Examples

"Which metrics are the best metrics for my software?". There is no silver bullet answer – but there is a process to evaluate the options. Every B2B software is unique and requires an assessment to evaluate potential options while weighing the respective pros and con. During this metric evaluation phase, product and pricing teams can ask the following questions to determine the most ideal metric option for their software:

- Does the metric represent value delivered?
- Does it provide incremental monetization opportunities?
- Is using one metric overly simplified? Or alternatively, do you have too many metric options that overwhelm the client?
- Is it sellable and well understood by your client?
- Can it be measured and billed? (ie., does it require enhancements to your current billing system?)
- Does it mitigate any unforeseen risks? (in particular, help to recover underlying 3rd party license costs)
- Is it scalable? (ie., does your revenue grow as your client grows organically and inorganically)
- How will these metrics change based on delivery model type? (on-premise vs single tenant SaaS vs multi-tenant SaaS)

One software company, who specialized in helping healthcare providers detect insurance claim errors and fraud using AI changed their licensing metrics from "number of members" (a good proxy for usage and client company size), and ultimately adopted a "per transaction type" metric (eg., out-patient, in-patient, and professional claims) that was a better reflection of their true value and use case for their software engine. This metric change alone resulted in +30% gains in how they priced (and won) new opportunities.

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iii. Tiering

Tiering is a methodology that creates variation in pricing and/or packaging value that targets a defined client segment. These clients can vary in terms of size (small, medium, large), usage volumes (low to high), requirement needs (low to high feature requirements), or price sensitivity. For example, tiering can include price-volume discounts where a discounted per fee metric is applied for larger overall volumes. Or alternatively, a good-better-best packaging format that increase a package's content and features alongside a respective increase in price.

Volume Discounts. In any B2B or B2G sales environment, its common practice to discount per unit prices with increasing volumes. Volume discounts can provide significant guidance during the sales negotiation process, but it can also be a major source of margin leakage when applied sub-optimally. A starting point for determining volume discounts is to understand where you want to price your smallest client tier (ceiling prices), and lowest allowable price to your largest client tier (price floor); this helps to establish your overall discount slope across tiers.

Be mindful of excessive "discounting on top of discounting", meaning, providing a volume discount price structure that is even further discounted via aggressive Sales negotiation. A best practice approach involves establishing a well-structured volume discount structure in alignment with designing the allowable Sales discount range for each tier.

Tiering Packaging Value (Good-Better-Best, or G-B-B). G-B-B tiering approach serves both as a packaging type and tiering methodology. G-B-B can address several strategies including offensive plays aimed at generating new growth and revenue, defensive plays meant to counter or forestall moves by competitors, and behavioral plays that draw on principles of consumer psychology, whatever the competitive landscape (Mohammed, 2019). Examples include: apply low-priced "Good" offer to make a product accessible to more customers; apply a premium priced "Best" offer (a decoy) to drive buyer psychology that shifts an incremental mix volume from low-end buyers ("Good") to a middle offering ("Better"); or apply a "low hanging fruit" tier to encourage upsell with current clients to a more value-enriched offering.



Price Levels. Price levels are defined categories of client segments that receive differences in pricing. For example, a software firm selling to municipal governments might create six (6) price levels, each consisting of ranges of number of inhabitants (Level A = between 1 and 25,000; Level B = between 25,001 and 50,000; etc). Price levels should contain a relevant mix of clients – too many price levels can lead to margin leakage and irrelevant discounts from one band to the next. In many cases, price levels act as a proxy for usage – consider instead applying a direct measure of usage that is a better reflection of value delivered (See Metrics).

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iv. Indicative Commercial Price List (pre-Financial Analysis phase)

Every B2B software firm, even those companies that have but a few deals per year, should document their packaging, metrics and tiers into a well-defined price list. This can take the form of a deal pricing calculator tool that integrates all the analysis and findings through the Offer Design process (Figure 9). This indicative commercial price list can be used in external communications (published to clients, GSA price lists) or used for internal price purposes only (deal pricing calculator tool).

An example for an B2B software enterprise price list (with a deal calculator tool):

	Price List	Example Deal	
	(USD)	Qty	Amount (\$)
Total Annual Subscription			\$475,910
Price List Calculator Tool (Packaging, Metrics, Tiers)			
a. Access Fees			
i. SaaS Enterprise Platform			
ACME Full Suite 4.x (up to 25 Named Users)	\$50,000	1	\$50,000
ACME - Workflow Package 1 Only (up to 25 Users)	\$30,000		
ACME - Workflow Package 2 Only (up to 25 Named Users)	\$30,000		
ii. Additional User License Fees (Overage)			
Per Named User (Overage only beyond 25 Users)	\$750	+5	\$3,750
b. Architecture Fees			
Per Integration	\$2,500	12	\$30,000
c. Content Fees			
Advanced Analytics	\$12,000	1	\$12,000
Per Custom Report	\$8,000		
d. Usage Fees			
i. Per Transaction (Based on annual avg)			
0 - 4,999	\$24		
5,000 - 19,999	\$22		
20,000 - 49,999	\$20	17,600	\$380,160
50,000-99,999	\$20		
100,000+	\$19		

 2,000 ft
 ~ Price positioning for this segment as defined by Price-Value Analysis

 500 ft
 Packaging, Metrics, and Tiers roll-up to your holistic pricing for defined segment

Figure 10: B2B Software Price List and Deal Calculator Tool Example

Successful Price Lists include the following considerations:

- Pricing is strongly linked with the value story (Price-Value Analysis)
- Structured to address different client segments, requirements, and use cases (Packaging, Metrics, and Tiers)
- Encourages monetization and growth (Packaging, Metrics, and Tiers)
- Sales and channel partners are trained to effectively sell the new price structures and respective value (Enablement)
- Updated and aligned with the product roadmap and versioning
- Continuously monitored and updated throughout the year (at minimum, once a year)
- Linked with discounting guidelines and policies
- Linked with profitability and sales incentive views

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FINANCIAL ANALYSIS AND PRICE STRESS TESTING (Ground-Level View)

The last sub-process within the Offer Design phase involves conducting financial analysis and price stress testing to determine price structure breaking points, potential for pricing and offer structure re-work, and even the possibility of re-evaluating the larger product and segmentation strategies.

This testing of model inputs and financial views will need to be tested across a variety of different possible scenarios to determine where a price model may have some unforeseen nuances, improvement areas, or even high risk areas that will require rework. These risks can ultimately influence adjustments to one's pricing structure and offer design, identify which profitable client segments to target (and unprofitable segments to avoid), prioritize internal activities to mitigate certain costs, or even highlight a need to change the product strategy itself.

Various tools can be applied to analyze and stress test price structures, including:

- Rate Card Visualization;
- Mock Deal Financial Analysis;
- Customer-Level Impact Analysis;
- and Business Case.

Rate Card Visualization. "A picture is worth a thousand words": Rate card visualization is an analytical approach that helps translates tables and numbers into a visual summary of the rate card. This visualization can quickly highlight some discrepancies that may not be apparent in rate card tables. In particular for those cases where that involve tiers (volume discounts, price levels), rate card visualization can help identify nuances between price levels and tiers and can provide a holistic view of "total license/subscription pricing" across a range of possible metric values that may not be apparent in a tabular format.

Mock Deal Financial Analysis. Mock deal analysis should be conducted across small, medium, large, and super-sized client-type profiles. Finance teams can help link these models with direct and indirect cost allocation assumptions. Be sure to test extremes for possible metric outcomes that can "break" a pricing structure. In other cases, mock deals can also show low or negative profitability to smaller client sizes, which identifies a need to rework an offer, the respective volume curve, or to reevaluate a more cost-effective product strategy.

Customer-Level Impact Analysis. This analytical approach can help a pricing team understand how historical clients would have been priced under the new price structures. Is the new pricing structures driving to the desired objectives? Which clients would see the largest gain in pricing (and which clients would see the largest decline in pricing?). This analysis is often useful to help tweak pricing and offer structures across client types to reach the desired objective, And in those cases that involve migrating clients to the new pricing structures, "gainers versus decliners" help sales team plan for those challenging price increase conversations.

Business case. Once a pricing strategy is determined, this can then be linked with annual volume assumptions (e.g., pipeline) and annual costs to develop a year-over-year business case view. In particular for those organizations undergoing major transformations (e.g., on-premise to SaaS), it may be important to highlight and get executive alignment in those cases where there are potential short-term losses in exchange for future profitability. Ultimately, the business cases become the company's best financial estimate that links the overall strategy with the proposed software pricing and offer structures.

Conclusion

With a solid foundational understanding of B2B industry pricing practices as well as adopting processes and tools defined within **The Digital Pricing Framework**, your organization can embark on their journey towards developing and implementing optimal value-based and segmented offer structures that not only compete in the market place, but also deliver material improvements to your organization's recurring revenue and market performance.

About The Author



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Scott Miller is a leading expert in enterprise B2B software pricing, offer design, and deal win-tactics. With over 20 years of pricing experience that includes over 50 major pricing transformation initiatives as well as hands-on global pricing director roles with \$10B technology firms, Scott understands the nuances and complexities of B2B and B2G pricing in the digital era. He is also a CPP, CPA, CMA, a published author, and speaker on best-in-class pricing practices. Scott is based in Toronto, Canada and can be reached at scott@miller-advisors.com



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Strategic Pricing for Software (Scott Miller)

<https://pps.mclms.net/en/package/754/course/748/view>

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