



A Whitepaper for Independent Software Vendors (ISVs)

Properly Pricing Software-as-a-Service Within an Established Product Portfolio

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Executive Overview

The rapid growth of the SaaS market is forcing nearly every established independent software vendor (ISV) to develop their own SaaS options. However, they face a myriad of challenges including:

- Re-architecting their existing applications to enable them to fully leverage the web and an assortment of new software development tools.
- Re-orienting their research organizations to fully understand the fundamental differences between software products and services.
- Re-structuring their packaging and pricing models to properly reflect the value of their new 'pay-as-you-go', subscription services.

While all three of these pose critical challenges, pricing is the most pivotal. It is also one of the most complicated challenges. Unlike a SaaS startup established ISVs have to fit their new SaaS offerings into an existing product portfolio with limited visibility into how customers might value them.

In avoid severely cannibalizing their existing product revenue stream, established ISVs must clearly differentiate their various products and service solutions. They must also deploy the means to support these new pricing models. Specifically they need to deploy a software monitoring and metering mechanism which can automatically measure and bill for software utilization.

This whitepaper will examine the SaaS pricing challenges facing established ISVs, present specific strategies for addressing these issues in a cost-effective manner, and describe how LeCayla Technologies' solution can satisfy many of these requirements.

The Fundamental Pricing Challenge for Established ISVs Migrating to SaaS

THINKstrategies research has found that interest and adoption of SaaS solutions among organizations of all sizes is escalating. Users are attracted to SaaS alternatives because they are fed up with the challenges and added costs associated with traditional software applications.

A pivotal challenge for the established ISVs seeking to join the SaaS movement is how to package and price their new offerings. The ISVs' first concern is cannibalization. They need to minimize the risk of customers abandoning their existing software products in favor of the SaaS solutions.

In truth, this may not be a bad outcome when the alternative could be losing the customer entirely. SaaS solutions can succeed in both saving disgruntled customers and attracting new customers, who were either unable or willing to acquire an ISV's traditional software products in the past.

The second major concern is the financial implications of the SaaS model on their revenue recognition. Most established ISVs recognize the full value of their perpetual licensing agreements upfront. SaaS revenue can only be recognized as it is earned.

A third concern is the apparent low price-points offered by SaaS many of whom are offering prices below \$100 per month per user. Some SaaS providers are even offering single-user licenses for free in the hope that their starter sets will enable them to quickly gain marketshare and convert users to more profitable enterprise packages. Many are discovering that it is more difficult than they expected to generate the add-on and up-sell opportunities which they were hoping would offset the financial sacrifices of a low-cost solution.

While this type of commodity pricing may be appropriate for some, it is clear that one model does not fit all. For example, eCommerce or supply-chain SaaS solutions could be priced based on the number of transactions or volume of data transmitted. Even customer relationship management (CRM) or Salesforce Automation (SFA) solutions can be priced based on the number of accounts, prospects, or bookings they support.

Determining customers' price-sensitivity when it comes to SaaS is especially difficult for established ISVs who need to balance their new solution pricing against their existing product pricing schedules. ISVs that have relied heavily on channel partners to sell and support end-users are at a particular disadvantage because they don't have a direct means to gauge customers' pricing preferences.

Adopting the Right Pricing Methodologies and Mechanisms for SaaS Success

The fact is that many established ISVs will need to revisit the basic principles and best-practices for product pricing to overcome the challenges of SaaS.

The first step in properly pricing a SaaS offering is determining how a software service will be utilized by the customer and its intrinsic business value.

The way users employ a SaaS solution will determine the pricing structure. Utilization patterns will shape whether it is priced on a per user/seat or per transaction basis. The perceived business value will determine the pricing range. Under traditional perpetual software licenses, customers paid upfront for the capacity they expected to need long-term, whether or not they used it. As a result, the customer's software buying decision was based

on whether their business return warranted the long-term investment in the software and the associated infrastructure and support costs.

SaaS solutions change this equation. Customers now look at the immediate return on investment (ROI) and shorter time to value of SaaS in business terms, along with the lower total cost of ownership (TCO) over the long-run.

The second consideration is how a SaaS solution is positioned competitively in the market against traditional applications or comparable SaaS solutions. In the cases where a SaaS vendors are trying to displace traditional applications, offering attractive pricing models will be just as important as providing strong software capabilities. SaaS providers competing in a segment of the market where others already exist must design their pricing models to match those competitors.

Complicating the pricing process is how channel partners fit into SaaS providers' go-to-market strategies. Building a multi-tiered pricing model that accommodates the margin requirements and provides sufficient incentives to channel partners is essential.

Ultimately, the SaaS providers will have to adopt pricing structures that suit both customers and channel partners if they are going to achieve significant market penetration. Developing flexible pricing models is becoming one of the key challenges for the SaaS industry.

While developing the right pricing metric is important, there is another pivotal piece to the pricing puzzle—how will the provider provision and measure SaaS utilization?

In the past, application vendors created elaborate pricing schemes to govern their licensing arrangements. Unfortunately the traditional application pricing wasn't designed to permit variable usage or real-time variable pricing like that permitted by many SaaS. Therefore, many established ISVs as well as new SaaS providers must implement a software utilization monitoring and metering capability.

ISVs that want to offer complex end-user or enterprise SaaS solutions must adopt an economical and a practical means of metering and billing for their solutions 'on-demand'.

LeCayla Technologies' Versatile SaaS Metering and Billing Solution

LeCayla Technologies has developed metering and billing solutions enable ISVs to offer software applications on a utility, perpetual licensing or hybrid pricing basis. LeCayla's metering and billing solutions allow established ISVs and new SaaS providers to quantify software utilization across a multi-tiered channel structure. Specifically, LeCayla provides three key capabilities:

- flexible usage recording allowing the ISV to determine what data is collected,
- flexible usage rating allowing the ISV to determine what is charged ,and
- the ability to vary pricing and rating terms on a per customer per contract basis.

The company's metering and billing solutions enable ISVs/SaaS providers to identify the usage data to be collected and how the data will be interpreted. The data generally falls into three billing metric categories. *Resource metrics* include users, CPUs, and connections that can be billed on a 'per use' or 'per concurrent use' basis. *Transactional metrics* may be charged on a one-time only basis. *Workflow metrics* include document flows or other process-oriented activities.

LeCayla's solutions allow ISVs/SaaS providers to establish rules for each of these metrics which allow them to build complex pricing matrices which can be combined within a specific customer contract. For example, the ISV/SaaS provider can charge users a one-time only fee for service activation, plus a fixed monthly subscription fee with a surcharge based on activity. Each contract can also be modified to suit the specific customer.

The company's Service-Oriented Architecture (SOA) interface reports usage events. It tracks complex transactions within a single application process, and can compile utilization data across multiple deployments and along a multi-tiered, supply-chain of various channel partners or enterprise entities. This makes LeCayla's solution particularly valuable in the multi-tenancy SaaS world.

LeCayla's solution can be deployed by the ISV/SaaS provider within their hosting environment, or at the channel and enterprise levels. LeCayla provides an agent which logs usage data by monitoring the operating system (OS) or application database in a non-intrusive fashion that requires no change to the application code. LeCayla's metering engine can pass the usage data back to a LeCayla account server and billing engine via Web Services Interface or LeCayla API.

When a deployment is behind a customer firewall, the LeCayla agent can be deployed "On-Premise". The agent securely stores and forwards data to the account server ensuring that metering is not dependant on network. LeCayla allocates digital certificates to track usage levels across the supply-chain of third-party distributors and enterprise departments.

Figures 1-2 show how LeCayla's metering and billing solution works in each of these scenarios.

Figure 1

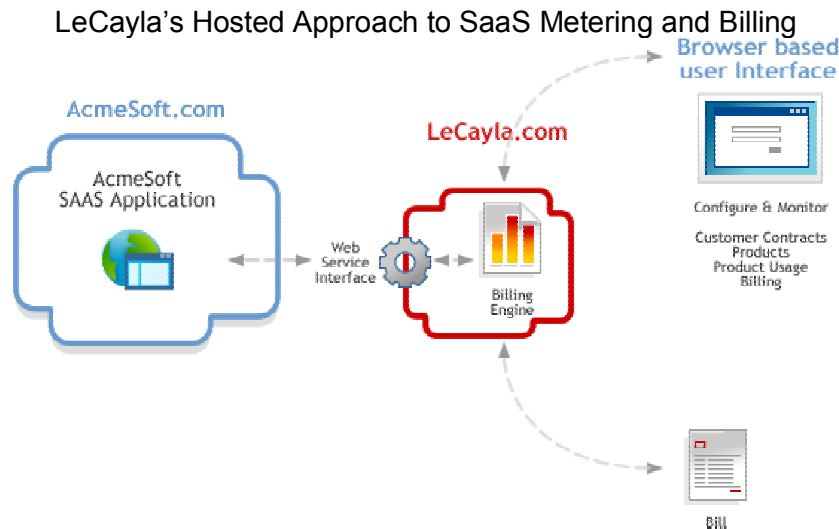
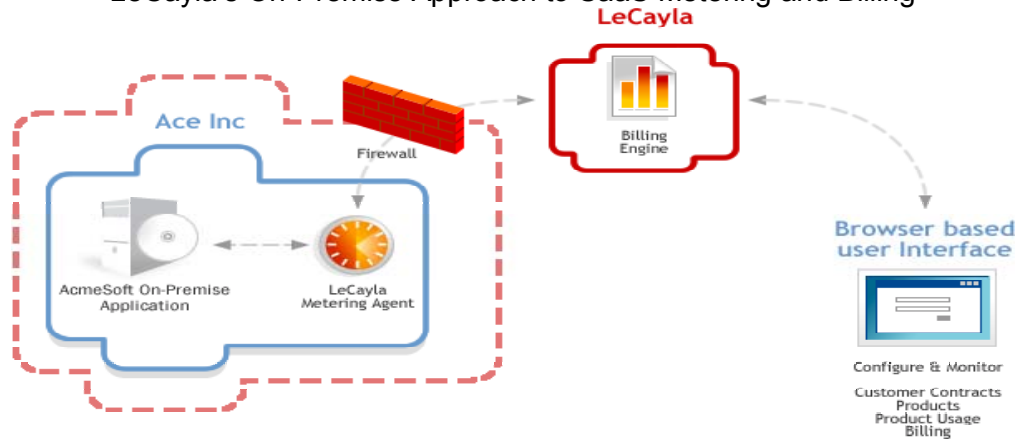


Figure 2

LeCayla's On-Premise Approach to SaaS Metering and Billing



The company has succeeded in attracting the attention of a variety of ISVs/SaaS providers and system vendors grappling with pricing and metering challenges. For instance, LeCayla is currently working with a leading design software company that needs to cost-effectively track customer usage and with a data warehousing company that wants to charge users on a resource consumption basis. LeCayla is also working with a major system vendor in a joint engineering project and in various customer pilots.

Summary

THINKstrategies' research and client engagements have found that SaaS is generating significant end-user interest and adoption because of its functional advantages and flexible pricing mechanisms. The rapid growth of SaaS is fundamentally changing the nature of the software business and disrupting traditional pricing models in the software industry.

Yet, it is important to recognize that the SaaS market is as diverse as the overall software industry, and as a consequence there will be many SaaS pricing models which will evolve to accommodate varying customer requirements and preferences.

Therefore, SaaS providers must develop flexible pricing models that allow them to cost-effectively charge customers for the value of the specific software solutions based on actual usage patterns. Whether it is delivering relatively simple end-user oriented on-demand applications or extending the SaaS model into the enterprise software market, cost-effective provisioning and pricing mechanisms will be essential.

A critical factor for established ISVs, as well as emerging providers, to succeed in the SaaS market will be implementing the right tools to meter and measure software utilization so they can properly determine the value of their software solutions and price their offerings accordingly.

LeCayla Technologies has developed sophisticated, yet versatile and easy to implement metering and billing solutions which can enable established ISVs, and emerging players, to measure and bill customers in a systematic and cost-effective fashion.

This whitepaper was sponsored by LeCayla Technologies.

About LeCayla Technologies

LeCayla Technologies offers a new technology that enables software publishers to quickly and easily introduce On-Demand pricing. LeCayla delivers a metering and billing infrastructure for packaged software applications. It allows software publishers to deliver products using any pricing model or any mix of pricing models such as perpetual licensing or pay-per-use. LeCayla makes it possible for software publishers who are considering On-Demand software applications to gather usage data and develop pricing models before bringing an On-Demand solution to market, and it allows software publishers who are ready to offer an On-Demand solution to start delivering it immediately.

Founded in 2004, LeCayla is privately held with offices in the US and Europe. The company is headquartered in Dublin, Ireland. For more information, go to www.lecayla.com.

About THINKstrategies, Inc.

*THINKstrategies is a strategic consulting services company formed specifically to address the unprecedented business challenges facing IT managers, solutions providers, and investors today as the technology industry shifts toward a services orientation. The company's mission is to help our clients re-THINK their corporate strategies, and refocus their limited resources to achieve their business objectives. THINKstrategies has also founded the **Software-as-a-Service Showplace** (www.saas-showplace.com), an easy-to-use, online directory and resource center of over 600 company listings from around the world organized into over 75 Application and Industry categories, and insights and information regarding industry best practices. For more information regarding our unique services, visit www.thinkstrategies.com, or contact us at info@thinkstrategies.com.*