The Pricing Strategy Guideline Framework for SaaS Vendors

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ABSTRACT

Software as a Service has become a dominant IT news topic over the last few years. Especially in these current recession times, adopting SaaS solutions is increasingly becoming the more favourable alternative for customers rather than investing in brand new on-premise software or outsourcing. This fact has inevitably stimulated the birth of numerous SaaS vendors. Unfortunately, many small-to-medium vendors have emerged only to disappear again from the market. A lack of maturity in their pricing strategy often becomes part of the reason. This paper presents the ‘Pricing Strategy Guideline Framework (PSGF)’ that assists SaaS vendors with a guideline to ensure that all the fundamental pricing elements are included in their pricing strategy. The PSGF describes five different layers that need to be taken to price software: value creation, price structure, price and value communication, price policy, and price level. The PSGF can be of particularly great use for the start-up vendors that tend to have less experience in pricing their SaaS solutions. There have been no SaaS pricing frameworks available in the SaaS research area, such as the PSGF developed in this research. The PSGF is evaluated in a case study at a Dutch SaaS vendor in the Finance sector.

Keywords: Guideline Framework, Pricing Strategy, SaaS Vendor, Software as a Service (SaaS), Value Creation

INTRODUCTION: THE EMERGENCE OF SOFTWARE AS A SERVICE

The number of Software as a Service (SaaS) solutions in the market has been rapidly growing in the last few years. There have been several success pioneer SaaS vendors in many different sectors such as Salesforce in the CRM sector, NetSuite in the Finance sector, and Workday in the HRM sector. These big vendors have had good experiences of specializing in the kind of software they want to offer, to which markets, and how they are going to sell them. Unfortunately, this is not the case for the small and medium vendors, particularly the start-up SaaS vendors. Many of them have emerged and then disappeared again in the market. This is often partly due to a lack of maturity in their pricing strategy. Of course, there is no single pricing strategy that fits best for all vendors because it is always involves other elements that need to be taken into account.

One of the most important benefits of adopting SaaS software is the availability of having more flexible payment methods (Geisman, 2008; Kaplan, 2008; Mahowald, 2009; Merchant &
Geisman, 2006; Pring et al., 2007; Rowell, 2009; Sääksjärvi et al., 2005). Customers are offered the finest payment possibilities while still maximizing the vendors’ profits, which is not a trivial task to accomplish. There have been various pricing issues faced by SaaS vendors in the market like low sales cycles, low win rates, chaotic pricing, and difficulties to enter new market (Jones, 2008; Geisman & Nelson, 2008). Therefore, in order to minimize these issues, the availability and integration of a good pricing strategy as part of the overall corporate strategy for SaaS vendors is essential.

However, up till now, there have not been any frameworks in the SaaS research area that provide the vendors with such pricing principles. Hence, this research presents the “Pricing Strategy Guideline Framework” (PSGF) as a solution that provides SaaS vendors with a guideline to ensure that all the fundamental pricing elements are included in their pricing strategy. The framework is intended for small-to-medium SaaS vendors, particularly the start-up vendors that tend to have less experience in pricing their SaaS solutions. This paper builds upon and evaluates the exploratory research as described in Abdat et al. (2011).

In order to construct the framework as the main deliverable of our design research, we have performed an extensive literature study and conducted a series of semi-structured interviews with nineteen different SaaS companies, six of which are domiciled in the Netherlands and the remaining are spread out around the world. The framework has been validated by several experts in their fields. The final incarnation of the framework is depicted in Figure 1.

The remainder of the paper is organized as follows. First we describe several related literatures to be the foundation of the framework. We elaborate upon the different layers of the framework including the elements of each layer as well as their examples. We present a case where the framework is implemented in practice. Finally, we conclude this paper and recommend further research based on our framework.

Related Work: Software Pricing Strategies
SaaS vendors must establish their pricing strategy before bringing their software solution to the market. They must be able to understand all the potential revenue sources, deployment and distribution costs of their solution, its ability to sell them at prices which will allow for maximum and ensure that the strategy is sustainable over time so that the vendor can continuously achieve its objectives (Kittlaus & Cough, 2009). Hogan and Nagle (2005) also describe that a comprehensive pricing strategy is comprised of multiple layers that create a foundation for price setting to minimizes erosion and maximizes profits over time.

Our framework was inspired by the ‘Strategic Pricing Pyramid’ of Hogan and Nagle (2005). This is the best applicable software pricing framework so far (Kittlaus & Clough, 2009). Their framework exemplifies the five different layers (steps) that need to be taken to price a software, which are value creation, price structure, price and value communication, price policy, and price level. These layers become the core of our PSGF framework.

The Strategic Pricing Pyramid uses the value-based principles where a deep understanding of the values that a product or service can create for the different customer segments becomes the key to develop the pricing structure. A lack of understanding of these values is even more prevalent for new products with unfamiliar features and functionalities. The created values can be various such as a cheaper price compared to rivals, more sophisticated features, ease of use, user friendliness, and many others. In the pricing structure layer, how a product or service being priced is determined and its price needs to align with the delivered value. Next, when the prices have been determined, the software company will need to communicate it to the different segments of their customers. The authors affirmed that “a poor communication of value results in higher price sensitivity and more intense price negotiations”. According to
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