Technology Solutions Pricing and Licensing:

Optimizing Operational Capabilities for Growth

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Well-managed technology companies are exploring new pricing and licensing strategies to maximize revenue and profits. However, without careful attention to building the right operational infrastructure—both internally and across the channel/customer ecosystem—these pricing and licensing innovations will be impossible to execute. The value growth prize will go to those who build the right operational capabilities at the same time they develop new ways to capture value for their products and services.

Figure 1. Disruptive trends in the technology marketplace

Multi-functional/converging devices needing to work together any time, any place	Centralization/virtualization of server capacity and hosted virtual desktops	Shifting customer preferences towards minimizing fixed costs of technology operations
Blurred distinction between enterprise and consumer devices	**Technology Trends**	Virtualization through hybrid (public and private) clouds
Software explosion due to increasing use of digital multimedia, media tablets, mobile app stores	Portability and mobility—with built-in connectivity (across devices, environments, fixed and wireless networks)	Service-centric vs. Server-centric (XaaS)

Source: Accenture trends analysis

Over the last few years, technology companies—whether hardware or software, enterprise or consumer—have faced a continuous stream of disruptive market trends. As shown in Figure 1, these trends are coming from all sides, and include such game-changers as increased virtualization, a greater emphasis on portability and mobility, blurred lines between formerly distinct segments, and growing demand for multifunctional devices that work together seamlessly and support users' mobile lifestyles.

In recent years, these trends have been reflected in a surge in innovation in hardware, software, and service offerings. Microsoft's Windows Azure, for example, helps developers build, host, deploy and manage applications and content through a cloud-based infrastructure, while Amazon's Cloud Drive enables users to store their music on cloud servers and access it from anywhere through a Web browser or mobile application. Further, the increasing popularity of Android phones made Google's platform the top-selling smartphone operating system in 2010[1].

In addition to this evolution in technology offerings and trends, business models and operating models have been transformed as well. In fact, as first covered in a previous Accenture report *Where the Cloud Meets Reality: Operationally Enabling the Growth of New Business Models*, the impact of recent trends on technology companies' business and operating models is profound. For example, while historically technology companies tended to have two business models throughout their existence, in the future they will have portfolios of business models to manage. And as shown in Figure 2, the revenue/

pricing model is a critical component of a well-designed business model. Further, as business model complexity increases, technology companies must ensure they maintain control over the resulting complexity of their operating models.

At the same time that technology companies are adopting emerging business models, they also must develop new or enhanced operational capabilities to support them. These include such things as simpler metering, flexible pricing and billing, and creative packaging and bundling of products and services to optimize upgrades, add-ons, and renewals. Technology companies also will need to develop multiple routes to market that allow customers to do business with them online, direct, and through resellers.

1. Source: Canalys Worldwide Smartphone Market Share Data, 2011

Figure 2. Definition of business and operating model

What is a Business Model?

- The essence of how a company makes money in a particular market
- Each business model is a unique and logical combination of target customer + value proposition + offering + revenue/pricing model + go-to-market approach
- Historically, most technology companies operated only 1-2 business models
- Enabled by the rise of cloud computing, technology companies will have a portfolio of business models
- Examples: Licensed software and Software-as-a-Service

What is an Operating Model?

- The holistic set of operational processes, people and systems needed to successfully deliver against the business model strategy
- A company may have one or more operating models
- Each operating model has unique cost and service level characteristics
- As business model complexity increases, the risk is that operating model complexity may explode
- Examples: Volume vs. value; low cost vs. high innovation; low touch vs. high touch

Requirements expectations →

← Cost and SLA agreements

Source: *Where the Cloud Meets Reality: Operationally Enabling the Growth of New Business Models*, Accenture 2011

To develop these capabilities, however, companies must re-invent how value is captured, committed to, delivered and managed throughout the customer relationship. Such value reinvention, therefore, must go beyond the traditional sales cycle and include service, support and maintenance up to the end of a solution's useful life. In this broader sense, "value" must take into consideration the current and future business needs of the stakeholders who will benefit from the use of these solutions and services.

A company's goal, therefore, is to determine the "win" price that captures this holistic value without leaving money on the table. Licensing and providing "rights-to-use" enable a company to express the price in clear metrics for committing to, delivering and managing value (even as customer needs evolve over time). While these are discrete capabilities, tapping the full monetization potential of an offering requires companies to make the right strategic and operational connections between them.

Untapped Potential: Key Challenges for Evolving Pricing and Licensing Models

In Accenture's experience, many technology companies are experiencing considerable revenue leakage and/or increasing operational costs as they execute these evolving pricing and licensing models.

For instance, one technology firm implemented a new cloud-based offering with various usage-based pricing and licensing models. This was a considerable shift from the firm's traditional subscription-based model, and its legacy capabilities and systems could not manage the necessary pricing, packaging, usage metering and billing, leading to price and revenue leakage of approximately 10 percent.

Likewise, a software company extended its enterprise offerings to the small- and medium-sized business (SMB) segment, leveraging its existing operational capabilities. This "one-size-fits-all" operating model resulted in 5 percent to 10 percent higher costs of doing business across the high-transaction, low-volume SMB segment. The operating model also resulted in extended sales and fulfillment cycles, which negatively impacted win, adoption, and renewal rates, leading to lost revenue, reduced customer satisfaction and a negative market image.

A third organization, a hardware company, began offering software solutions but, to do so, merely adjusted systems and capabilities that were built to support a manufacturing sales-to-cash operating model. These systems' inability to support the complexity of a subscription-based or recurring revenue sale-to-cash operating model resulted in approximately 10 percent increases in revenue leakage and operational costs.

In addition to having measurable financial impacts, the shortcomings of these companies' pricing and licensing strategies erode customer satisfaction and convenience, while contributing to customers' fears of being "nickel and dimed." Customers, for example, may feel forced to buy more product than needed due to inflexible pricing, packaging, bundling, and billing, and may have to pay extra for shelfware maintenance. Technology customers may experience sudden increases in costs driven by inappropriate usage thresholds, or may find themselves paying more than necessary upfront (due to the vendor's need for recognizable revenue) and subsequently losing leverage for maintenance, support, and services.

Sub-optimal pricing and licensing schemes also may lengthen sales and contract cycles by forcing customers to navigate complex pricing structures and conduct negotiations based on too many variables (e.g. length of commitment, total bandwidth needs, total size of storage required, etc.). And while virtualization is designed to help companies reduce costs, poorly conceived pricing and licensing can result in spiraling lifecycle costs related to maintenance, support, and services.

Given these impacts, technology vendors have no choice but to make their pricing and licensing innovations scale better for their customers and themselves. The pressure to reduce costs will not abate: In fact, Forrester predicts cost reduction will continue to be the top priority for CIOs for years to come.[2] Also, new commercial/revenue models such as software-as-a-service (SaaS) and "pay-as-you-go" or utility-based pricing and licensing will become increasingly common—driven by cloud and mobility trends—putting even more evolutionary pressure on pricing and licensing models.

2. 2010 to 2012 Global Tech Industry Outlook, Forrester Research, January 2011

The Root Cause: A Lack of Integration

Figure 3. Business impacts of the current approach to pricing and licensing

Business impact	Example causes
Increasing operational costs and decreasing speed-to-market	• Highly-customized, complex pricing and licensing capabilities developed incrementally for individual point-solutions rather than standardized/scalable across the solutions portfolio • Silo'ed organizational structures with cross-functional barriers/dependencies, inefficient "thrown over the fence" handoffs and lack of appropriate overall accountability • Loosely-integrated ERP and CRM systems (e.g., foundational master data and BI systems, back-office systems, financial controls, etc.) with manual hand-offs, creating inability to leverage complete, accurate and real-time license & entitlement data for pricing analytics
Missed revenue growth opportunities and revenue leakage	• Poor value capture strategies and/or negotiation concessions for maintenance, support, services, upgrades, renewals, cross-sell, up-sell, etc. • Mis-aligned pricing, license, deal, program and discount structures that leave money on the table • Lack of flexible re-pricing policies for license migration/transfers/changes
Decreasing partner/ customer satisfaction	• Insufficient/inaccurate understanding of critical customer/channel/regulatory requirements • For evolved delivery models (XaaS): lack of understanding customer's true TCO across licensing, maintenance, support, services, consulting, infrastructure • Using labor-based economic models vs. value-based pricing models for maintenance/support/service • Poor understanding of customer usage behavior and life-cycle cost of ownership • Poor understanding of evolving partner economics • Poor customer/partner/user experience due to extended sales cycles

Source: Accenture client experiences

How did the technology industry get into this situation? Its inability to successfully execute these new and evolving pricing and licensing models has both strategic and operational causes, as most technology companies today think of pricing and licensing in sequential and fundamentally un-integrated steps:

• Pricing and licensing strategies aim to monetize embedded software, increase software and support revenues, and ensure proactive renewals of licenses and maintenance and support agreements. Accomplishing all this with scalability, simplicity and efficiency requires pricing and licensing models that are value-based, simple, fair and future-proof.

• Actual price levels typically evolve in the context of customer segment needs and competitive activity on a deal-by-deal basis during the sales cycle. This is particularly true when companies must manage complex license metrics, terms, and conditions. Models with inflexible pricing and licensing metrics can prove to be a detriment in these instances.

• Pricing and licensing execution, both internally and across the channel ecosystem, is then supported by developing incremental operational capabilities based on individual point solution needs. This is generally accomplished by making ongoing enhancements to some combination of existing ERP and CRM systems and processes for opportunities, quotes, contracts, orders, billing/invoicing, master data and customer support. In addition, there typically are manual hand-offs between some of these processes at points where systems cannot seamlessly connect.

Overall, this siloed, non-integrated approach is ill-suited to the demands of a rapidly changing marketplace characterized by the need to develop new value propositions. As a result, technology companies often experience the sorts of problems outlined earlier, leading to the business impacts shown in Figure 3: Increased operational costs and more sluggish go-to-market capabilities, missed opportunities to grow or maintain revenue, and lower satisfaction among customers and partners. In today's competitive environment, no technology company can afford such liabilities.

Critical Success Factors for Improving Pricing and Licensing Execution

What's the solution? Accenture's analysis points to substantial opportunities for technology companies to improve top-line growth, reduce operational costs and increase customer satisfaction by implementing a well-integrated pricing and licensing approach. Our work with a range of high-tech companies has revealed three critical success factors to this end: defining cross-functional value levers to align and integrate pricing and licensing strategies, identifying the strategic value chain for each targeted segment, and building the operational capabilities that can unlock the power of pricing and licensing.

Defining cross-functional value levers to align and integrate pricing and licensing strategies

As noted, a lack of alignment and integration is a common problem for technology companies devising new pricing and licensing strategies. In Accenture's view, the key to better results is defining value levers that integrate four primary components: customer segment needs, value propositions, routes to market, and analytics.

Consider first the needs of a technology company's customer segments. Companies must understand their customers' total value perceptions, cost of ownership and willingness-to-pay, taking into account current and future business needs. Such an understanding must go beyond the initial offering license and include maintenance, service, support, delivery, renewals, upgrades, infrastructure, time to market, self-service, and other aspects of the customer experience. Companies also must understand channel and regulatory requirements, as they may constrain or enhance some of these value levers.

Amazon Web Services provides a good example of how to tackle these challenges. They recently launched an on-demand Relational Database Service (RDS) for Oracle Database in a two-tier licensing approach that supports pay-by-the-hour access for customers who need licenses and those who already own Oracle 11g.[3] Understanding the needs of their particular targeted customer segments, Amazon provides tailored value, including RDS Oracle management capabilities for common database administration tasks and the ability for customers to utilize RDS for Oracle through Amazon Web Services or through an Amazon partner. Amazon also forgoes mandatory upfront fees or long-term commitments, and provides significant discounts for customers that purchase Reserved Database Instances.

In comparison, one of Amazon's competitors, which has a similar offering, requires an upfront monthly fee and does not necessarily include all the same capabilities and access. Therefore, while the competitor's pricing may appear to be simpler (a fixed monthly fee for a certain amount of storage), Amazon's RDS for Oracle is more flexible and scalable with, in the long-term, probably better economics overall.

3. Source: Amazon Website, Accenture Analysis

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In terms of developing optimal value propositions, technology companies must develop a clear strategy to determine which services are value-adding and which are not (including add-ons, upgrades, updates, transfers, re-hosting, partial fulfillment, support, and maintenance).

In the preceding example of Amazon's RDS for Oracle, the value proposition is very clear. RDS for Oracle allows organizations that already have purchased Oracle to use Amazon to host and manage the low-level administration of their database(s), and includes maintenance and administration capabilities that help companies reduce costs and overhead. It also gives Amazon Web Services customers the ability to "scale up" over time (up to 1 terabyte) and compute resources, as well as obtain support both from Amazon and from Oracle. Overall, the RDS for Oracle value proposition validates Amazon's pricing model with both new and existing customers: all fees and extra charges are based on what their target customer segments value most.

Route-to-market is another essential value lever. Today's technology customers are more interested in complete, tailored and vertical business solutions (provided by multiple technologies and vendors) than they are in individual features. In addition, technology distributors and resellers are turning to solutions (which encompass both products and services) to increase their margins. These changes mean that technology vendors must engage their various channels and routes to market in new and different ways, while developing relationships with new partners and independent software vendors across

verticals. The resulting new vendor-channel business models, vertical solutions and added complexities of the overall channel experience (for vendors, partners and customers) require technology vendors to develop a clear understanding of where value is being created and captured across the channel ecosystem. Technology vendors also must profile partner segments by competency and specialization; define the appropriate bundling and licensing approaches, programs, and incentives for each segment; and capture the added costs-to-serve in the overall pricing strategy where feasible and appropriate.

Traditional hardware companies such as Dell and HP provide a good example of this approach, having launched comprehensive programs to engage and reward mid-market partners for cloud-based initiatives (including SaaS and managed services).[5] These programs' evolving licensing and pricing models are designed to make it easier for channel partners to share in the managed service revenue stream without making significant infrastructure investments, thus optimizing channel return on investment.

The final consideration for technology companies defining cross-functional value levers is value analytics. More specifically, technology vendors can generate maximum impact from pricing and licensing by ensuring that well-defined customer and partner segmentations are linked to entitlement information. Such linkages support ongoing enhancements to solution value-pricing, packaging, license programs, bundling, support, services, and campaigns to drive cross-selling, up-selling, and volume growth.

Apple has been a leader in this regard, optimizing its revenue streams through improved targeting of offerings to customer behaviors and needs.[4] Apple's long-standing focus on the needs of its key "iCustomers" has helped the company manage premium pricing and licensing models, effectively cross-selling and up-selling their hardware and software offerings (and associated maintenance, support and service solutions). For example, the iPod and iPhone have long been driving increased Mac sales, as unlocking the seamless experience promised by these mobile devices requires a Mac. The launch of the iPad continues this trend.

Focusing on these critical value levers will help technology vendors refine their packaging, bundling, licensing and pricing strategies while avoiding the revenue leakage that can occur with complex license models that are difficult to administer, track, and measure.

Identifying the strategic value chain for each targeted segment

By orienting themselves around these value levers, technology companies can achieve a segment-specific, cross-functional, multi-channel, and end-to-end view of their business. This multi-dimensional view allows companies to define and build a value chain with the right balance of infrastructure investment, capability flexibility, and standardization, without adding unnecessary complexity.

4. Company annual reports, Accenture analysis

Figure 4. Building required operational capabilities
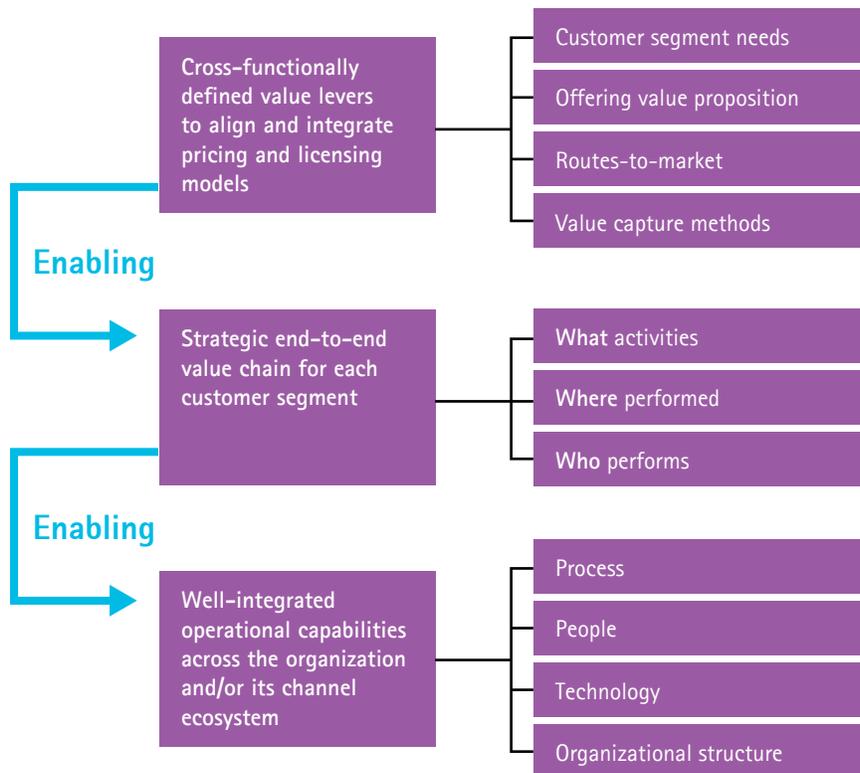
As noted earlier, new and enhanced business and operating models have, in turn, created new (and still evolving) strategic value chains across customer and partner segments. Within these value chains, new co-delivery distribution models are being developed to scale sales and delivery for emerging markets, and for high-volume SMB segments. These new distribution models require considerable infrastructure investment from both the hardware company and from its various partners to ensure effective execution of new pricing and licensing models across shared revenue streams.

Building required operational capabilities (processes, people, technology and organizational structure)

As shown in Figure 4, defining value levers and the associated segment-specific value-chains will enable technology companies to gain greater clarity into their required operational capabilities across both the organization and the channel ecosystem. Companies must assess their capability gaps in the context of the strategic value chains just discussed to avoid unnecessary, low-value processes, disparate and non-integrated systems, cross-functional misalignment, and unclear organizational responsibilities. Furthermore, such context will help a technology company identify exactly where the gaps are (for instance, within the lead-to-cash cycle or across the channel ecosystem) so that it can take appropriate proactive measures.

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Unlocking Competitive Advantage through Pricing and Licensing

Given the emerging dynamics of today's high-tech industry, companies cannot continue to operate in silos, with pricing and licensing models that lack integration. Operational complexities will continue to drive higher costs, result in revenue leakage, and increase customer dissatisfaction. In addition, the lack of scalability and sustainability resulting from the use of inadequate pricing and licensing models will prevent technology companies from capturing the value of both existing and new innovations.

Therefore, pricing and licensing capabilities must be well integrated at both the strategic and the operational level, and managed cross-functionally as well as across the channel ecosystem. Three critical success factors are central to this pursuit: Defining cross-functional value levers that boost alignment and integration, identifying segment-specific strategic value chains, and developing key operational capabilities. Companies that can adopt these structured, practical approaches can potentially unlock new growth opportunities and pull ahead in the race toward high performance.

About the authors

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