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Soft•letter

BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS

Building a SaaS Software Pricing Model

When a software company moves from a licensed to a SaaS model the issue of how to price the new offering is a vital one. We decided to sit down with Bob Conlin of Centive, publisher of Compel, a software firm selling sales and executive compensations systems under both the licensed and SaaS models. He took us through Compel's decision matrix as they wrestled with the pricing issues surrounding the SaaS-based version of Compel.

- **In developing its initial pricing, Centive was able to use its existing pricing schedule to begin the process of orienting itself in the SaaS market.** "We know that in this market people pay between $400 to $1K per seat. This allowed us to examine how and if we should simply take our existing pricing and "divide by 12" as many SaaS companies do. But we realized we had to come up with a better value driven proposition than this."

- **When sizing its market, Compel used a very top-down approach.** "People tend to sneer at this model, but for us it proved effective. We first, based on our own market experience and some hands on research, estimated that most companies who focus on direct sales efforts normally have 10% of their headcount dedicated to sales personnel. We'd already decided that our target market for our SaaS offer was companies with 50 to 500 sales reps. Based on that, we used services such as Hoovers, Yahoo Finance, and OneSource to search for companies with 500 to 5000 employees. Our searches determined our overall target market was comprised of about 27,000 companies in the US and Canada. We then refined our search further by picking out specific verticals with which we had previous experiences. This included companies in the high-tech, telecomm, life sciences and retail markets. We also decided to focus our efforts initially in English-speaking audiences. One point about localization in these markets; while you do eventually need to customize your American English products for local spelling, idiom, and jargon, with initial product rollouts you can get away with American products while the market develops; as you move forward, you will need to customize."

- **Value propositions driven by ROI analyses are vital.** "We spent a lot of time working on creating a very robust ROI argument. Our model incorporated the following factors:

(continued on page three)

Marketing isn't doing so well in our latest CMO compensation survey; median pay declined in 2005
See pages 4-6.

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How to Build an Effective Affiliate Program, Part I of III

by Ted Finch, Chanimal

Affiliate selling programs have grown in popularity over the years and many software companies, particularly those in niche and retail markets selling software under $500 have found them to be an effective way to build sales and generate revenue. Companies selling higher-end software can also find affiliate programs valuable if they're selling lower end products that offer an upgrade path to a more robust offering. One of the most compelling reasons to investigate affiliate programs is that you can develop an effective one- and two-tier channel at a fraction of the cost normally associated with this effort. Another factor to remember is that affiliate programs allow you to fully identify revenue and customers from multiple sources, something not always possible with traditional channel programs. If done efficiently, anticipate it will take from four to six weeks to plan and implement your affiliate program.

The primary goals of a successful affiliate program are to generate incremental revenue and develop a reseller sales force for current and future products. A successful affiliate program normally generates between 10% to 50% of a software publisher's revenue once it is fully developed and properly managed. I've recently worked with several companies to set up successful affiliate programs (most recently Edit.com) and would like to share with you my tips for success.

When setting up your affiliate program you will need to create the program and decide which software or systems you'll use to administer it, build out your affiliate channel, and then make sure you've enabled it to manage and fully participate in your program. The first point you need to consider when creating your affiliate program are your margins. Affiliate discounts normally range between 5% to 20%; specific margins are determined by the kind of product you're selling, what current affiliate programs you compete against, and what programs for similar items (such as books) offer. One useful way to establish medians in your market is to visit the websites of your competition and examine the various elements of their program and pricing.

Another useful exercise is to visit one of the more than 50 affiliate program directories online; I particularly recommend www.affiliatescout.com. These aggregators categorize affiliate programs, analyze their features and price structures, and in many cases rake off additional margin if visitors join an affiliate program through them (typically between 2% to 5%). Also factor in the need to offer what I call a "quickstart" price; this is a one-time, deep discount offered to new affiliates that incents them to follow through on implementation after they've signed up for your program. Typical quickstart program discounts can double margins for either X amount of time or on X number of units. The Edit.com quickstart price offers a $75 price per person for signups generated by affiliates for thirty days after they join the program; the normal amount is $50.

Also consider how many levels of distribution (downlines) you build into your program. I built one program that included five, but scaled it back to two after discovering many affiliate sites won't allow you to register programs with more than two levels; this is so as to avoid being associated with MLM and pyramid schemes. I suggest you follow the two-level paradigm in most cases.

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- How many administrators per number of reps; typically one will be assigned to sales groups between 35 to 50 in size.

- Amount of time spent to calculate commissions and in dispute resolutions.

- Typical error rates in calculating commissions which are normally from 4% to 8%; this is due primarily to the fact that in the mid-sized markets Centive targets, companies rely on error-prone Excel spreadsheet systems.

- Savings realized by cutting down on the turnover rate generated by disgruntled sales people leaving a firm because of a compensation dispute.

- Costs saved by eliminating "shadow accounting" (time spent double checking management's commission figures).

When we'd completed this work, we'd learned that hard costs for managing sales rep compensation ranged from $40 to $70 per salesperson per month; when you factored in "soft" factors such as personnel churn and shadow accounting, the cost per sales rep rose to about $210."

"When building our initial pricing models we didn't factor in the channel in the first year; we knew we had to prove the value of our offering first."

—Bob Conlin
Centive

- **When moving from license to SaaS-based pricing, keep in mind your customers will be thinking about operating budgets instead of capital expenditures.** "This is a tremendous advantage in closing sales because it simplifies the process greatly. For instance, IT no longer becomes as major a factor as it normally is in licensed sales because they're not going to be doing major implementation work. But in a typical sales organization, the VP of sales will have a budget line of $120 for cell phones; a similar SaaS chage cost fits their expectations. VPs have major latitude in their monthly operations expenditures."

- **Salesforce.com is establishing a basic SaaS pricing framework many companies are discovering that they need to factor into their own pricing considerations.** "Salesforce has established the $65 per month per one user price as something of an industry benchmark. If your product competes in sales management and sales automation services like we do, it's a factor you must consider when making your own pricing decisions. We did a candid estimation of the value we bring to a sales group and estimated we fell between 60% to 80% of a CRM system, depending on the ROI factors."

- **The final decision was driven by all of the above.** "We decided on a per seat per month price of $50. This helped separate us from capital expenditure issues, allowed us to present a compelling ROI argument to prospective customers, and kept us comfortably within the Salesforce.com framework."

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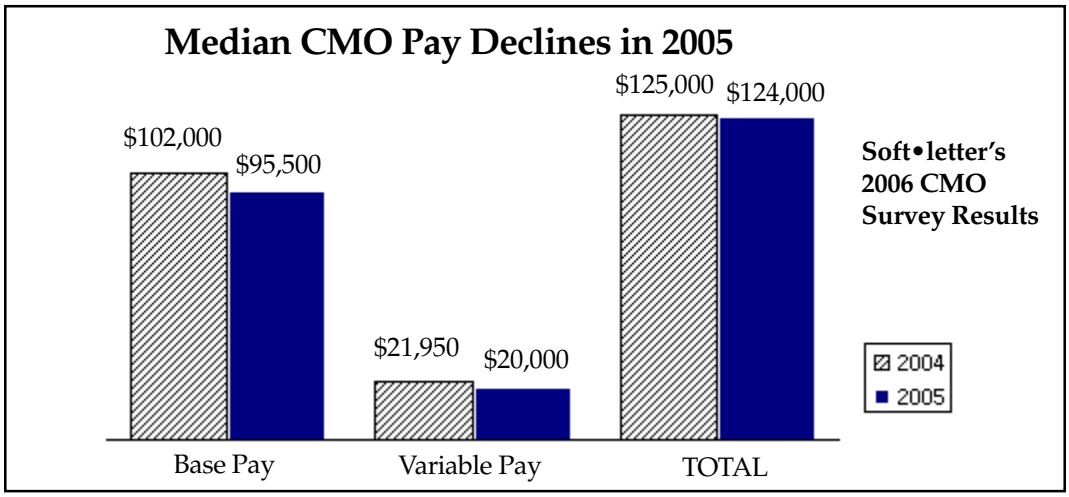

Benchmarks: CMO Compensation

Soft•letter's Top 50 CMOs are summarized by medians below; 24 of them exercised stock options (Long-Term) in 2005:

	Base Pay	Variable Pay	Total Pay	Long-Term
Median	$230,481	$166,463	$288,881	$262,556
Top 25%	$268,531	$214,032	$492,541	$306,488
Bottom 25%	$182,691	$26,400	$216,164	$208,185

Because the CMO title tends to be used in larger firms, we also selected Vice Presidents of Marketing if they were the top-ranking marketers in the company, or we picked officers described in the proxy or corporate literature as having top marketing responsibility. But in a number of companies known to have CMOs, the CMOs were not listed in the proxy statements with the other officers and their compensation; it was easier to find the top sales people.

Software companies tend to be technology-driven. Procter & Gamble became a marketing powerhouse because their soap products would be commodities without P&G's effort to add value and differentiation based on a constant probing of buyers' desires. Too often in software firms everyone from founders to funders agrees that IP-protected and uniquely innovative technology will win the customer, and far too often marketers are tossed a product that they must launch before customers have even said how they might feel about it.

Soft•letter's recent surveys on product managers probed the growing tendency to move marketing people into the technical end of the company so that products can be designed using customer input. SAS Institute, for instance, has nearly 10% of its employees marketing (not selling) its business-intelligence software and associated products.

A final point is that it's becoming increasingly difficult to find people with the specific title of CMO; however, we suspect that as more companies implement a SaaS strategy this will change. A successful SaaS approach requires that extensive resources be dedicated to customer identification and satisfaction, traditionally marketing roles.

Overall CMO Compensation*	Median	Top 25%	Bottom 25%	Raise
Base Pay—current	$95,500	$150,000	$74,000	-6%
Base Pay—last year	$102,000	$147,000	$74,500	
Variable Pay—current	$20,000	$40,000	$1,750	-9%
Variable Pay—last year	$21,950	$40,000	$3,000	
Total Pay—current	$124,000	$182,000	$87,250	-1%
Total Pay—last year	$125,000	$164,809	$80,500	

* Number of respondents = 72 for "current," 59 for "last year."

CMO Pay by Company Size*	Base Pay	Variable	Total	Raise
Under $1 million—current	$86,500	$15,334	$104,500	33%
Under $1 million—last year	$65,000	$25,000	$90,000	
$1-$5 million—current	$75,000	$8,500	$94,000	3%%
$1-$5 million—last year	$73,000	$6,000	$83,500	
$5-$10 million—current	$115,000	$22,500	$146,500	7%
$5-$10 million—last year	$107,000	$20,000	$118,500	
$10-$99 million—current	$140,000	$22,500	$160,000	0%
$10-$99 million—last year	$140,000	$27,500	$157,500	
$100+ million—current	n/m	n/m	n/m	n/m
$100+ million—last year	n/m	n/m	n/m	

* Number of respondents = 8 for Under $1 million, 20 for $1-$5 million, 12 for $5-$10 million, 23 for $10-$99 million, and 5 for $100+ million. Values are medians. n/m = Sample size too small for accurate comparisons.

CMO Pay by Development Stage*	Base Pay	Variable	Total	Raise
No significant customer revenue—current	n/m	n/m	n/m	n/m
No significant customer revenue—last year	n/m	n/m	n/m	
Privately owned, privately funded—current	$90,000	$20,000	$120,000	6%
Privately owned, privately funded—last year	$85,000	$15,000	$110,000	
Privately owned, venture funded—current	$153,000	$37,500	$192,000	2%
Privately owned, venture funded—last year	$150,000	$40,000	$186,000	
Public—current	$147,500	$11,250	$155,073	3%
Public—last year	$143,000	$20,000	$170,500	

* Number of respondents = 1 for No significant customer revenue, 41 for Privately owned, privately funded, 14 for Privately owned, venture funded, and 12 for Public. Values are medians. n/m = Sample size too small for accurate comparisons.

The Top 50: Highest Paid Public Company CMOs

		Base Pay	Variable Pay	Total	Long-Term
1	**Keith Block**, Oracle	$800,000	$3,422,100	$4,222,100	$150,588
2	**Léo Apotheker**, SAP	$519,120	$3,447,612	$3,966,732	
3	**Graeme Cooksley**, SSA Global Technologies	$390,000	$935,554	$1,325,554	
4	**Greg Corgan**, Computer Associates	$395,833	$898,221	$1,294,054	
5	**Tony Sirianni**, Cognos	$260,000	$934,175	$1,194,175	
6	**Kevin R. Johnson**, Microsoft	$502,386	$558,983	$1,061,369	$25,899
7	**David Laverty**, Cognos	$250,000	$593,856	$843,856	$218,623
8	**Thomas M. Ashburn**, BEA Systems	$416,062	$355,056	$771,118	
9	**Burton Goldfield**, Hyperion Solutions	$300,000	$333,396	$633,396	$884,646
10	**Mark A. Duffell**, Epicor Software	$332,800	$290,011	$622,811	$868,351
11	**John D. Brennan**, Adobe Systems	$355,000	$261,955	$616,955	$1,342,025
12	**Marty Beard**, Sybase	$331,000	$199,097	$530,097	$321,310
13	**Cosmo Santullo**, BMC	$177,083	$315,998	$493,081	
14	**M. Salahuddin Khan**, NAVTEQ Corp.	$320,000	$172,000	$492,000	$8,368,993
15	**Dan T. H. Nye**, Advent Software	$260,000	$193,163	$453,163	$306,488
16	**Murat Sonmez**, Tibco Software	$237,400	$210,564	$447,964	$15,666
17	**Jeffrey Carr,** Taleo Corp.	$225,000	$217,500	$442,500	
18	**James Kizielewicz**, Kronos	$277,062	$163,451	$440,513	$733,145
19	**John Entenmann**, Informatica	$258,895	$141,433	$400,328	$373,097
20	**Patricia C. Foye**, MRO Software	$215,000	$183,915	$398,915	
21	**Mark H. Cieplik**, Dendrite International	$322,917	$68,863	$391,780	$117,087
22	**James R. Milligan**, Quadramed Corp.	$158,986	$195,496	$354,482	
23	**Steven Edwards**, Sonus Networks	$245,000	$107,226	$352,226	
24	**Douglas P. Dow**, SPSS	$177,500	$166,463	$343,963	$3,730
25	**Michael W. Lodato**, QAD	$250,000	$68,025	$318,025	$46,571
26	**Joseph A. Staples**, Interactive Intelligence	$185,000	$103,881	$288,881	
27	**Steven M. Allison**, Midway Games	$285,962		$285,962	$501,369
28	**Peter Havart-Simkin**, NetManage	$231,641		$278,918	$47,277
29	**N. Nobby Akiha**, Actuate	$210,000	$66,582	$276,582	
30	**Joseph T. Trino**, Indus International	$64,500	$211,250	$275,750	
31	**Martyn Christian**, FileNet Corp.	$260,000	$4,362	$264,362	$379,831
32	**John J. Bruggeman**, Wind River Systems	$250,000	$4,380	$254,380	$160,318
33	**Timothy J. Lorello**, TeleCommunication Systems	$225,000	$27,341	$252,341	
34	**B. Bruce Dale**, Docucorp International	$234,000	$14,792	$248,792	
35	**Carol Meyers**, Unica Corp.	$184,167	$59,513	$243,680	$555,864
36	**Mario I. Barrenechea**, Raining Data Corp.	$180,000	$53,554	$233,554	
37	**Jeffrey S. Seiden**, Pervasive Software	$230,481	$737	$231,218	
38	**Joseph G. Tinnerello**, Mobius Management Systems	$200,000	$26,400	$226,400	
39	**Poul E. Nielsen**, Altiris	$209,222	$6,942	$216,164	
40	**H. Allen Dow**, Logility	$180,000	$30,782	$210,782	
41	**William Willis**, ImageWare Systems	$200,000	$504	$200,504	
42	**Jeffrey W. Coombs**, American Software	$181,948	$8,500	$190,448	$160,742
43	**Derek Dawson**, Navtech	$182,691		$182,691	$70,938
44	**Steven E. Kaye**, Optio Software	$180,000		$180,000	
45	**Bernard Wu**, Falconstor Software	$180,000		$180,000	
46	**Sean C. Forbes**, Rightnow Technologies	$110,986	$62,732	$173,718	$5,787,708
47	**Mary C. Sauer**, Sonic Solutions	$162,000		$162,000	
48	**Arne Johnson**, Proginet Corp.	$158,125		$158,125	
49	**Todd Liebman**, Intelli-Check	$135,128		$135,128	
50	**Adrian van Haaften**, CallWave	$72,692		$72,692	

Note: The 50 individuals here received the highest annual compensation of CMOs of public software companies with a current market capitalization of $14 million or more. "Variable" compensation includes bonuses, commissions, company-paid insurance, relocation and housing allowances, forgiven loans, memberships, profit-sharing contributions, etc. "Long-Term" compensation is income from the exercise of stock options.
Source: Company proxy statements for most recent fiscal years.

Asia Is Coming, Part II of II

By Miro Parizek, Corum Group

In the first part of this article I asked how long before the Asians move from being code manufacturers to designers of software impacting the global IT industry? The answer is we are already seeing more and more creativity being sourced in Asia. Despite increased wages and the rising rupee, Indian companies post strong cash flows, allowing them to go out and acquire abroad. Just recently, Mumbai based i-flex solutions invested in Castek Software from Canada, Tata Interactive Systems (TIS) took over two European units of Tertia Edusoft Group, MASCON Global Ltd. acquired US-based Anthem Technologies Inc. for $19M, Kanbay International acquired Adjoined Consulting for $165M and Wipro Technologies acquired Austrian New Logic for $56M, US based mPower for $28M and cMango for $20M. While Indian companies look abroad, foreign companies are making acquisitions in India. Oracle acquired 41% of i-flex Solutions for $550M while US-based Corpus purchased Bangalore-based Itellix Software Solutions for $2.5M and Israel-based Ness Technologies took over Hyderabad-based Innova Solutions for $25M.

We have also monitored increased activity in China as well with transactions such as Yahoo's purchase of a 35% stake in alibaba.com for $1B leading the way. Chinese companies were also busy finding strategic investments both at home and abroad, as Shanghai-based Shanda Interactive Entertainment´s purchased a 19.5% stake in Sina.com. Within the mobile entertainment segment, Focus Media Holding announced it would acquire Beijing-based Dotad Media Holdings and Tencent Holdings stated it would acquire Korean-based Joymax.

As an example of the impact Asian companies are now having on the global software M&A market, we can look at the mobile sector where they accounted for eight of the 38 deals we tracked last quarter. In 50% of the transactions, foreign companies acquired Asian companies with the goal of providing not only channel for their buyers, but also content and technology for the local and international markets as exemplfied by Monstermob, a U.K.-based mobile games and ringtones firm, acquiring M Dream, currently the largest maker of mobile games in China, for $35M. In the other four deals, the Asian companies were the ones doing the acquiring.

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Company/Description	Acquired by	Price/Terms	Revenues	Multiple
AVIEL Systems	TAC Acquisition (TACA.OB)	$100,000,000	$56,300,000	**1.78**
• IT services to the federal government		*Terms: Cash, stock, and debt*		
Mailbank.com	Tucows (TCX)	$18,000,000	$2,000,000	**9.00**
• Web publishing domain name portfolio		*Terms: Cash and stock*		
Temtec International B.V.	Applix (APLX)	$14,500,000	$3,500,000	**4.14**
• Self-service analytics software		*Terms: Cash and stock*		
Altea Holding AB	Ementor ASA	$143,000,000	$21,600,000	**6.62**
• Self-service analytics software		*Terms: Stock* (EBITDA)		

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- **Technorati** (www.technorati.com): Website that searches a wide assortment of blogs focused on different industries; service is free.
- **University of Massachusetts report on blogging "Behind the Scenes in the Blogosphere: Advice From Established Bloggers"** (http://gilbane.com/cmrblogstudy.pdf): Survey report that contains suggestions and information on effective business blogging from 74 bloggers. Report is free.

DESKTOPPIPELINE EDITOR STACY COWLEY ON ADOBE'S OFFICIAL POSITION ON WHETHER THE PDF FORMAT IS, OR ISN'T, OPEN: "Adobe executives are staying quiet about the apparent contradiction. The company is declining press requests for interviews on the topic, and Adobe representatives asked about the issue treat it like a live grenade." (Quoted on www.desktoppipeline.com/189401893, 06/15/2006)

BLOGGER ED BOTT ON RECENT SECURITY UPDATES: "I would take all these articles much more seriously except for the fact that *every single one* just happens to tout a new study from a security software company that just coincidentally happens to have the product that will solve this alarming new problem." (Quoted on (www.edbott.com/weblog, 06/25/2006)

INFORMATIONWEEK EDITOR-IN-CHIEF ROB PRESTON ON PATENTS: "But the tech patent issue is a lot more complicated than the small fries having their way with big business. Take SCO's aggressive (preposterous?) stance on its Unix rights. SCO has hauled Linux champion IBM and even a couple of big Linux users into court for allegedly violating those rights, positioning itself as a plucky David vs. Goliaths. Yet in the process, SCO has alienated the entire open source community of Davids. Meantime, IBM isn't just a victim of patent speculation; it earns more money from technology licensing than any other company. The lesson: Patent law reforms are necessary, but every case must be judged on its own merits." (Quoted in InformationWeek, 06/25/2006)

THINKEQUITY PARTNERS STEWART BARRY AND MICHAEL ZHANG on Google and China: "We feel that U.S. Internet firms, in particular Google, will continue to struggle to penetrate the market as core ideological conflicts between the Chinese government and American media make China a far-off, if altogether limited, opportunity, given China's current political realities." (Quoted on www.marketwatch.com, 06/26/2006)

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