PC Software Workshop
Marketing: Pricing and Packaging

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PC Software: Marketing: Pricing and Packaging

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Abstract: Participants discussed how early pricing was determined for PC software and Seymour Rubinstein of MicroPro discussed how the standard $495 software price came about. Pricing for software that was bundled with hardware and product upgrade pricing are also covered. Changes in the retail channel over time are identified along with how those changes affected how the software vendors sold their products, including the use of VARs. Finally, software product packaging was discussed and how that affected product placement in retail stores.

Participants:

Name	Prior Affiliation
Jeff Tarter	Softletter, moderator
John Brackett	College of Engineering, Boston University
Connie Galley	tsi
Bill Goodhew	Intelligent Systems, Peachtree, MSA
Gary Harpst	TLB/Solomon Software
Doug Ross	EECS MIT
Seymour Rubinstein	Formerly MicroPro
Paul Ceruzzi	Smithsonian Institution, historian
David Grier	IEEE Annals, historian

Jeff Tarter: [The attendees introduced themselves]

We'll be talking about marketing and distribution issues and I'll let the historians take over, but I have a burning question of great historical importance, and that is: Who the hell invented the $495 price point? And I'm going to ask Seymour because I think he did it.

Establishing the Standard $495 Price

Seymour Rubinstein: Yes, I did. Before we released WordStar, there was a lot of soul searching about what the right price should be. We were selling WordMaster and SuperSort for half that – $250. But I felt that it was the right price because it was high enough that said we think this product is worth something. So in other words, there's a psychological aspect that we were not selling it cheap because its functionality was really profound. At the same time, it would give us the latitude to provide a significant opportunity for the dealers to make money. And it also provided a way in which they could obtain something that would compete with the so-called commercially available word processors which were selling for three times the price. I almost changed the price at the last minute to $250, but I just decided to go with $495.

Tarter: So this was a very scientific process.

Rubinstein: Oh, it was the scientific process known as licking your finger and holding it up in the wind. And I might tell you that we announced it by issuing some press releases, and we also took out an advertisement in *Interface Age* magazine. The lead time for the magazines then was really not too bad. You had up to two weeks before publication to get an ad in. But we took out a four color spread. Well, it wasn't a spread; it was just a one page ad: "What you see is what you get." Somewhere someone decided to call it WYSIWYG. I didn't use WYSIWYG; I just said, "What you see is what you get." And the reason for that is because we were the first word processor to actually show on the screen where the page break was. When you did tabulations, it showed you where the tables would line up. And all the other commercially available word processors that sold for $15,000 and up in old dollars ... you had to print it first to see what happened. And then, after you printed it, you went and fooled around with it, and hopefully it came out better the second time or the third time or the fourth time.

David Grier: Even with WordStar you didn't see capital letters and italics and bold face and underlining and so forth on the screen, right?

Rubinstein: You could see capital letters, of course. It didn't show font styles but it did show layout. It did allow you to choose fonts but you wouldn't see those on the screen.

Grier: You put a code in at the beginning of a font?

Rubinstein: That's right, and that was because full GUI [Graphic User Interface] facilities didn't become available until a few years later, and then we had it, of course. But the point is, though, that from a page layout point of view we did handle that part.

Grier: When you thought about the price point, you talked about setting a value on the program?

Rubinstein: We wanted to have a higher price but not too high. There was the implication that as the manufacturer we thought it was worth the price to the end user because of the value to the end user.

Grier: But my question is, when you thought through that process, even though you didn't do a whole lot of focus research, did you have one picture of an end user who paid for it himself and another picture of an end user who was a corporate type who paid for it out of the company's budget and how much each would pay?

<u>Retail Selling of WordStar</u>

Rubinstein: Not the latter. The reason for that is because the venues we were using to sell the product were store fronts; we were not selling it directly to end users.

Grier: But they had to sell it to somebody.

Rubinstein: They were selling it to people who walked into the store. Yes, they did some newspaper advertising, but still, even with newspaper advertising, it still functioned like a retail establishment in the sense that you went to the store and you bought something. And the corporate sales even then were done by salespeople calling on them and going through the whole committee buying process; that really wasn't what we were doing. If we were going through the committee buying process, it should have been a $2,000 product because the cost of selling would have been much higher.

Grier: Yes, but you would be able to sell a lot of units at one time.

Rubinstein: Well, that's true if you get the sale. But as my own experience from doing that sort of thing prior to that was that the case for a company making a purchase like that was not always justified by getting the best bang for the buck. There were frequently other considerations like how big a company you were; will you be around next year to support it; and other kinds of stuff like that. And we couldn't handle those kinds of questions at that point in time, so the best thing we could do was to sell it through the stores, and the stores provided the local support to the customers so that if they had a problem they could come back to the store.

Grier: And your product, as I recall, was a big deal to the dealer channel and they sold a lot of units.

Rubinstein: Yes, they loved it. The software was the catalyst that said here's a reason to buy this machine because without the software, the machine was just a boat anchor – not a very good one, either.

Grier: But it's interesting that the pricing that was designed for this specific application ended up being a ubiquitous price point. Everybody did it. Even Lotus came out with a $495 price point. That became the very standard price point for high value products.

Bill Goodhew: It was not a coincidence. The consumer picked the point that worked. People felt it was worth it, and yet the sellers could make a profit. It turned out to be a workable price.

Rubinstein: Yes. I factored in a number of aspects.

Paul Ceruzzi: So whether it was scientific or not, it was a good answer.

Rubinstein: Well, it was scientific, except that it was sort of done in a vacuum. But it was still scientific to the extent that I had all these considerations in mind when I chose the price point. But it was chosen rather than done by some statistical measurement or something.

Ceruzzi: So what was your experience with price points? Did you actually get involved in deciding them at Peachtree?

Goodhew: Oh, Yes. And discounts and stuff like that.

Determining the Price for Peachtree Products

Ceruzzi: But how did you set the list price to begin with?

Goodhew: Well, at one time we did a very scientific approach. We had this product called Back To Basics which was going to run on multiple platforms and was written in, of all things, Forth. It was a good language for running on multiple machines, but it didn't handle files very well. So it was not very good. But anyway, that was one where we actually tested the price, and we did it by running ads in either *Personal Computing* or *Popular Computing*. The ad had a card in there to buy the product, and the card was the only thing that had the price on it. The price on the card varied: 5,000 at $50, 5,000 at $99, 5,000 at this… We wanted to see what the elasticity was of that kind of thing, how many units we sold at each price and what the total revenue was. That's how we picked the price point. It was sort of scientific but it wasn't really in that we just picked the readership of one magazine on which to base the price. It was sort of a horizontal magazine and the salesman sold us on the idea. So that was the one time where we did something definite to try to set a price that would allow us to make money and for the dealer to make money.

Grier: And what did that study show?

Goodhew: I think we ended up not at the lowest price. We ended up something like $99 a module at the time, and we had tried $50 and $149. Did you write about the price points?

Tarter: We had an article about these and the natural price points in other industries and so forth and we tested various prices. And the results showed that there was no difference between $89.95 and $79 or something like that.

Grier: Well, I was looking more at the gross levels right now. Were you selling accounting software for $2,000 or $495 or something else?

Goodhew: Well, we started out with IBM distributing the product, and I think it was $750 a module. When we were carrying it on our own, it was about the same thing – $695, $795, or something like that.

Rubinstein: By the way, we did find other ways of adding onto the price. For example, when we came out with MailMerge, that was an additional cost of $150. When we came out with a spell checker, that was an additional cost of $150. It was only later that those features were incorporated into the main product.

John Brackett: Whenever you have a product that's 95 percent gross margins then pricing is whatever you would like it to be, and then you just cram all the other expenses into the remaining money that's left. You know, whatever you have left, you just do it for that; you don't have any kind of discipline as far as what it costs.

Rubinstein: Well, there are other industries that have similar situations where the actual cost of making the product is very small compared to the pricing, such as pharmaceuticals and perfume.

Goodhew: In the mainframe days when we were talking about $400,000 for a general ledger package or $1 million for a suite of several products, that pricing was the same. We just pulled a number out of the air. And certainly at the end of the quarter when we needed to make our numbers, the number could be anything we wanted.

MSA used to have about 15 vice presidents, of which I was one, and we would go out at the end of the quarter and help salesmen close the business. Every time we'd make a sale, we would call the office and as soon as we had made the number, we'd say, "Okay. Now we've got the number that we need to make our numbers for the quarter," and then we'd stop discounting. Customers pretty well learned that if there was going to be a deal available, they'd get it at the end of the quarter so they'd buy at the end of the quarter.

Pricing Bundled Software

Grier: Well, this leads to the differences between selling through retail, which is clearly the start of this, and moving into corporate sales. And there is also the issue of pricing when the products started getting bundled with the machines themselves. How was pricing set?

Rubinstein: When it was bundled with the machines, the principal requirement to get maximum pricing or the least expensive pricing was that a copy went with every box. There were no exceptions because then we had the loyalty of the manufacturer. And in those cases we did give up to a 90 percent discount, which was very substantial.

Tarter: So you charged like $50 a copy at that point?

Rubinstein: Yes, we were getting $50 a copy, and all we sold them was a serial number. And they bought so many serial numbers at a time to satisfy the manufacturing, and we got paid for that. We didn't print the manual. We didn't copy the disk. We didn't print anything. All we did was just collect money.

Tarter: And you got paid for every unit that they sold.

Rubinstein: Exactly.

Tarter: Except that in the long run, that kind of got the notion in people's heads that they didn't have to pay so much for software.

Rubinstein: No, it depended on how they bought it. If they bought it as part of the hardware package, then it just came; if not, they had to pay extra. Just like when you buy a laptop computer today it comes with all kinds of software, but if you want Microsoft Office you've got to pay for it.

Tarter: But in MicroPro's case, it actually worked the other way because the hardware vendor who was doing this bundling was very proud of the fact that he was giving you a $500 product along with the hardware.

Rubinstein: Exactly.

Tarter: So he made a big deal over the $500 price. He helped support the price because he said you had a special deal with his $3,000 machine or whatever it was. It was $500 worth of the world's leading software.

Doug Ross: What about user manuals for the customer? How did you handle them?

Rubinstein: The manufacturer of the hardware had a master copy that he would print.

Ross: You gave the copyright to them?

Rubinstein: Yes. He had a machine readable version of the manual. The point is we didn't have any of those costs or manufacturing scheduling or anything. We didn't have to put anything together whatsoever except serial numbers.

Goodhew: Later when Microsoft started selling licenses to hardware vendors, they used the same deal in that you had to buy one copy for every machine you sold, whether you included their operating system or somebody else's operating system.

Rubinstein: Well, they didn't care. It was for every box.

Tarter: And they got in trouble for it, and you got a gold star for marketing.

Rubinstein: Was it gold? I don't know what color it was.

Goodhew: You didn't get hit for some kind of a monopoly thing?

Rubinstein: No. The only reason why Microsoft got hit is because of their predominant position in the marketplace. You're talking about a market share in excess of 90 percent, and ours was only 70 percent.

Goodhew: I'm glad you showed some restraint. [laughter]

Tarter: When did you start doing that with every machine? Was that ahead of Microsoft?

Rubinstein: Oh, yes, of course it was.

Goodhew: But that was only for bundling deals, though. That was the promotions.

Rubinstein: Yes, we did that in 1980.

Tarter: Okay. So you were ahead of Microsoft's deals they made with the IBM PC and with the clones.

Rubinstein: We did a lot of things that a lot of people copied.

<u>Software On The IBM PC</u>

Brackett: As I recall, when IBM shipped the PC, you had your choice of three operating systems. You could buy something from UCSD, whatever it was, from San Diego.

Goodhew: PASCAL.

Ross: It wasn't PASCAL. It was an operating system.

Brackett: Yes, and then CP/M was available and PC DOS. Gates' genius at the time was making his the cheapest.

Rubinstein: It was not Gates' genius. I had nothing to do with it but I do know what happened. Prior to making the arrangement with Bill Gates, IBM approached both Digital Research and MicroPro in advance of them coming out with the machine. I'll tell you the deal they wanted us to do because they knew we had the most popular word processor. They said, "We like your word processor and we want to put it on our 8186 machine." At that time we were running on the 8086 machine and the 8186 was not compatible. So they said, "We will pay you a reasonable price for the conversion of your program to work under PC DOS for the 8186. And when we pay you for that, we will own that conversion. You are free to go and make your own conversion, but you have to do it in a totally different clean room so that they don't interfere with each other." Well, I was not running a place where I had lots of developers to do all of this stuff so I balked at that arrangement. They made the same arrangement, or tried to make the same arrangement, with Gary Kildall [DRI], and he said that he would do it for free. He just wanted to be paid for each copy of the operating system IBM sold. In other words, he was willing to do it just on the basis that it would be on their computers. They said, "Oh, okay."

Grier: And who owned it? If he would do it for free, would IBM own it?

Rubinstein: No, IBM would not own it, but he would certainly do it to accommodate them. Well, IBM went away with that, and then they went to Bill Gates and they gave him basically the same deal they gave me, but he didn't have an operating system then. He went and bought a program from Seattle Computer Works and converted it but retained the right, which I would have had done too, to subsequently develop his own version of it, totally independent of what they did for IBM. As a result, there ended up being two implementations – MS DOS and PC DOS; one they did for IBM, one they did for themselves. But they didn't come out with MS DOS right away; they just held it. And at the same time they also obtained a contract from IBM for what later became OS/2.

Grier: That early?

Rubinstein: Well, it took a long time to develop.

Grier: I know, but was the contract that early?

Rubinstein: The contract was that early. And OS/2 was supposedly going to be a real operating system. Well, of course, it never materialized as being a very important thing in the marketplace. But in the meantime, Microsoft had additional revenue streams and went about building its own MS DOS and later building its own version of Windows. But at some point Bill went to IBM and said, "We don't want to work on OS/2 anymore. You can have it. Here's all the source code. It's all yours. And by the way, we don't want to work on PC DOS anymore. It's all yours, also. Goodbye." Of course, IBM was totally shocked because they thought they had another little manufacturer by the nuts, but they didn't. At any rate, that's how that all happened.

Goodhew: But with the original PC, there were different price points for IBM’s three operating systems.

Rubinstein: Yes. That was IBM's strategy because they figured that since they “owned” the one they got from Bill, they could have given it away for next to nothing. But they didn't want to seem like they weren't supporting what was already out there. As a result, you could get IBM's PC DOS for $50 and CP/M for IBM for $250.

Goodhew: But CP/M-86 was late. It was not delivered on time, and that was a factor. And the operating system was slow, as I understand it.

Harpst: Yes, and big.

Brackett: Plus Gates was out there seeding copies of PC DOS to all these developers so the other operating systems didn't have the most applications available, too. So you would have to decide which operating system you were going to use.

Rubinstein: Bill was very brilliant, and what he did was under his arrangement with IBM because he figured out a way to get around it. And had I had extra developers, I would have done the same thing, but I didn't.

Tarter: There's the whole business of the origins of PC DOS. The guy who wrote it at Seattle Computer Products wrote it because he was waiting for CPM-86 and he said, “Damn it, I'm going to do it myself. Otherwise I'll wait forever for this guy to deliver.”

Rubinstein: He was selling a one-board computer, and he wanted to have some sort of operating system to go with it.

Tarter: And Seattle Computer Products kept the right to sell it on some computers, but it turned out to be a meaningless computer, right?

Rubinstein: Well, it was their single board computer.

Tarter: They exercised that right after the world changed. And as the story goes, Bill Gates went to the guy and hired him. [laughter]

Rubinstein: Right, I made him an offer he couldn't refuse.

Tarter: It wasn't that simple. I happen to know the guy who negotiated the final deal with Seattle Computer Products. Basically, they had a license. The company bought a major electronics company which I never learned the name of just to get that license. So Gates wrote him a check in his office for $1 million for his company.

Rubinstein: Wow, that's really something.

Tarter: Yes, it's a very convoluted story, but Tim Patterson is the guy's name. He became an employee of Microsoft when they hired him as a part of the deal.

Rubinstein: He got a terrific enlistment fee. [laughter]

Tarter: Part of the deal was also that he would speak the corporate line.

Brackett: So IBM shipped Electric Pencil with the IBM PC.

Rubinstein: No, no. They came up with this other ghastly thing...

Gary Harpst: There was one that was done by [John] Draper, the guy who was Captain Crunch.

Connie Galley: PC Writer, wasn't it?

Rubinstein: Yes, that's right – PC Writer.

Harpst: Oh, was that a terrible program.

Brackett: It was the one that was done by the guy who was the famous hacker who hacked in the phone lines with the 2600 hertz signal?

Rubinstein: Michael Shrayer is the guy who did the Electric Pencil, but I don't think he did anything like that.

Harpst: No, this was somebody else. This was a guy named John Draper. Captain Crunch is his nickname because apparently this whistle would give you free phone calls, and hackers learned that. And he went around selling blue boxes.

Goodhew: Yes, we had one of those in the dorm at Georgia Tech. You put this little thing on the speaker of the phone and it would generate 2600 hertz. I've forgotten how it worked, but with that thing you could make free long distance calls.

Harpst: In any event, he got arrested and he was sent to prison, but IBM hired him to write this program that you just mentioned, whatever it was, because they desperately needed a word processor to ship with the computer.

Rubinstein: And they weren't willing to buy WordStar on an OEM basis. And by the way, we did our own conversion to the 8186, and WordStar was still absolutely the most popular word processor on the IBM PC.

New Speaker: It was the 16 bit conversion?

Rubinstein: Yes, and I'm talking about 1982, 1983, and 1984. It was very popular. WordStar really was king of the mountain until I gave up control. I gave up control because a few months before the public offering I had a heart attack, and I was prevailed upon, lying there in the intensive care unit, to sign papers to turn it over to the VC, Fred Allen.

Upgrade Pricing

New Speaker: But actually, that raises an interesting question on pricing. You were obviously into upgrades at that point.

Rubinstein: Yes.

New Speaker: How did you come up with upgrade pricing?

Rubinstein: We did have a strategy for upgrades. First of all, I wanted the customer base to feel that we were going to come out with annual or maybe even semiannual upgrades that were going to be worthwhile. And we couldn't really charge them a lot of money compared to what they had paid. Otherwise, there wasn't any incentive to keep on doing business with this company. And we certainly knew we had a copying problem because in those days just making a copy was no big deal.

So we had to provide them with a reason to have a continued relationship with the company, and therefore we charged a relatively nominal fee like $150 for an upgrade compared to the $500 cost for the product. But for $150, many people who had stolen the program now wanted to become customers. We would carefully ask for the person's serial number when they called, but we didn't care if he said gigibotchers – We'd say, "Okay." We sold it because now we had a customer. laughter]

Harpst: And all of that money went direct to you, I take it.

Rubinstein: Oh, Yes.

Changes in the Retail Channel

Goodhew: You were not going through the retail channel?

Rubinstein: No. Initially, the retail channel didn't want to sell the upgrades.

Goodhew: Why not? It was only $150.

Rubinstein: Well, that was one of the reasons.

Goodhew: Any other reason?

Rubinstein: It meant that they might have to answer support questions.

Grier: Eventually the retail stores went away all together.

Rubinstein: Well, that came much later.

Grier: Well, they're still there. There are still some.

Goodhew: CompUSA.

Rubinstein: No. CompUSA is not a retailer in the conventional sense that I knew it because in my days – I'm going to sound like an old fart, but what the heck…

Tarter: It's okay to sound like an old fart for this purpose. That's why we're here today. [laughter]

Goodhew: Why don't you think CompUSA is a retailer?

Rubinstein: Approximately four and a half years ago, maybe five, I came out with a product called Web Sleuth and attempted to sell it as a retail product through the channel. That's not yesterday. I mean, it's still five years ago. And I found out what it was like to sell through CompUSA and so on.

First of all, everything had to go through Ingram because they're the only distributor left – no more Softsel, no more Micro D. It's only Ingram. Ingram wants a $10,000 fee up front to simply carry the name of the product and not necessarily carry an inventory. But when they want inventory, they don't pay for it until they've been paid. So you don't have net 10, net 20, or net 30. It's like maybe net five years or maybe never.

In other words, the manufacturer – if I may use that term – has to front everything. Now, in addition to the fee for the so-called line item, there can also be a fee from the store that says they will maybe carry it for the shelf space. In other words, the manufacturer, instead of being in the driver's seat, is reduced to a coolie that has to shell out all of their dough not for developing a product, but for the shelf space just to be there in case somebody passing along sees it and decides they're going to buy it. And they also wanted to know about comp programs where you'd advertise, and spiffs for the salesmen. I would say that even when I tried to sell what was a very innovative product for the time, it was just too expensive. And they also wanted to know if I had other products. So I had to have a selection of products so that they would have a way of giving back what didn't sell and keeping what did. So that's why CompUSA is not really a retailer in the sense that I knew it.

Ceruzzi: So really, you're talking about a difference between what the retail channel was like then and what it is like now.

Rubinstein: Yes. None of the early conditions still apply today. You cannot get paid for anything until someone actually comes up with the cash for it and it goes through the different handling. As it turns out, the only way to sell software as an independent developer today is on your own, not through the stores.

Ceruzzi: So back then, when there really weren't distributors, how did you work with stores? Was it a direct relationship?

Rubinstein: Yes.

Ceruzzi: How did you get paid?

Rubinstein: Well, we sometimes would extend credit terms. Sometimes we would get a credit card, depending on the relationship we had with the company. But we had a variety of relationships: there were people who were on net terms with us; there were people who were on cash terms. In ComputerLand's case, they were on net terms, and during their heyday we were getting something like $550,000 a month of business from them. And a single source was buying for all their stores.

Goodhew: But except for ComputerLand did you have to travel to all of these cities for the retail stores and visit each one?

Rubinstein: Well, we had a field sales force. The field sales force for MicroPro transformed the company. Our first year of business, we did not quite have a half a million dollars in revenue, the second year $1.8 million, the third year $5.2 million, and then I put in the field sales force. And from $5.2 million, we went to $25 million. You can't imagine the wrenching experience that was to climb from a $5 million company to a $25 million company in the space of one year. And then, we almost doubled again the following year. We went to $44.9 million the following year. But that's because we changed the very character of the company by putting in a field sales force. We went to more conspicuous type of marketing, more conspicuous type of advertising, more conspicuous type of trade show and what have you. We also started moving into Europe in a very big way. We had all of our languages localized. We opened up a subsidiary in Ireland. I personally traveled to most of the western European countries and went to Japan where we opened up our own subsidiaries.

Ceruzzi: And we sort of have two endpoints of marketing here.

Rubinstein: Yes.

Ceruzzi: And you've taken us a little bit from it. From the small almost mom and pop retailers, we see a consolidation of retailers, and sometime in the 1990s we start seeing sort of the national PC connection companies, places where they were running their business largely by phone and then eventually by Internet.

Rubinstein: Yes.

Ceruzzi: How does that transformation go? What are the issues about? Clearly you're at the point now where the manufacturer of the software – whatever we now call them – has to up front the inventory costs.

Rubinstein: Well, that's where we are today.

Ceruzzi: Yes, that's where we are. Now, how did we get there?

Rubinstein: Well, it happened gradually. It didn't happen all at once. What happened with the software retailers was the early ones were the most successful. They sold programs where there was a high margin, and they made a lot of money, and they hired new people. But what they didn't do was pass on what they learned about how they did business to the new people, and the new people were far less capable than the original people. We trained the original ones and we said, "You get a discount based upon the fact that you will know our product and you can support it so that we don't have to support it. And therefore you will save us the money for support, so we're going to give you a discount." And the discount was based upon volume, and they were very successful with that. But as new people came in, they knew less and less; we got more and more support calls, and they lost more and more money taking on new products because they didn't have the ability to evaluate them and because the quality of the products wasn't necessarily as good. And so in retaliation if you will, they looked for ways to reduce their losses, they looked for other business models to reduce those losses.

And a very popular business model is the supermarket. A supermarket's products are under no risk whatsoever. Everything you see in the supermarket is only paid for by the supermarket when it's sold, not when it sits on the shelf. There are people who are merchandising people who are not employees of the supermarket who come there and stock the shelves. The retail business has just gradually moved into that type of business model. Macy's department store does not pay for anything until it's sold, and there are merchandising people that come there and set up the displays and arrange everything, and do everything except actually do the transaction with the customer. Macy's collects the money and then pays for the merchandise.

So the retail stores changed because basically they wanted to move into the least risk position as possible. It didn't happen all at once. They couldn't or they were reluctant or they found it very difficult to do that with popular products, but they certainly did that with innovative products because they found, much to their regret, that they had no ability whatsoever to distinguish a good product from a bad product. So they just simply didn't want to spend the money to buy anything.

Goodhew: But again, there was a long period of time after what you're describing when it didn't change that much. I left Peachtree in 1997 and we didn't have that problem when I left. We were selling product to distributors and the distributors were paying us for it.

Rubinstein: You had a legitimate brand name, totally different from what I'm talking about. What I'm talking about is why we have no software stores today, and it's not because of Peachtree or WordStar, because those were good products that had reputations that were well established and that the retailers didn't feel that they were taking a risk on. So they didn't have to worry about changing their business model. But when it came to XYZ, whatever it was, they simply got away from that.

Goodhew: But for a long period of time, we had a more or less standard vanilla American two-tier system where the manufacturer sold to the distributor. He took physical possession of the goods and title, paid for it and passed it on to a retailer who generally had the right of return to the distributor. And some of these were people like you originally described that would buy one copy or two at a time or bundling it with hardware and doing a lot of consolidation.

Rubinstein: That is still true today for companies like Peachtree, like Adobe, like

Microsoft, and maybe there are two or three others – Symantec – but that's it. There are no new software companies and no new products coming from new software companies that you see on the shelves today.

Grier: Because it's so easy to sell it over the Internet.

Rubinstein: Well, it's not just because it's so easy. It's also because it's so difficult to sell it through the channel.

Goodhew: That's interesting. I'm just thinking back. When Microsoft got into consumer software, they did a blitz of something like 100 titles. And they were shocked to discover that they couldn't get them on the shelves.

Harpst: Right, even though they were Microsoft.

Goodhew: Yes. This is the first time anybody had said to Microsoft, "No, I'm not going to put your stuff on the shelf." The dealers were going in and cherry picking 5 out of 20 or so new titles and saying to Microsoft, "The rest of them we don't want." And they actually had to close down that whole consumer division because they couldn't get these titles on the shelf. There were many bad products, but it was interesting that they just put so many SKUs out there.

Tarter: When you buy a PC now, there's stuff that they bundle in that you probably never bother opening. What do they call it…."shovel ware?" I got this mapping program on my PC. I didn't ask for it and I hope I didn't pay for it. It's worthless because if you really want it, you go to Mapquest.

Brackett: There's a lot of stuff on your hard drive that's there but you don't pay for it until you install it and register it – your anti-virus program and some other things.

Ross: I see it when I click on things, and I think, "What the heck? I didn't ask for this;" but it's there.

Goodhew: And that's a typical consumer reaction.

Brackett: And then, there's the doubt…"Can I get rid of it?"

Galley: And I'm afraid to because it might mess up my computer.

Rubinstein: You just want a big enough hard drive so it doesn't matter

Brackett: Well, that's another thing. Moore's Law in the disk drive area has led to a lot of this kind of thing.

Rubinstein: Well, just what we were talking about – WordStar is 237,000 lines of code, approximately, which if you compressed it, I think would fit on one floppy.

Use of VARs

Ceruzzi: Let me ask you something. An accounting package obviously is more of a product for a value added reseller. Was your experience of building a VAR network any different than building a dealer network?

Goodhew: Well, Gary Harpst is probably a better person to answer because he successfully held a $700 price point. We bailed out down to $299 for everything you would ever want so he had a much more viable VAR network than we did and started making money on it.

Harpst: Yes, there were a lot of changes throughout the 1980s. What happened in the end and the beginning were very different. In the beginning, the computer retailers such as Business Land, Micro Age, ComputerLand, and Entree were the big players. And we had started building a VAR channel.

Rubinstein: By the way, I think it's relevant to see that none of those establishments have survived.

Harpst: That's right. So we started building the VAR channel. But as we got bigger, PR came into play. Our business tripled in 90 days because of an award given by *PC Magazine* in January of 1985. Well, that created instant demand all over the country. People went into computer stores to ask for our product. It's kind of like this brand image thing we're talking about. All of a sudden Solomon was a brand and we didn't have enough channel. We just had some sporadic VARs around the country with no systematic coverage. Entree had about 110 stores, BusinessLand had 250 and ComputerLand had 600. I don't know what the exact numbers were, but at one point by the end of 1985, half our units were sold through the computer retail type stores. However, the problem with the retail stores was they just had junior salespeople. They were just salespeople. They were not truly value added retailers. Their value was stocking the shelves.

Rubinstein: Yes but that was not the way they started out.

Harpst: No, that's right.

Goodhew: It was not a good fit. It was not worth our while to have to train them on accounting.

Harpst: Even if you do train someone, he's gone within six months.

Rubinstein: Because he can get a better job elsewhere.

Harpst: Yes, that's right. So in the middle of the decade, half our units were going through the VAR channel and half were through BusinessLand, ComputerLand and others. And then, by the end of the decade, that was completely gone. There were none of the specialized computer retailers left.

Rubinstein: And by the way, you can still get that stuff, but you would go through an accounting services type of company now.

Harpst: Well, the attraction of the whole thing with accounting was that somebody who had an accounting services company could become a VAR. And by selling the software, he might make a few dollars on it, but he got a new client. And he was a legitimate CPA or a licensed practitioner. He could do your taxes. He could do your personal financial planning. He could help you close your books at the end of the month. It was part of his business or her business and they were knowledgeable. They could come in and help you implement the product because they understood accounting, and that was a great fit. Everybody made money or thought they were making money. That was a very legitimate long run, and that still applies. You can still go out and buy any of these products. Now Microsoft has a big deal with Solomon products and they have a big play in the market. And these Value Added Resellers are vital to the business. They have two or three employees, five or six employees; there are a lot of them running people out of their home with two income families. It's mainstream, guts of America, because it works.

Goodhew: And the interesting pattern or the Catch-22 of this whole channel issue is that what emerged over the years was there never really was a dominant accounting software player. If you look in the 1980s, there weren't any $100 million accounting software companies created. There were several of us in the $10 to $20 million range, and I'll bet there were 30-40 vendors listing products. But what you found was that the investment to learn those products and really add value was so substantial that many vendors never got to critical mass, and they were always worried that the vendor, since they didn't get a critical mass, would open it to somebody else in their territory because we weren't getting the business we needed. Well, that undermined the very incentive they had to invest, so they protected themselves by carrying more than one product, and we protected ourselves by having more than one reseller. And the dynamic was that it was not very profitable for the partner channel, and we found that where we were growing was by just opening more and more resellers; this became a short term gain in a sense.

Tarter: You're selling dealer kits. You're not selling software.

Harpst: In a sense, that's true. But in defense of the dealers, they very often had what they considered a consultative sale in that they would look at your business and recommend the best product for you. So they had to carry more than one to make that game legitimate.

Tarter: Yes.

Goodhew: I would say, especially in Gary's segment of the market, we did everything anybody could ever want. There were very few things that one product did and another one didn't. So you really didn't need to carry multiple products. But if you were really going to be a consultant and say, "I'll recommend what's best for you and I'll do a little study," then you had carry multiple products.

So the fight for VARs was intense in the accounting business. There really weren't nearly as many of VARs as you would think. *VAR Magazine* would tell you there were 24,000 because they would want you to advertise in them. But there really weren't that many, and a good one was hard to find. An exception was Great Plains Software which was a company with mid-western values working out of Fargo, North Dakota. There was nothing else to do because you can't even ski up there so you did nothing but sell. They did a marvelous job of building a dealer channel. But when they decided to go into Europe and looked to set up dealers, even though it was a very strong company with impeccable products and an impeccable reputation with lots of money, they couldn't buy dealers.

We even thought about it with our manufacturer dealers. We were going to put people in business; we'll go find some guy who worked for a VAR and make him a VAR and fund him so he could buy part of his inventory to get him started. There were not nearly enough competent accounting VARs to go around. I don't think there still are. Of course, Microsoft did it the right way and bought a company which got them into 221 countries with a good VAR base all over Europe, and they bought Great Plains which had the dominant position. Great Plains had already bought Solomon.

That didn't seem to be an antitrust problem, since it was a different market. And so they bought all this business, and it will take them a while to get the products rationalized because they had all this kit and caboodle of products. But they'll all get to some standard and they'll use all of these dealers in the selling, and Microsoft will have a big percentage of the sales.

Galley: But it's interesting. In a way, nothing's changed; you need the expertise at the ground level, just like you did at the beginning.

Goodhew: Accounting may be unique. Maybe only accounting is that way where you really need a knowledgeable practitioner to help you to implement the product because it's just like trying out an accounting product.

Harpst: Or doing a review of one. We never got helpful reviews... except when Price Waterhouse through *PC Magazine* did a high quality job. All of the rest of the reviews – somebody would get paid $300 or $400 to do a review. But it's one thing to write some stuff with a word processing product you can kind of see, or a spreadsheet or a graphics product. But with accounting, that's a totally different kind of thing. You need to build up several months of data. You need to have a quarter and you need to close the quarter. You need to close the year. You need to go back and postdate to a closed year – all these kinds of things that no reviewer is going to take the time to do.

Tarter: It's interesting that no matter what channel it was or what kinds of products they were, the re-seller channels for software just seemed to constantly deteriorate.

Galley: Well, maybe to you, but it seems like with the end user products there came a body of knowledge among the end users that they could share.

Goodhew: Right. When you have a horizontal product that everybody in a company can use, then that's one kind of knowledge transfer within the organization because you have the local guru. At one time it was the secretary who had been using it the longest. She knew the most. We don't have secretaries anymore, so different people know how to do it. But with accounting there was only one copy sold for one department, and they are the ones who know how to use it and nobody even wants to touch it. I hated accounting and I don't want to even know how to spell it.

Tarter: What I meant was that at the high end you still have this problem with the VARs sort of losing their expertise or not having enough expertise, and there aren't enough of them.

Harpst: Now we still have them out there, and they're very important because you have to have them. Small businesses need some kind of accounting consulting, and they're not going to hire the Big Four or however many are left. They're going to hire some local firm. That's all they can afford. And it's hard to sell to small businesses, too, because they don't read the small business journal or whatever it is. They read *Furniture World* or *Lighting Today* or whatever their specialized magazine is; they're vertical businesses. They might read *Business Week* but that's expensive. They read *The Wall Street Journal* but that's expensive. So you might say, "I'm just going to promote my business to small businesses." Well, that's easily said but hard to do.

Goodhew: Well one thing I remember that amazed me at the time was the percentage of Peachtree customers who said they made their decision about what to buy by reading the box copy. I mean, this is scary, and yet we're all guilty of it. We were one of the first people to do the flaps because we had more copy space.

Harpst: And then, when you go in and ask the salesman "Will Peachtree do this?" he'll say, "Oh, let me read the box to you." So he gets out the box, and he's the expert. Well, that's no help, either.

Goodhew: But I think it's almost scary when you think about the software that's going to run your business. The buying decision was made by walking into a store, sort of looking around, picking up a box and saying, "Okay."

Galley: That's called trust.

Goodhew: I had a great idea for a business, and I'll give it to you if anybody would like to try it. There are not enough stores, I don't think, to do this. But my idea was you put a kiosk in there with a telephone. You know if you go to an airport and you want to get a motel, you pick a motel, you push the button, and it dials the motel. Well, with this kiosk, it dials the vendor. I talked to a lot of vendors, myself included, and we would gladly pay a dollar per call or some amount. Here you've got a guy standing there with your product in one hand, a credit card in the other hand and the cash register is in sight. He has one question. Give me that guy. I would give you $1, $5, $10, to put me on the phone with that guy because I would say, "Buy it now. Put this number on the registration card, and you'll get a free tee shirt; you'll get a year's support." I'd give him an impetus to buy right now, push him to do it because he is right there. He is right on the edge, and he just has one question. And if I can get him on the phone, he's mine. But now they read the box or they go to the web site.

Tarter: Yes, that’s actually where they’re making a lot of their decisions.

Packaging Peachtree Software

Ceruzzi: But let's talk about the packaging. At what point did you figure out that you could actually sell people off the box? I mean, the Peachtree box, as I recall, started being sort of abstract pictures.

Grier: They had pretty peaches on them for a long time.

Goodhew: Well, there was a guy in Chicago who ran a mail order business, and he believed in tightly packed ad copy. He sold electronic stuff. He went out of business. He got in a fight with the IRS or something and went out of business. But he sold all kinds of electronic things, and his ads were solid copy.

And it was like who would read all of this stuff, but it turned out a lot of people did read it. People buy magazines and they read the ads. I did. So we did the same thing. You keep adding a lot of features and you've got to tell people about the features. You've got to have a place to tell them about the features. You've got to have a bigger box or pages on the box or something. So we ended up putting pages on the box. At one time we had flaps on the front and flaps on the back. They were Velcro, and I think they just have flaps on one side now.

And furthermore, the bigger the box, the better because you elbowed everybody off the shelf. And if you were strong enough to get on the shelf, you wanted everybody else off. Microsoft had a deal where their boxes had to be faced out. That was part of the deal. One out of every so many had to be faced out – not spined out – so they were taking up a lot of shelf space. Coke certainly does that in the grocery store. If you go to a grocery store, you pay $5,000 a foot for eye level. You pay $2,000 for knee level, for 50 cents you get toe level, and heavy things up on top are free because nobody wants to pick them. So they're doing the same thing in the stores. It's merchandising, and it's been done for years.

But shelf space is at a great premium because there aren't many stores. But we have the web. Do you ever buy anything where you don't look it up on the web? I hardly buy bottled water without checking the web.

Ceruzzi: So how radical was this within the company to go from these abstract pretty boxes with the peaches on them to really direct sales information.

Goodhew: I don't know. We stayed in a constant state of panic for as long as I can remember. We talk about things moving fast in our history. Well, when you're in the middle of things moving fast it's scary. You know, people say "vaporware" or all of a sudden the VC wouldn't get within 100 miles or something because there was a rumor that Microsoft was going to be in it. Things were moving fast and there were large, dangerous objects flying around so you were mostly staying out of the way and trying to do something. Our price point changed from $5,000 to $199. Well, that was out of desperation, not out of marketing brilliance. If that didn't work, we were out of there.

We gave it a try and we decided we were going to cut our price. And when you cut your price 95 percent, you've got to sell over 20 times as many units in order to earn the same amount. We cut our price 95 percent, and I had learned the hard way several times that you better have product ready to ship before you advertise it, or you have wasted an ad. And not only that, but you've irritated everybody.

Rubinstein: And they don't trust you anymore.

Benefits of Advertising

Goodhew: Yes, they don't trust you anymore. So this time I waited until we had the product and the packaging. It was all there in the warehouse before we made any kind of a press release. And you don't want to have a press release unless you have product on the shelf. And we couldn't put any product on the shelf because the channel was full of this $5,000 stuff and they weren't going to take the new product, which was the same thing just repriced and repackaged, unless we took back the old stuff. Well, we couldn't take back the old stuff and give them the new stuff because we couldn't even afford the cost of goods to put it out there. So it was goodbye to the channel. We just said, "Goodbye, Softsel. Goodbye, everybody." I remember a guy with Softsel just closed up his notebook and he walked out of the room when I told him we had this new product and we weren't going to swap it for the stuff that he had. So we had to sell it direct. We just walked away from our channel that we had meticulously built up, all these VARs, accounting VARs, over the years and decided we were going to sell it direct. And a newspaper was the only place you could put an ad where you could get something fast because of short deadlines. *The Wall Street Journal* is the newspaper for accounting products.

Rubinstein: An ad costs $50 grand.

Goodhew: Well, they used to have these little tabloid kinds of things on certain subjects. They'd have a full tabloid, and it came out erratically. But there was one on computing in the home which wasn't exactly dead on for us, but it was better than a corporate kind of thing because we don't sell to corporate. And all of the people who use accounting in their business do have a home, so that's close enough. We spent $10,800 to get a junior page in that thing, and the advantage of the tabloid thing is that it lasts about a week, whereas a newspaper has a shelf life of a day, and then you throw it away. We spent $10,800 and that was a big damn deal. We walked in the next morning and all of the lights were lit up on the phone. And by noon we had made up for the cost of the ad, which was a major milestone; we got the price of the ad back. By the end of the day, we'd sold a lot of units. Now, we thought, we sold around 300 copies; maybe there are only 300 people and nobody will call tomorrow; maybe we cherry picked the market. Well, the next day they kept calling and kept calling. And this guy from Softsel, pretending that we had never met before, called me up and said, "We want to carry your product."

There was no discussion about swapping product. It was the same guy. I've forgotten his name. Anyway, he called me and said, "Our dealers are demanding it. We've got to carry it. What's the deal?" And I think he bought like 20 units or something.

But I remember we did have a special deal with one outfit, I think it was in Buffalo, New York. I had gone to Softsel and they said they wouldn't take it, and then I went to two of the people who were at Micro D and they wouldn't take it for the same reason. So then I went to Buffalo, and at that time Lotus had given an exclusive to somebody and that was a big deal. They wanted an exclusive on something – anything – even features. So I said, "I will give you an exclusive on this deal. I won't give it to Micro D and Softsel," but of course they had already turned me down, anyway.

That was an easy decision. The guy said, "Oh, an exclusive, I'll take it." He didn't know what he was getting, but he didn't have anything to send back because he wasn't a distributor of ours anyway. So he took the product. We went from $5,000 a month to $2 million a month over a short period of time. It went to $2 million a month because the price point was attractive. Now, we had a competitor, DAC Easy, who we were copying. They had done the same thing. But the trick, the difference, in my mind anyway, other than the fact that it was good management and a superior product and all that, but the real difference was they had a $79.95 product, but it had always been $79.95. So they didn't have a value argument. We said 1,000 sold at $6,000 for the suite. Very few people actually bought them all and paid the full list price, but anyway, 1,000 was a legitimate point. We sold thousands of copies at the high price point, and so it was a great value at the low price point; that was a valid argument that stood up. And we had all this data and you got this big heavy box; the actual cost of shipping was $19.95. We were the only software company in the world that charged the actual price of shipping for a while. Most people make all their money on shipping and handling. So it was a venture company kind of thing. It was desperate. If we hadn't done that, we would have been gone. We had two or three months worth of cash left. And in fact, we bought ads that we couldn't pay for if it hadn't worked.

Rubinstein: That's the way I launched MicroPro. I bought ads I couldn't pay for.

Goodhew: And we bought product. We had product manufactured that we couldn't pay for; we were duplicating and printing and all that for very small quantities so the cost of it was horrible. It cost like $40 a unit which was 25% of the selling price. And then pretty soon we started manufacturing and we knew it was going to work. We got everything all on one disk or two disks, and got it down into one volume and all of that. But there was desperation. You had no idea what went on, though. We're talking about it as if it was rational.

Galley: How did your channel mix change if you were selling all through VARs and now you were going to sell direct. How did it turn out?

Goodhew: We sold direct, but a few VARs came back, even though they didn't make much money on a $199 product. They only made money on the drag-along service. When a customer came in and said, "I already bought this thing for $200 and it looks to me like it will do everything," and indeed it did. Then, the guy said, "Well, I'm not going to sell you the product. You already bought it but I'll help install it." So we set up several hundred authorized support centers around the country. And like everybody else, we had a few bugs with our new release. And when you've got a lot of customers out there and you sell a new release and they all install it and they're running their payroll with it and the payroll doesn't work, that's a problem. So they all call at once, and we had the support center to take the calls after a while. So that worked out.

Tarter: I have to tell you, every year at COMDEX I'd run into Bill Goodhew. We'd ride the same bus together. And I was a Peachtree user and they were doing upgrades. Every year I'd ask Bill, "Is it safe to upgrade this year?" So we still had the database problem. And finally, I think it took about four or five years, I sat next to Bill at COMDEX and I said, "Is it safe this year?" And he said, "Yes!" And I did buy; I actually did buy a paid upgrade. However, I bought it through the channel.

Goodhew: The only journalist to ever buy anything.

Tarter: No, I buy software. But what happened – and this was an interesting channel experience – Peachtree had something like three SKUs on the shelf. I asked the dealer which one to buy. He gave me the wrong information so I ended up having to ship it back to Peachtree – all this paperwork and customer service because of a bozo in the channel. That irritated me. And of course, it cost Peachtree probably more than it did the manufacturer.

Goodhew: Yes, and we had a lot of bozos, too.

<u>Packaging WordStar</u>

Ceruzzi: For the sake of history, I want to ask Seymour a little bit about his experience with how his packaging evolved because I remember the WordStar packaging also was very abstract. You really didn't know what it was, or am I thinking of something else?

Rubinstein: No, you're not. The original packaging for WordStar consisted of a mimeographed manual. It was not printed or anything but it was actually mimeographed. And along with the floppies it was wrapped in a baggie. A baggie with staples and hung on a peg, $495. That was our original packaging. But it did grow more sophisticated so that the design of the manual changed. The original manual was in a tufted white binder with this horrible reddish color; it was iridescent red lettering saying “WordStar” across it; I don't know how that ever got picked. People thought that was my taste. But the biggest reason for it was that when you hung it on the shelf, you couldn't miss it. It was just so ugly you couldn't miss it.

We did go to much nicer boxes, but that did not happen until the IBM thing because IBM came up with a standard for its software. They had the cloth binding. They had slides of the manuals and the slipcase for the book. They had a loose leaf binder in there. It was a whole spec. So we decided to emulate that. We went to graphics and then we went to having a flap with explanations. We later went to having premium packages which had mail merge and spell check merged into the program, and those boxes were big, heavy, fat boxes that made it look like you were getting something for your money. Mind you, the program didn't weigh any more or have any more bits in it or anything like that. But you felt like you were getting more value for your money.

Ceruzzi: Was it expensive to have these three ring binders with the slipcases?

Rubinstein: Well, it is very interesting about that. The price is extremely quantity sensitive. And when you're buying in the hundreds of thousands, it really doesn't matter. It's just pennies back there.

Harpst: There's a funny thing about the size of the manual in software – at least with accounting software. In the focus groups that we worked with, it was almost a 50/50 split. Half of the people thought more is better. The other half said, "If I have to learn all of that stuff, it's too complicated." And we never did come up with a real clear market indication of what to do. Half the people buying would get a whole set of encyclopedias. So we found that the way we split the difference was we called it something like the reference volume, as if you didn't have to read it but it was there if you needed it.

Rubinstein: We also had the quick start guide and the reference.

Tarter: But thinking back, did anybody ever actually open up the loose leaf binder, pull out a page, and insert another page or something?

Rubinstein: Well, when you bought an update, that's the way we provided it. We provided you with the update and you could merge the pages.

Tarter: I never did that.

Brackett: But that was the IBM model.

Tarter: Right, the idea was inherited from the mainframe era. I don't know about anybody else, but I lost the manual after I installed the program.

Rubinstein: That's why we got all those customer support calls.

Tarter: I lost the manual because they were so badly written. I didn't want to read it

Rubinstein: MicroPro actually got complimented on the quality of the manual content.

Tarter: I think we're out of time now.

Brackett: Can I ask one question? Was Peachtree as well as Great Plains both P-system customers? Because I have artifacts from one or the other or both.

Goodhew: I don't think Peachtree was ever a P-system product.

Tarter: Okay. Thank you, everybody.

