

## OPINION

### 3 Ways to Maximize Revenue

**Software vendors can improve sales by simply optimizing licensing strategies with their current customer base.**

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Are you leaving money on the table?



Although most software executives would agree that traditional licensing models need improvement, few understand how much revenue their company could gain by improving the pricing strategies used with their current customers and products.

In fact, pricing is the most powerful driver of software company value. According to a study by McKinsey & Co., a 1 percent increase in pricing can deliver a 7 percent increase in earnings, on average, for software companies generating between \$100 million and \$10 billion in sales. There is no better way to drive stock price than getting pricing right.

Without selling to a new customer or developing a new product, savvy software companies can increase revenue at each stage of the product lifecycle by deploying the following revenue maximization strategies.

#### **1. Target New Users Within Current Customer Organizations**

Most companies price their software products based on one customer segment, the heavy users of the product, and ignore the needs - and revenue potential - of medium or low usage customers.

Tracking the usage of a particular application, like a financial application, across an organization would reveal three segments of users. Order entry clerks are entering transactions into the application throughout the day. Financial analysts use a subset of functionality, perhaps twice a week. And the CEO may only need to access the data once a month, but when he or she needs that access, it must be immediately available.

Most likely, only the financial order entry clerks- the users with the highest, most frequent need for the product -have a paid license for the application.

A software vendor can increase revenue from such an organization by deploying three different licensing models. Heavy users can utilize a "locked" pricing model which ties the license to the machine. Medium users can use a "floating" model, which allows shared usage. In a floating usage scenario, perhaps 50 users would share 10 licenses. Infrequent users can take advantage of a "usage" licensing model, enabling "pay-as-you-go" buying on a per-day basis.

Pricing in this scenario should be set accordingly. Locked licenses would be priced at, say, \$1,000 per PC per year, floating licenses would run \$3,000 per floating user per year, and pay-as-you-go licenses would cost \$100 per user per day. This ensures that customers are legally providing the software to everyone who needs to use it and vendors are accurately compensated for each user. In this example, if a customer had 100 clerks, 500 managers and analysts, and 15 executives, the software vendor could grow revenue from \$100,000 to \$276,000 - a 176 percent increase.

#### **2. Create New Feature Bundles to Serve Additional Users**

Today, many software companies build products for a particular market segment, typically some kind of business manager. Other people in the organization - the system administrators and the executives, for example - may have a need for the product but with different functionality requirements, generally a subset of the complete application. In a typical company, only the most experienced, most active users typically buy a license for the product.

Vendors can increase revenue by rolling out different product configurations for different users. If you ever need validation of this strategy, go to your local supermarket and check out the 100-plus different formulations in the cereal aisle. A vendor can continue to ship one binary but use license keys to unlock specific features needed by different user groups. By marketing a "lite," "standard," and "premium" edition of the same product, and pricing the offerings appropriately, the potential market for the application expands and revenue grows accordingly.

Product segmentation can be implemented in three ways. The first method involves "feature clipping" or "licensing by component" which provides select capabilities to different user levels. The second way is by bundling related products to the application and creating suites of capabilities - like Microsoft did when they combined Word, Excel and PowerPoint into Office. The final method involves segmentation by the product capabilities based on actual usage.

To best serve customers, vendors must price software based on the value the client is receiving from it. Nokia has successfully segmented its products by turning on and off functionality using license keys. Precise market segmentation and enforcement of licensing helped the company create substantial new revenue streams.

Consider this example: you are selling a high end photo-editing package to designers for \$1,000. Last year you sold 10,000 units. Your research shows that with the rise of digital cameras there is a consumer segment of 50,000 people who need rudimentary functionality. You "feature clip" (i.e. turn off) 70 percent of the functionality and offer a \$99 version. Your market potential just grew by 50 percent, without any new product development!

### **3. Control Unlicensed Application Usage**

Software piracy is a \$30 billion problem. In North America, one out of four applications is pirated. Most piracy occurs with business-to-business applications - not surprising considering 96 percent of enterprises don't track license compliance according to an IDC study.

The reality is that vendors don't suffer from indiscriminate application theft. Very often, a vendor's enterprise customer is inadvertently using more software than it actually purchased. Vendors that can plug these holes in unlicensed usage provide a great incentive for their customers to purchase more licenses - an easy way to grow revenues.

Consider this example. A vendor estimates 20 percent of its product usage is pirated. If the vendor can successfully identify pirated situations, one in three users will actually buy the product. If the vendor earns \$10 million per year today based on an average sales price of \$250, approximately \$660,000 in gross incremental revenue will be generated in the first year after implementing a piracy protection program.

### **Begin with Best Practices**

Many software business leaders recognize the potential of these strategies to grow revenue. However, many vendors have hard-coded licensing constraints into their applications. This tactic prevents marketing groups from easily offering flexible product configurations and pricing models. It is critical for software companies to separate product pricing and licensing from the application itself.

The case of implementing each of these approaches is directly dependent upon the flexibility of your licensing system. The system should be tied to your software code base to ensure automatic enforcement of your licensing terms. Now here's the most important part - it should be designed so that your business rules, pricing policies and product configurations can be changed *at any time* without changing your software code.

This type of a flexible licensing system ensures that your products and their pricing remain agile and responsive to market conditions and your business strategy. It will enable enterprise vendors to offer products that better meet customer needs, elongate product livelihood, maximize revenue and improve company value.

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