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STARTING A SOFTWARE PRODUCT COMPANY

BY

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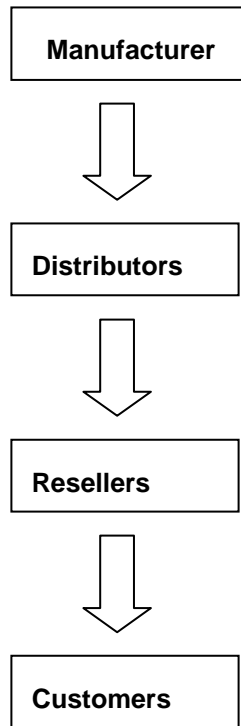
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1. Introduction

Building a new company can be one of the most rewarding activities you may accomplish in your life. Those rewards often come not in the form of large sums of money, but in the forms of new and interesting challenges.

2. The Channel

Most software is sold through the channel. Manufacturers sell to Distributors; Distributors sell to Resellers; Resellers sell to Customers.



This model is focused around creating efficient operations for large software companies. As a startup, you will need to utilize the parts of this model that you can while working around the model as much as possible.

As a startup, you will not be able to work directly with Distributors. Distributors are simply too large to be interested in your new product, no matter how good it is.

You will be able to market your product through a limited number of resellers. Each of these resellers will need to be approached individually and sold on the value your product will bring to their customers. The payoff comes when you sell a reseller and that reseller then sells multiple customers. You will also have to support your resellers throughout the sales process. Resellers can be of great benefit to you, if you manage them wisely. If you do not, they can be an enormous time sink that distracts you from the tasks you need to accomplish to be successful. Resellers buy software from software manufacturers at a discount and then mark it up for sale to end users. Discounts to resellers are normally within the 25-35% range. You should be careful not to compete with your resellers, or they will rightfully abandon you and your product.

End-user Customers are the key sales target of successful startup software companies.

3. Starter Customers

As a software product startup, starter customers are your most critical asset. The visionary customers that implement your new product before it has been proven in the marketplace provide many of the things your new company needs to succeed.

Starter customers provide:

- Feedback on Market Requirements

Software development is driven by product requirements. Initial product requirements will most likely be driven by your vision of what the market wants. Your vision will be shaped and honed through interactions with your starter customers.

Microsoft started with a vision of selling a BASIC interpreter. They changed that vision by listening to their customers. Where would Microsoft be today if they had stuck by their original vision?

- Customer List and Testimonials

When selling a new software product, one of the most common customer objections you will run into is “Who else has implemented this software?” Few customers feel comfortable purchasing or implementing software that is not already in use by similar firms in their industry.

Reference customers, especially those that will write testimonials, are a critical component of a successful sales strategy for a software product startup.

- Field Testing

As much as we hate to admit it, all useful software has bugs. Any software you create will have bugs. Years of lab testing will not discover all of the bugs in your software.

Starter customers will find bugs in your software. You must build strong relationships with your starter customers so that when they do discover these bugs, they do not simply throw you and your software out the door. You must embrace bug reports from your customers and thank your customers for their valuable feedback. Then you must repair these bugs in a timely manner and communicate the repair status back to your customers.

- Short-Term Cash Flow

At some point, you will begin charging your customers. This may start with your first customer or it may start much later.

If you are building your software product around requirements defined by a single customer, you are probably charging that customer for some or all of your development time.

If you are building your software product around requirements defined by your vision of what the market wants, you may have to identify and sell a number of starter customers, and you may or may not be able to charge them for your new software.

4. Generating Cash Flow Through Services

Many software product startups generate revenue to fund software development through the sale of professional services.

The upside to this approach is that the company can be built without relying upon personal funds, angel investors, or venture capitalists. The downside is that companies that take this approach must then focus their limited management resources on succeeding in two separate fields. Lack of focus can kill a software product company even if the professional services division is profitable.

Successful software product companies eventually phase out all service offerings not directly related to their products.

5. Vertical and Horizontal Software Products

The overall market for software products can be divided into two types of markets, vertical and horizontal.

Vertical software products serve a limited market, usually in a specialized industry. Horizontal software products attempt to serve a much broader and more general customer base.

Here are some examples to illustrate the difference between vertical and horizontal software.

| Horizontal Software | Vertical Software |
|--------------------------------|--|
| General accounting software | Accounting software for power plants |
| Word processors | Fuel pump management software |
| Project planning software | Oil exploration management software |
| IP network monitoring software | Geologic telemetry monitoring software |

Software product startups in horizontal markets are very difficult, because most horizontal markets are characterized by:

- Many competitors
- High volume
- Low prices

Software product startups in vertical markets are much easier, if you have specific knowledge of the specific vertical you are targeting. Most vertical markets are characterized by:

- Few competitors
- Low volume
- High prices

Another significant advantage to startups in vertical markets is that if you know enough to create software for a vertical market, you probably also have good contacts in that industry. Those contacts will become for starter customers, which are your most critical asset.

6. Shareware and Public Domain Software

Few software product companies have succeeded in the long term by publishing shareware or public domain software.

Startup software companies that market their software through shareware channels almost always remain very small companies, seldom growing past a handful of employees.

Service companies may reap benefits from publishing public domain software because they use it to advertise their services and they generate revenue by selling services designed around their software.

7. Documentation

Product documentation is a large, and largely overlooked, expense in building a software product company.

The documentation you should provide with your software depends both upon your customer base and upon complexity of your product offering.

Common documents you should consider are:

- A Getting Started Guide
- A User Manual
- A Reference Manual
- An Administration Manual

The burden of creating these manuals will be split between your software developers and specialized technical writers. Your software and your company will often be judged by the quality of your manuals. This is not a good place to attempt to save money.

A good set of manuals will also reduce support costs, which will become one of your largest costs.

Printed manuals may be required based upon the expectations of your customer base. If your customers are willing to forego printed manuals, production cost can be reduced somewhat by providing product manuals in HTML and PDF formats.

8. Support

As a software manufacturer, you will have to provide support to both your resellers and your customers.

This support may start out as one of your software developers with a pager, but should quickly grow to a dedicated support organization.

Product support is usually accomplished in a tiered model. Tier I personnel respond to initial support requests and resolve simple issues, such as software licensing. Tier II personnel are more technical, and resolve more complex user issues. Tier III personnel are usually the software developers themselves. Each tier is more expensive to operate than the previous tier. Economic efficiency requires that you manage each tier carefully to limit the number of calls escalated to the next tier. At the same time, you must escalate every call that needs to be escalated in order to maintain successful and productive relationships with your customers.

Product support is usually offered through a dedicated support telephone number, often a toll free (800) or (877) number. Support should also be offered through e-mail, as that is a less expensive method of communications.

As your product matures, you should develop a list of Frequently Asked Questions (FAQ) or a knowledgebase for use by your support department and eventually by your customers. Customer self-support is a key to reducing the burden of support costs while maintaining satisfied customers.

Product support is normally free for a limited amount of time from the purchase of the software product, anywhere from 90 days to one year. After that time, product support is normally a separately priced item. Typical costs are 10-20% of the initial purchase price of the software.

9. Training

An effective training program can generate revenue while also reducing support costs and increasing customer satisfaction.

Software vendor training is usually priced separately from the software product. Typical pricing is around \$500/day.

Adequately trained customers initiate fewer support requests, which lowers your total support costs.

Customers who are not adequately trained on software products they have purchased tend not to utilize those products. Those products then tend to become “shelf-ware” as the customers grow less and less satisfied until eventually the software ends up in the trash can.

Properly trained customers can become valuable customer advocates for your product offering.

10. Media

Even for your first customer, a professional looking CD in an attractive box will help you to appear more professional and more serious about your product and your business.

Working with a specialized media duplication company will enable you to achieve these goals at a minimum cost and in a minimum amount of time.

11. Conclusion

Building a software product company is an enormous task that will require significant dedication from you over the course of several years. If done well, it can be extremely rewarding, both financially and personally.

This effort will require you to wear a number of different hats and develop a wide range of personal skills. You will make mistakes and you will suffer setbacks, but perseverance and clear decision making will lead you to your goal.