THE POWER OF PRICING EXPERIMENTS

Best Practices for Pricing SaaS Products

ProductPlan

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INTRODUCTION
WHY WE WROTE THIS BOOK

Software product pricing is a complex and tricky topic—one of the most difficult aspects of product management to get right. But despite possessing the greatest opportunity for growth, most SaaS companies are afraid to experiment with their pricing.

Pricing needs to be built into your product's DNA, not treated as an afterthought. Throughout my career, I've had a hand in setting pricing for several successful SaaS products, including GoToMeeting, GoToMyPC, AppFolio, and ProductPlan. I've learned that a smart pricing strategy requires not only an in-depth understanding of the market but a proactive mindset and willingness to adapt to the competitive landscape.

Pricing is four times as efficient in improving revenue as acquisition and twice as efficient as improving retention.[1] Yet most SaaS organizations miss out on potential revenue by relying on the decisions informed by guesses and an outdated market. Overcoming the experimentation fear will position your organization at the forefront of the competition, bring in new customers, and increase revenue from your existing customer base.

Experimenting with product pricing can deliver unique growth opportunities for product teams. In this pricing book, you will learn how to build experimentation into your pricing strategy to get to a more profitable product.

Jim

Jim Semick
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[1] https://www.priceintelligently.com/blog/bid/163986/a-complete-guide-to-pricing-strategy

1

UNDERSTAND THE HUMAN PSYCHOLOGY OF PRICING

1 **UNDERSTAND** THE **HUMAN PSYCHOLOGY** OF **PRICING**

A successful pricing strategy is based largely on human psychology. Due to the unpredictable nature of human psychology, pricing can affect consumers in so many counterintuitive ways. Here are some of the ways to consider:

- A highly priced product often generates a greater perceived value and can potentially attract more buyers.
- A low priced product can turn off customers, who will perceive it as less valuable.
- Simply having more than one pricing option, particularly when one seems very expensive, can drive customers to pay for the more affordably priced option.
- A sense of product scarcity—such as an ad claiming only a limited amount is available at a given price—will compel more customers to buy.

Notice that none of these examples represent the product's inherent value or importance to the potential buyer, or whether the price is actually what the customer was expecting to pay. It's all psychology.

"Greater Perceived Value" Pricing

"Greater perceived value" suggests that a higher price can influence us psychologically into perceiving the product as more valuable.

In *Influence,* by psychologist Dr. Robert Cialdini, he suggests that we make decisions for emotional reasons even when we think we're using analytical reasoning.[2] To illustrate this idea, Dr. Cialdini tells the story of a jewelry store owner who had trouble selling her turquoise jewelry.

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[2] https://www.amazon.com/Influence-Psychology-Persuasion-Robert-Cialdini/dp/006124189X/ref=sr_1_1?ie=UTF8&qid=1529683213&sr=8-1&keywords=influence+-+robert+cialdini

The woman tried everything. She placed them strategically throughout the store and guided customers to them at every opportunity. Nothing worked. She was ready to give up. But then, something happened. She instructed her store manager to "mark the prices x ½" on all turquoise inventory. The manager misread the note and doubled the price of turquoise jewelry. Interestingly, once the prices were raised by 100%, customers perceived them as much more valuable and they sold out almost immediately.

The Power of "Free"

Alternatively, the Power of Free can significantly influence a customer's purchase behavior. Chris Anderson discusses this point in his book, *Free.* As soon as the customer is confronted with having to pay any price for your product, fear-based questions pop up that can stop the buyer completely.[3]

Should I really do this? Is this a stupid decision? Do I really need this right now?

Your customers are probably not even aware they're asking these questions. All they know is: something just popped up (a price) that could lead to a problem (parting with money, even if it's your company's funds). They think, "Let me stop before I do something I'll regret."

This thinking helps explain why about 70% of online shopping carts are abandoned.[4] Offering a free version of your service may actually increase usage, rather than devalue your product.

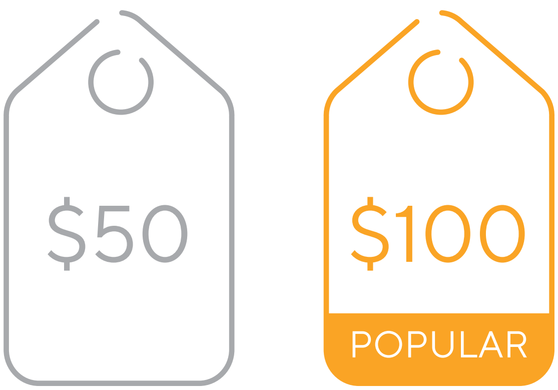
[3] https://www.amazon.com/Free-Future-Radical-Chris-Anderson/dp/1401322905/ref=sr_1_1?s=books&ie=UTF8&qid=1529683862&sr=1-1&keywords=chris+anderson+free

[4] https://baymard.com/lists/cart-abandonment-rate

The Anchoring Effect

Price anchoring taps into a powerful cognitive bias called "the anchoring effect"[5] that customers experience when making decisions. A pricing anchor provides customers with a price point anchor to rely on when choosing between several price options. Typically, it falls somewhere in the middle of the other price points.

For example, let's say you want to price your software at $100 with ten features included. To position this price point as the anchor, you might offer a $50 price tier with five features and a $150 price tier with fifteen features. The customer then compares the more affordable against the more expensive option to then land on $100.



When customers are provided with this frame of reference, they are naturally guided to the price that you actually want them to purchase.

[5] www.pon.harvard.edu/tag/anchoring-effect/

2 WHAT IS PRICING EXPERIMENTATION?

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The Value of Experimental Pricing

Pricing has the highest impact on revenue for SaaS companies. Even a small improvement in pricing can cause a significant increase in profit.[6]

When you fail to experiment with your pricing, you miss out on immense opportunities for growth.

Think about pricing just like you think about your product roadmap. Your product roadmap is never “done” — it is a living, breathing plan that requires consistent optimization. As you gather customer feedback, identify problems to solve, and shift priorities, the product roadmap reflects those changes.

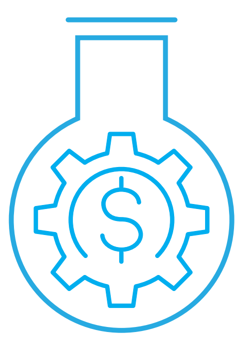
SaaS pricing is the same. Once you set the initial price for your product, you can’t just set it and forget it. The pricing process is a journey that evolves with your product and an ever-changing market. Otherwise, your company’s growth will stagnate.

[6] https://hbr.org/1992/09/managing-price-gaining-profit

What does Pricing Experimentation Entail?

You can't achieve a successful pricing strategy overnight. To adopt a sustainable approach to experimental pricing, there are some crucial people to involve and a few processes to put in place.

- **Pricing team:** Your pricing team will determine the structure of your pricing strategy and drive alignment across the organization.
- **Growth metrics:** Gather data and conduct research to guide your decisions.
- **Customer value:** Quantify customer value to understand what prospects are willing to pay for your product.
- **Pricing tests:** Implement incremental pricing tests to achieve your pricing goals.
- **Pricing validation:** Pricing validation will help you earn support buy-in from internal stakeholders.



3 CHOOSE THE **BEST PRICING STRATEGY**

3 CHOOSE THE BEST PRICING STRATEGY

Many companies neglect to spend time defining their organization's pricing strategy, instead they base it on intuition. A successful strategy that maximizes growth considers cost and the competition. But keeps its focus on customer value.

Don't be Tempted by Competitive Pricing

As you experiment with pricing, there is a temptation to set your pricing relative to the competition. It's common for new products to price using the same model as competitors, but slightly lower.

But with SaaS, there are so many ways to price the product that you have the ability to stand out in the market by thinking differently and long-term. If you go the competitive pricing route it will lead to missed opportunities. It's best to capitalize on the approaches that your competitors haven't considered.

Keep it Simple

Don't overly-complicate pricing. With so much flexibility in SaaS pricing options, there is a temptation to offer various flavors and packages. Moreover, sometimes there are legitimate reasons for doing so. For example, it's common to have three packages based on features. As we've mentioned, studies show that this approach anchors customers, and can be an effective technique for driving customers to your best-performing package. That's fine if this is your goal.

But beware, when you create an overly complicated pricing scheme it has the potential to confuse customers and create a nightmare situation for your finance team.

4 THE MOST IMPORTANT ELEMENT OF SaaS PRICING

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4 THE **MOST IMPORTANT** ELEMENT OF **SaaS PRICING**

Regardless of your product, the most important element of SaaS pricing remains the same: customer value. As you consider pricing your software products (particularly SaaS-based) it's essential to remember that the final-decision makers are always your customers.

With value-based pricing, you can understand how much your target customer will pay for your product or service. If you don't capture the product's economic value then you risk mis-pricing it. **Pricing too high or too low can significantly impact your revenue. Root the price in data that matters.** That way you can deliver what customers actually want and ultimately build better products.

Unlike other pricing methodologies, a value-based pricing strategy gives your company the unique flexibility to differentiate your product. As your product matures and you conduct more customer research, you're able to raise and adjust the price for maximum profit.

Because most SaaS products are priced with a recurring subscription, every month or year your customers will reevaluate whether they want to continue subscribing. This continual re-evaluation makes it even more critical to ensure pricing is in line with the value your customers receive.

Define "Value" in Customer Value

First, let's define "value." Value can be quantitative, such as time saved or additional revenue earned. Focused and straightforward, value provides a fundamental basis for Return on Investment calculations. If your product is B2B SaaS, customer value is important to factor in for your pricing decision.

But here is the tricky part: value can also be qualitative. For example, your product can solve pain points or provide lifestyle benefits. That's where customer interviews become crucial. By thoroughly understanding and documenting this vague qualitative value, you will begin to narrow in on possible pricing models and a price range.

If you can calculate the quantitative value (what makes sense economically), you can add on the qualitative benefit that pushes the customer over the finish line. After a few rounds of price testing, you will be able to combine your quantitative and qualitative value and know how much to charge.

Keep in mind that "value" will vary based on who is viewing your pricing. For example, SaaS companies focused on business buyers should segment their buyers based on company size, vertical market, buyer persona, and so on. Buyer segmentation can guide the pricing strategy you choose.

Qualitative vs	Quantative
• Time saved	• Lifestyle benefits
• Revenue earned	• Reduced stress
• Cost savings	• Pain points

A Value-Based Pricing Case Study

When I was part of the pricing team at GoToMeeting, we interviewed dozens of potential customers. We wanted to gain a deep understanding of the customer pain and the value they might receive.

We discovered:

- Cost and time savings from reduced or eliminated travel (quantitative value).
- Cost savings from switching to our solution versus expensive per-minute pricing of existing solutions (quantitative value).

- Increased usage of online meeting technology because users were no longer tied to per-minute charges (quantitative value).
- Lifestyle benefits from conducting meetings remotely (high qualitative value).
- Reduced frustration by eliminating complicated online meeting solutions (high qualitative value).

By understanding these quantitative and qualitative values, we developed GoToMeeting's unique $49 "All You Can Meet" flat-rate pricing.

The pricing model directly relates to the pain and frustration we heard from prospective customers in our interviews. Primarily, that their current solutions were difficult to budget because the per-minute charges varied so widely. The buyer experienced sticker-shock every month. Therefore, peace of mind was another qualitative value we could provide customers with our pricing model.

While it's hard to assign a dollar amount to qualitative values, these were the benefits that ultimately made GoToMeeting a no-brainer for millions of customers.

Because the product was SaaS, we had the flexibility to price our product differently from the competition and create a unique product in the market. In a sense, we made pricing a part of the product. Pricing became a differentiating feature that the marketing team promoted heavily.

Value is Key

Customer value should be the primary consideration for your price and pricing model. Not features. Not what competitors charge. And definitely not your costs. Understanding both the quantitative and qualitative value will help product managers determine the customer value to set their product apart from the competition.

5 BUILD YOUR PRICING TEAM

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There are varied approaches to how every SaaS organization builds their pricing team. In fact, fewer than 5% of Fortune 500 companies have a full-time function dedicated to product pricing.[7] Yet as businesses seek to scale and expand, it is crucial to have a balanced, devoted team leading the charge on pricing.

The exact pricing process and players involved may depend on the business strategy, company size, and resources available. However, a successful pricing strategy must be a collective effort across departments.

Collaborative Team Involvement

As you consider the members of your pricing committee, don't be afraid to be selective. Your committee will work cross-functionally, conduct customer analysis, and introduce organization-wide changes. Therefore, they should have strong communication skills and tackle pricing with an analytical lens.

Product

The product team is best equipped with knowledge of product value, market, competition, and development. To create a pricing strategy that aligns with customer values, product should be an integral part of the process from the initial stages. Typically, the product team will lead the charge on pricing.

Marketing

With a deep understanding of the target audience, the marketing team is responsible for your product's positioning. To decide how to best communicate value, the product team should partner closely with marketing in the pricing process.

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[7] https://pricingsociety.com/

Sales

The sales team will have an opinion about pricing and what will resonate with prospects. It's important that product includes sales early in the process and taps into the valuable feedback they aggregate from working closely with prospects.

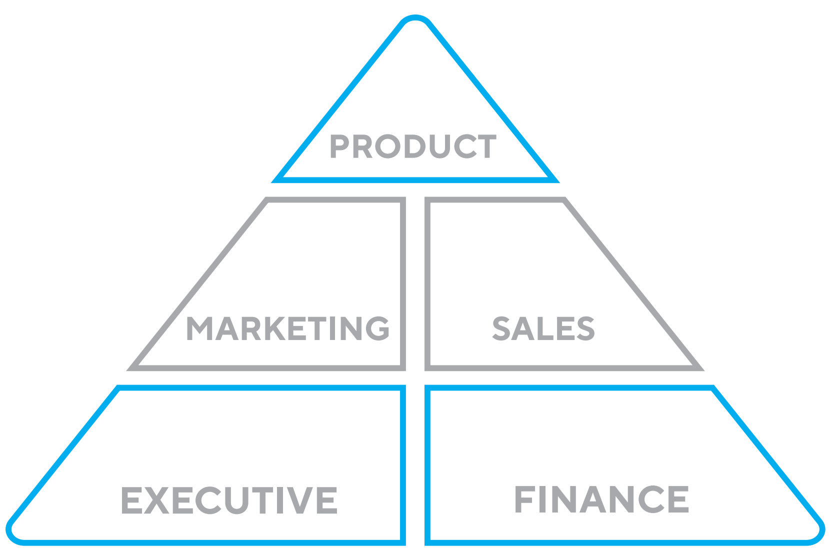
Finance

The finance team calculates and evaluates forecasted results, but they also expect the price to provide a return on investment. Product teams should use finance as a resource to validate the chosen pricing strategy for business growth.

Executives

Management possesses the influence, strategic knowledge, and power to drive the pricing strategy forward or hold it back. Product teams must ensure that the pricing strategy aligns with the overall business goals in order to receive approval from executives.

When all of these departments are involved, it drives consensus and buy-in throughout the entire organization. To avoid any indecision and bottlenecks, there must be a lead decision-maker that makes the final call around pricing. The person who assumes this role is dependent on the size of your organization. At smaller companies, the person taking point is typically the CEO. Whereas, at larger organizations the point person tends to be a C-level executive in product or marketing.



The Pricing Team's Core Responsibilities

Establish processes

In order to implement pricing changes that move the needle, your pricing team should meet at a regular cadence to evaluate pricing. The exact cadence will differ depending on the size of the organization. However, we suggest testing with incremental pricing experiments every quarter.

Empower the team

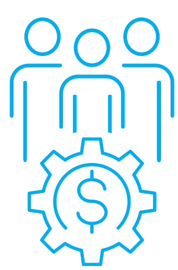
The pricing strategy does not solely affect your dedicated pricing team. Without alignment throughout the entire organization, a lot of issues can arise. Your team needs to communicate the strategy, develop an implementation plan, and provide support to each department.

Define how to measure success

The pricing team should make changes that align with the organization's overall business goals. Whether the goal is to increase growth month-over-month or improve customer acquisition metrics, the team should monitor key metrics to evaluate the success. Don't be afraid to run experiments until you get it right.

Get executive support and buy-in

Executive support is crucial. Without buy-in, the pricing team will not be able to implement any changes. The team must be able to validate the pricing and articulate the projected success of the strategy.



6 DEVELOP A **PRICING PROCESS**

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As your product evolves, so will your pricing strategy. Companies who regularly revisit and update their pricing every six months see nearly double the average revenue per user gain versus those who update their pricing only once a year or longer.[8]

> Keep in mind that pricing is an experiment that requires constant optimization. The 'right' price will change over time as the market evolves, your product grows, and the competition intensifies.

To instill experimentation into your organization's DNA, your pricing team needs to develop a regular pricing process cadence.

Identify Growth Killers

As you explore possible pricing issues, you want to identify and understand the factors that are preventing your company from growing. Where can you improve and increase value? Where are your blindspots that are preventing business growth?

The answer is not simple. Uncovering pricing gaps requires research and analysis of several key metrics. Here's what you should monitor in order to identify those growth killers.

[8] https://www.priceintelligently.com/blog/subscription-pricing

1. Churn

You're acquiring customers, but how quickly are you losing them? Churn is the percentage at which customers cancel their subscriptions. If you have a high churn rate, you'll want to shift your resources to user retention.

Solutions:

- **Align pricing with a value metric.** Make sure that you charge according a single value metric (contact, user, item, etc.) to convey the value your product delivers.
- **Reassess customer value.** To increase customer loyalty, design your pricing packages based on each of your buyer personas.

Success metric: Renewals

2. Monthly Recurring Revenue (MRR) Patterns

Monthly recurring revenue (MRR) measures predicted revenue a company can expect per month. While new growth can have the biggest impact on MRR, if your existing customers are not expanding then you may have poor MRR retention.

Solutions:

- **Justify the cost.** If customers can't understand the cost of your product, you won't be able to acquire or keep customers — let alone incentivize them to expand.
- **Re-evaluate and adjust.** Play with different packaging, positioning, and pricing to see which combination resonates with your prospects.

Success metric: Expansion

3. Customer Acquisition Costs (CAC) Challenges

If your customers are high value but are too costly to acquire and keep, then your company will struggle to grow. If your customer has a low willingness to pay, you might not generate enough revenue. Understanding CAC is crucial for selling to the right customer that is willing to pay, but doesn't cost too much to acquire.

Solutions:

- **Understand your buyer persona.** You must quantify their willingness to pay, what motivates them to purchase, and what product features they value most.
- **Focus on conversion rate optimization.** Analyze different stages of the sales cycle to understand where the problems are.

Success metric: Sales and conversion rate

Data-Driven Experimentation

When you've identified your growth killers, you have a baseline to test and find pricing alternatives. Your pricing committee should have a regular cadence in place to perform pricing tests over time. Though there may be many possible experiments, avoid testing multiple at once. Focus on one experiment at a time, evaluate its success, then implement another test based on the information gathered.

Identify grown killers	Run an experiment	Evaluate success	Repeat

There are several possible pricing experiments you can run, but here are a few examples that I've seen:

1. **Add a pricing tier.**
   When adding a pricing tier, you tap into that powerful cognitive bias, the anchor effect. This way, you can guide users in purchasing the "best performing" package.

2. **Adjust feature positioning.**
   Strategically rearrange the features included within each package to align with the perceived value of each buyer persona.

3. **Play with price points.**
   Experiment with the price point of each package to drill down the customer's willingness to pay.

4. **Less is more.**
   Try removing the prices of the more expensive packages from your pricing page. For instance, if you switch to "Contact Us" instead of showing price then you can attract those larger enterprise companies.

5. **Packages and alternative models.**
   SaaS gives product managers great opportunities and leeway in creating unique pricing models. Don't be tied to your existing model and restrict your team from experimenting with alternative packages and models.

Your pricing team should continue this process every few months. Identify issues, set goals, experiment, and repeat.

7 PRICING EXPERIMENTATION **GOOD-TO-KNOWS**

7 PRICING EXPERIMENTATION **GOOD-TO-KNOWS**

Now that we have a solid understanding of the importance of experimental pricing and the psychology that impacts it, here are ten lessons to keep in mind:

1. Pricing is a Constant Process

It is critical that pricing is treated as an ongoing project that evolves with your product, customers, and business. It doesn't have to be a full-time, intensive focus, but an experimental pricing mindset needs to be a part of your organization's DNA. Try to make adjustments to your pricing every quarter, or twice per year.

As you re-evaluate your pricing, let customer data guide your decisions. Actively interview potential decision-makers about their purchase process, how they purchased their current solution, and their frustrations with the current solution's pricing.

2. Estimate Customer Lifetime Value

Customer Lifetime Value (LTV) influences the sales model and what you can afford to spend to acquire customers. You need to estimate your LTV as early as possible–well before you have customers and revenue.

While there are lots of ways to calculate LTV, there's a simple back-of-the-envelope calculation.

($) Average Monthly Revenue per Customer× (# months) Customer Lifetime =($) LTV

3. Lifetime Value > Customer Acquisition Cost

The formula for success is simple in the SaaS world: LTV over time must be significantly greater than customer acquisition cost (CAC). The LTV:CAC ratio measures the lifetime value of a customer relative to how much it costs to acquire that customer.

($) Total sales and marketing expenses ÷ (#) New customers acquired = ($) CAC

SaaS companies with a recurring revenue stream should have LTV multiples that are three to four times the cost to acquire that customer.[9] However, if your ratio is too high you might not be spending enough to acquire customers and are stunting your growth. Doing back-of-the-envelope calculations on CAC will help you avoid surprises down the road.

($) LTV ÷ ($) CAC = (#) LTVto 1 CAC

4. Your Sales Model Influences Your Pricing

Pricing constrains the sales model options that are available to you. For example, if your outside sales team is expensive, you need to ensure that your customer LTV is high enough to support that model. You'll struggle if your average customer purchases $50/month over a two year lifetime. Ultimately, your buyer persona determines your sales model, so make sure you understand the expected purchase process.

5. Create Upsell Opportunities

One of the advantages of SaaS is the ability to offer upgrades and services that drive additional revenue. Consider these within your pricing model, as they can make a substantial impact on long-term product revenue.

6. Use Caution When Offering Annual Pre-Purchase Accounts

Many SaaS products that license on a monthly basis will offer a discount for annual pre-purchasing. However, use this with discretion. Analysis shows that over the long term, you leave significant revenue on the table.

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[9] https://www.priceintelligently.com/blog/subscription-pricing

7. Consider Free Trials

If your acquisition and activation model is simple enough, then a limited free trial is a great way to increase your sales conversions. It's common to offer 14-day and 30-day trial options.

8. Service is Key

Because SaaS is typically licensed as a subscription, your customers are at risk of churning every renewal period. Service and support are critical, so many SaaS products build support and regular upgrades into the standard licensing fee. Consider whether your customers will be receptive to additional fees for support and maintenance for a product that they expect to work flawlessly.

9. Customers Don't Care About Your Costs

Don't price your product working backward from cost. This is not how your customers will think about the pricing. Cost of goods sold needs to be a factor for you to be viable, but this is not related to how customers value your product.

10. Pricing Perception Doesn't Follow Economic Rules

Customers often buy products for reasons that seem disconnected from the return on investment (ROI) calculation. As we previously discussed, pricing is highly psychological. For this reason the demand curve is not linear – a lower price doesn't necessarily equate to more customers and revenue. Take this into account by thoroughly understanding the qualitative value that your product provides.

8

10 UNIQUE PRICING MODEL EXAMPLES

8 10 UNIQUE PRICING MODEL EXAMPLES

Arriving at the ideal pricing model for your subscription business can be a challenging process. However, SaaS is different. Unlike traditional software, SaaS gives product managers unprecedented flexibility and opportunity to test different pricing models.

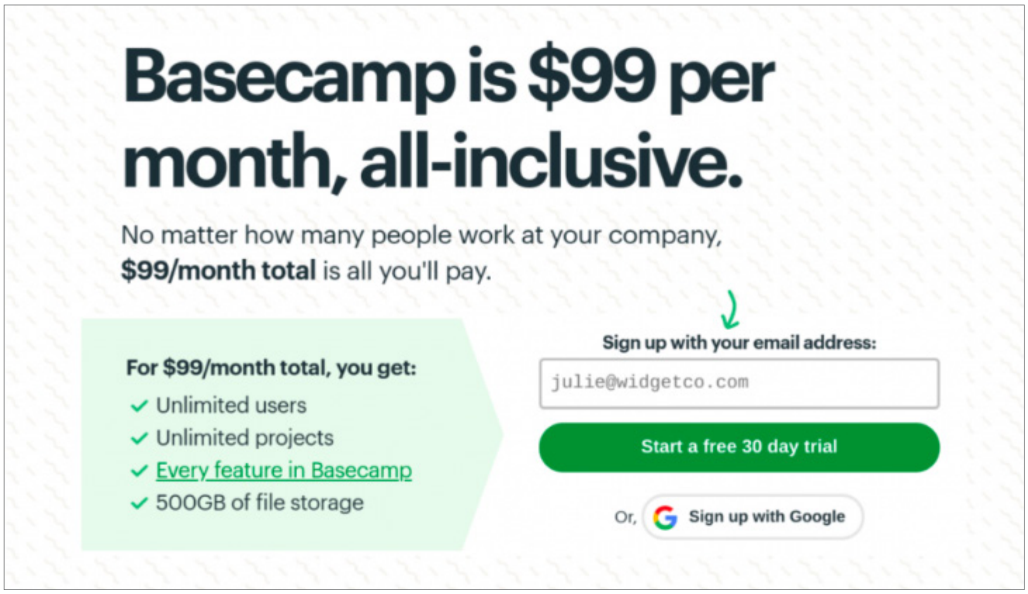
With so many options, you have the ability to discover a pricing model that can differentiate your product in the marketplace and align with your customers' goals. While there are dozens of potential pricing models for product managers to experiment with, here are ten common models to consider.

1. **Flat Subscription**
2. **Per-User Pricing**
3. **Per-User with Free Participants**
4. **Tiered Pricing**
5. **Freemium**
6. **Per Visitor/Traffic**
7. **Free with Advertising**
8. **Broker Fee/Peer-to-Peer**
9. **Storage**
10. **Per Item/Contact (Consumptive Pricing)**

1. Flat Subscription

Flat subscription pricing is simple. With this model, you offer one product, one set of features, at a single price.

Example: **Basecamp**

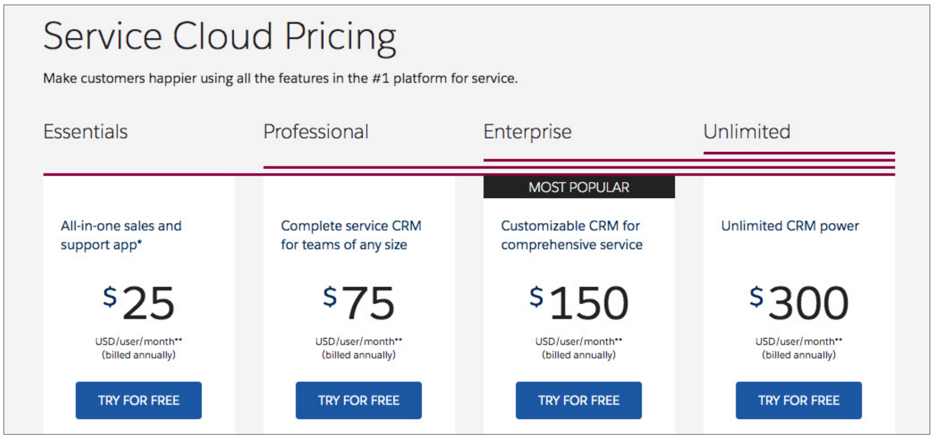


Pros:
• **It's transparent.** With only one option, it's easy to understand and users know exactly what they are paying for. • **It's easy to sell.** SaaS pricing can be complicated, especially when trying to communicate it to customers. This approach makes it easy to commit all resources to selling a single-priced product.
Cons:
• **You miss out on potential revenue.** By offering unlimited users, you're leaving money on the table, especially with larger companies. • **Customers are not one-size-fits-all.** There's little flexibility with this option - larger companies can take advantage of a lower price, but a high price deters smaller companies.

2. Per-User Pricing

Perhaps the most common SaaS pricing model, per-user pricing has customers pay different amounts based on the number of people using the service. A single user pays a fixed monthly price, add another user and the price doubles, etc.

Example: **Salesforce**



Pros:

- **It's easy to understand.** This straight-forward model is accessible for companies of all sizes, setting up a simple pitch for sales.
- **You can predict revenue.** The pricing for each company scales with the number of users, so forecasting profit is simple.

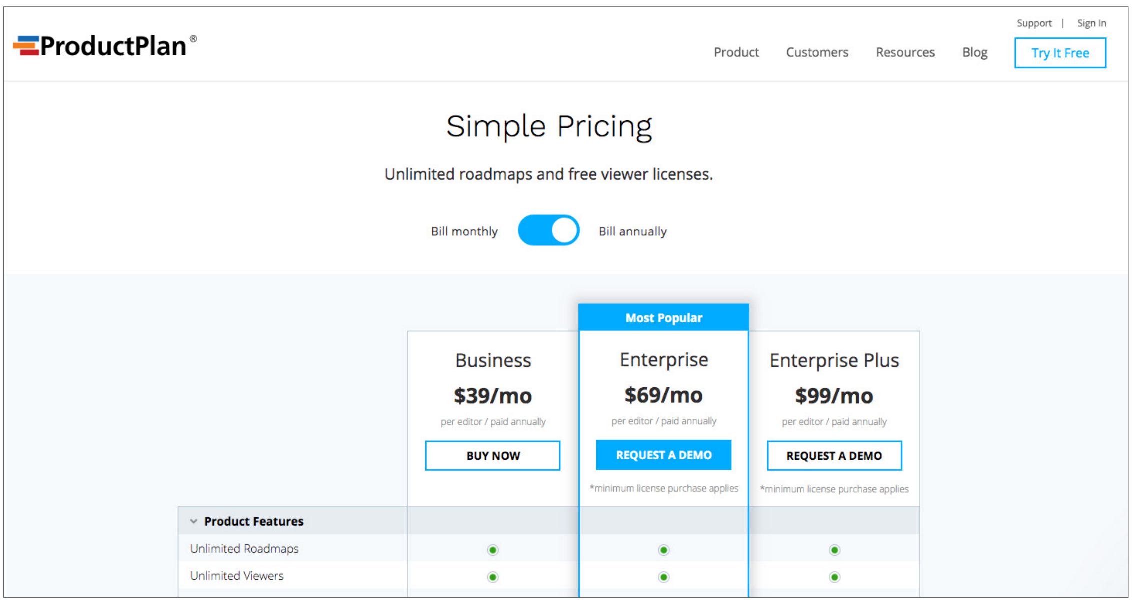
Cons:

- **Limits the potential number of active users.** Users can potentially bypass the usage costs by sharing credentials, negatively impacting revenue. Companies will try to choose the least amount of users, limiting adoption.
- **It's easier to churn.** If a company only has x licenses out of x employees, it's much easier to leave a software behind.
- **It doesn't communicate value.** It limits the value metric on the individual level, rather than showing the value it can bring to the entire business.
- **Limits adoption.** It reduces # of people within a single company who are exposed to your software.

3. Per-User with Free Participants

Similar to per-user pricing, per-user pricing with free participants requires payment based on the number of users. However, this model allows those customers to share limited access with an amount of participants that scales as the price increases.

Example: **ProductPlan and GoToMeeting**



Pros:

- **Creates easy opportunity for growth.** The customer's willingness to pay increases as they need to add more participants.
- **It can stimulate a viral effect.** As participants are granted access, they are freely exposed to a great experience.

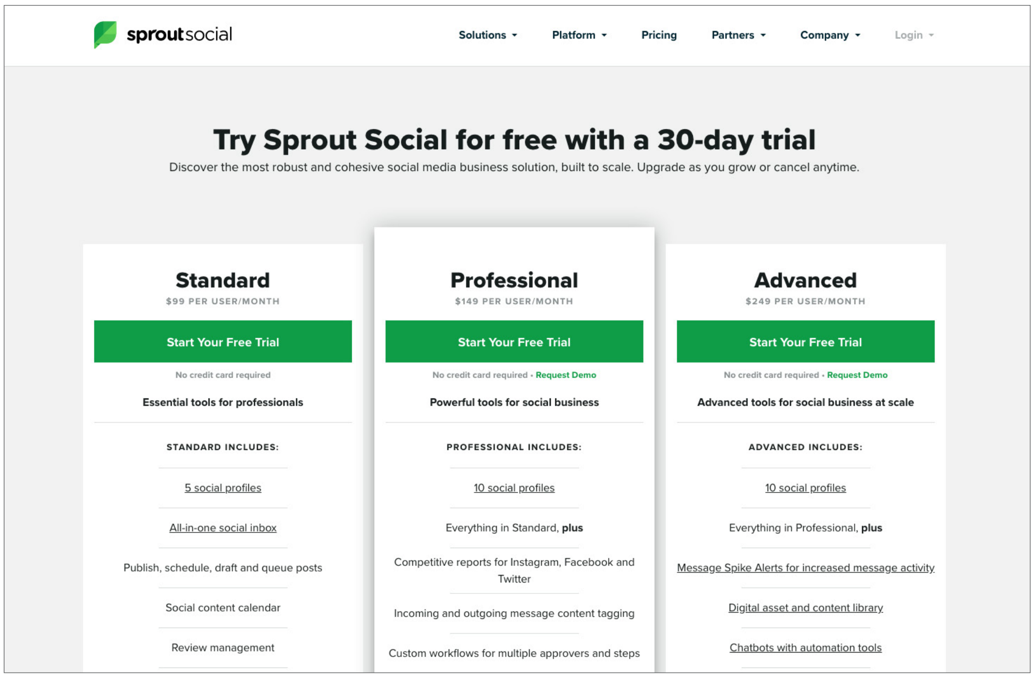
Cons:

- **It can discourage the number of paying users.** If free access is offered and the participants are content with the amount of controls available to them, then there's no need for them to convert.

4. Tiered Pricing

With a tiered pricing model, companies can offer multiple packages with different combinations of features or value added services. The more features offered within a tier, the higher the price.

Example: Sprout Social



Pros:

- **It appeals to different customer needs.** Designing multiple packages for several buyer personas allows you to maximize revenue potential.
- **It can stimulate a viral effect.** As participants are granted access, they are freely exposed to a great experience.

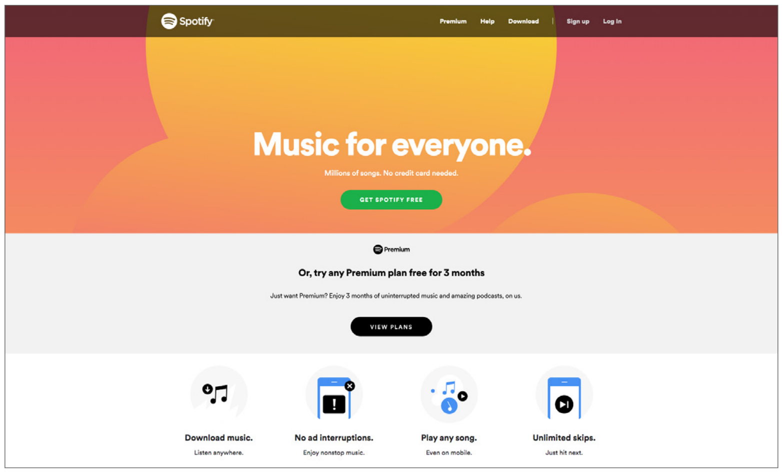
Cons:

- **You can scare off customers.** If more than two or three packages are offered, you risk overwhelming the user and lose the sale.
- **Balance can be tricky.** Depending on how many features your product offers, it can be difficult to figure out the right balance for each tier.

5. Freemium

Freemium is an acquisition model that offers two options: free or premium. Free tier users have access to your product with limited capabilities and features, while premium users pay a fee for greater access. This can be feature-based, capacity-based, or usage-based.

Example: **Spotify**



Pros:

- **It easily attracts users.** There is no financial information required for customers to get started, so they can easily explore and get hooked on your product
- **You can grow the product quickly.** Ease of use provides the opportunity to leverage user referrals to reach a wider audience.

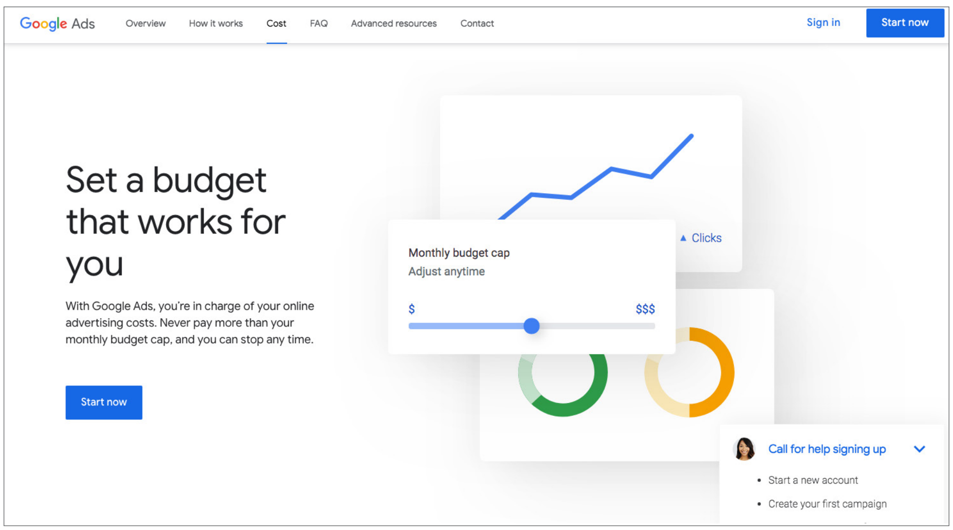
Cons:

- **Free users still cost money.** You need to factor in the acquisition cost of free users into your model.
- **It can be a revenue killer.** If free users never convert to the premium tier, you aren’t generating any revenue. In the end, you forever rely on paid users to offset the cost of acquiring free users.
- **It’s easier to churn.** A free product is easy to adopt, but even easier to abandon if it’s not delivering value.
- **Why pay when it’s free?** Users will be reluctant to pay for the product if the free version solves their problem.

6. Per Visitor/Traffic

The Per Visitor/Traffic model, often referred to as performance-based pricing, is an internet advertising model where users pay based on the number of visitors to their site or engagements with their ad. The payment can be based on the number of clicks, impressions, or conversions an ad receives. With this model, the user determines the maximum cost per engagement.

Example: **Google Ads**



Pros:

- **Clients pay for results.** The more leads you can generate for your user, the more they will be willing to pay.
- **There are natural growth incentives.** Companies will spend more as their results improve, so there is a natural incentive to deliver best results.

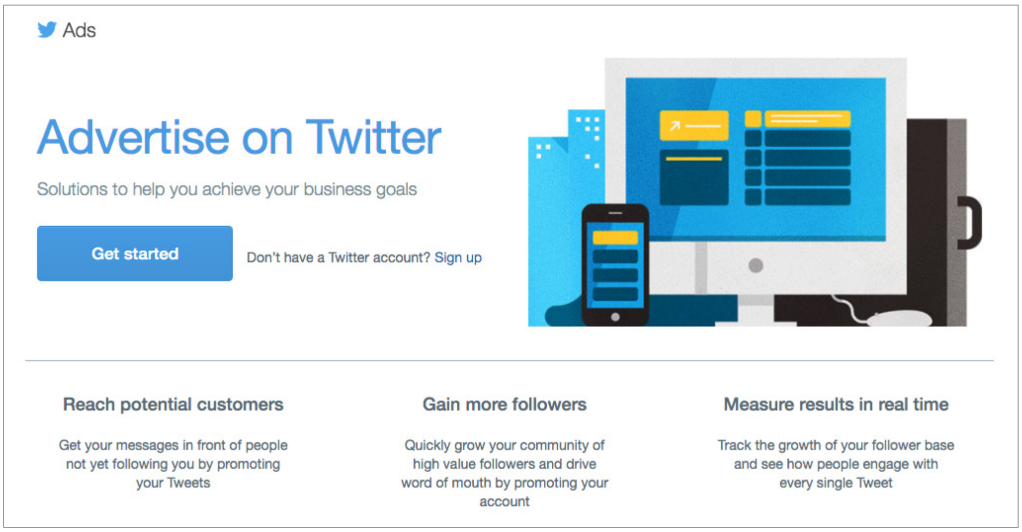
Cons:

- **If customers don't see results, they will abandon your product.** When customers continuously spend money on your service with no return on investment, you risk churn.
- **Security can become a roadblock.** This style of service requires users to share a lot of their sensitive data. If you don't make security a priority, users won't trust your company enough to purchase.

7. Free with Advertising

The advertising model offers the primary service to users for free, but generates revenue through sponsorship or online advertising. This is extremely common among social media sites.

Examples: **Facebook and Twitter**



Pros:

- **Adoption is simple.** It's very easy to attract users when the product or service is offered for free.
- **You can leverage a large user base.** With a large customer base, you can attract advertisers wanting to reach that valuable base.

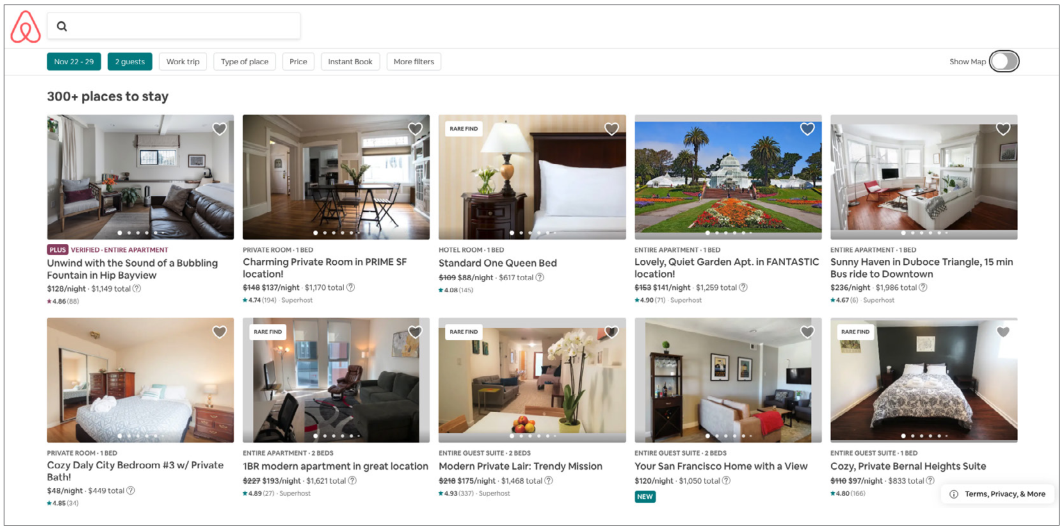
Cons:

- **It requires focus on customer acquisition.** Companies will only pay you to show their advertisements if you have an attractive amount of users. That means you need to spend either time or money on customer acquisition.
- **More users does not equal more revenue.** Since your customer base uses the service for free, revenue is dependent on advertisers, rather than loyal customers.
- **It can agitate users.** At a certain point, users and advertisers may come into conflict, and the responsibility falls on you.

8. Broker Fee/Peer to Peer

The Peer to Peer (P2P) model is essentially a matchmaking platform that connects individuals selling a service or product with individuals seeking to purchase that service or product. Revenue is often generated through a brokerage fee on sales through the online marketplace.

Examples: AirBnB



Pros:

- **There's potential for rapid growth.** Establishing a marketplace between buyers and sellers is inexpensive, and the ROI is quick.
- **People trust people.** Real users can leave reviews, adding a layer of transparency and trust to the platform.

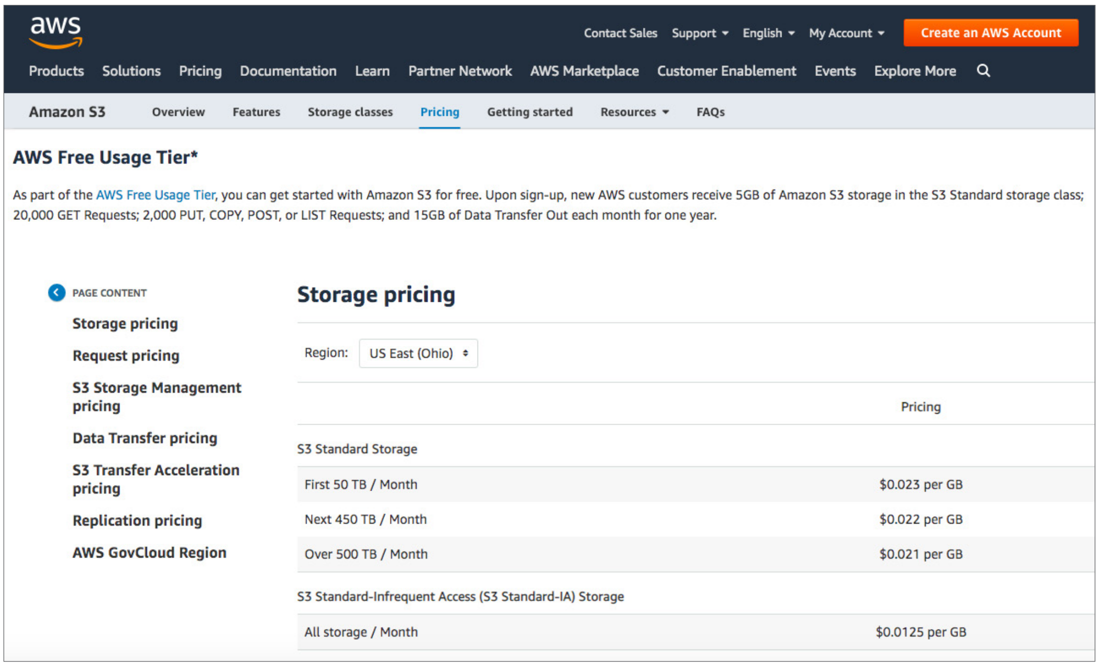
Cons:

- **Potential loss of revenue.** For example, if a Fiverr designer forms a relationship with a user outside of the platform, they can easily bypass the extra fees and sell their services directly.
- **There's a quality assurance problem.** Since the third-party seller is removed from the equation, there's a risk that the quality of the product won't be as expected. Customers that have poor experiences will most likely associate the fault with the platform rather than the individual.

9. Storage

With the cloud storage pricing model, users pay based on the amount of storage the user needs. Companies will often offer a limited amount of storage for free, and then require users to pay for additional space.

Example: **Amazon**



Pros:

- **It promotes viral usage.** This approach allows users to become familiar with and rely on your service; making them more willing to pay.
- **There's a clear incentive.** Once users reach their limit of free storage, they are forced to choose — free up storage by deleting content, or pay for more storage.
- **Cloud storage creates a clear opportunity for growth.** As users increase the amount of storage, the price increases.

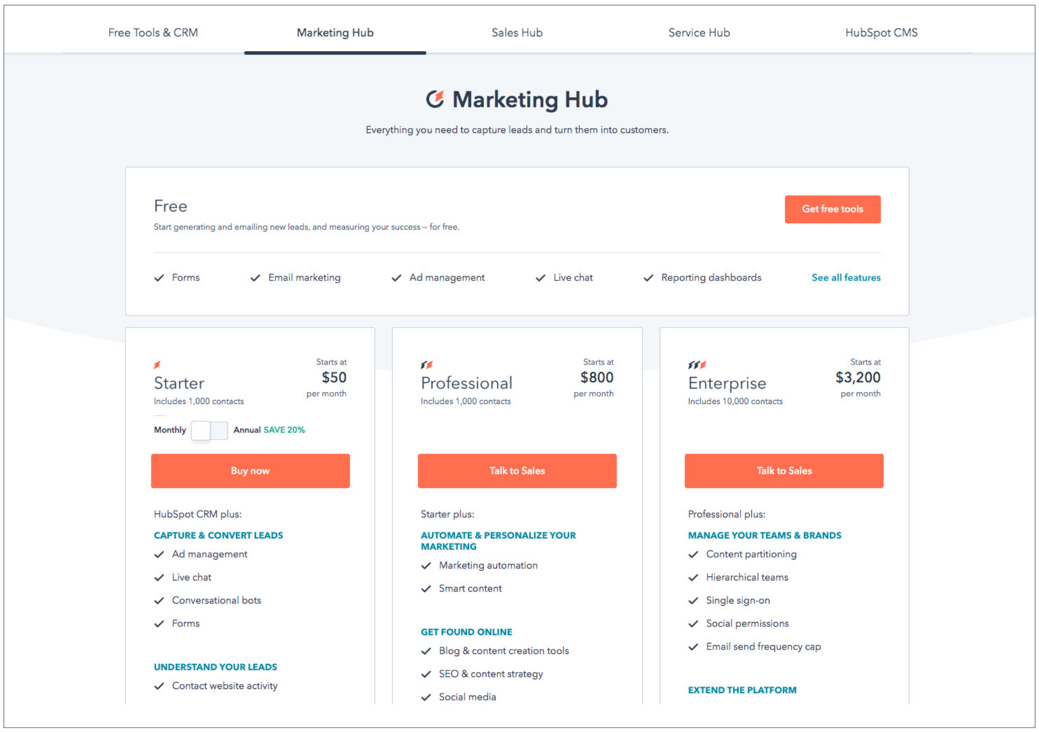
Cons:

- **Expansion can be difficult.** Depending on your target market, smaller companies or individual users may never exceed their allotted amount of free storage.

10. Per Item/Contact (Consumptive Pricing)

Per item/contact is a consumption-based pricing model where the customer pays according to the amount of items, or contacts, you host in the system.

Example: **HubSpot**



Pros:

- **It's simple.** By charging a fixed rate per item or contact, it's easy for users to understand what they're paying for.
- **There's a clear revenue path.** Customers pay more for the product only if they grow their business and add more contacts or items into the system. If your users are more successful, you are more successful.

Cons:

- **Growth is based on the success of your customers.** Your revenue relies on the growth of your customers. Without your users adding new contacts to the system, your revenue will remain stagnant.

9 VALIDATE YOUR **PRICING**

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After choosing a pricing model that best fits your organization, you need to validate it. Without validation, you won't get buy-in from key decision-makers and it's back to the drawing board.

Customer Interviews

The most effective method to support your pricing proposal is through customer interviews. These in-depth, hour-long qualitative interviews with real prospects enable you to estimate whether or not customers are willing to buy your product at that price.

Don't just jump straight into the numbers. That will most likely confuse and even scare off the customer from delivering valuable answers. Remember, you're interviewing customers to understand their pain, the problems that they want to solve, and how you can alleviate that pain.

When interviewing customers, the flow of the conversation should be structured like this:

1. **Focus on the problem the customer experiences.**
2. **Talk about the product as a solution.**
3. **Introduce the pricing.**

Profit Model Estimation

After conducting customer interviews, your product team must enlist finance and executive stakeholders to estimate if your pricing model will actually drive business. Using your collective knowledge about your market, there are some reasonable assumptions your team has to make.

Though they may differ for each business, here are some common examples:

1. **What will the deal size be for each customer?**
2. **What is the customer lifetime value?**
3. **How many people are going to sign up for a trial?**
4. **What percentage will convert?**
5. **How many average licenses will customers buy?**
6. **What is the average price per license?**

10 HOW TO IMPLEMENT PRICING CHANGES

ProductPlan

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Communicate with Internal and External Stakeholders

Once your pricing team has developed and validated their pricing strategy, it's time to start implementing those changes throughout the organization. This is when it becomes important to develop a plan for how you'll communicate these changes with the rest of the organization and your customers. Your plan should cover:

- **Internal communications.** Your pricing team needs to align everyone within the organization. Each department will need different information, so tailor your messaging based on their functional areas.
- **Messaging and positioning.** Fully flesh out the way you will talk about the pricing change with customers. Your should empower the customer success team to understand, communicate, and field questions about the pricing changes.
- **Logistics.** Identify which customers are affected by the pricing change, how far in advance you will notify them, and the channels you'll use.
- **A healthy feedback channel.** This will allow you to gauge the success of the pricing change and to identify unexpected pain points.

Design a Pricing Page that Converts

Many companies that have a public-facing pricing page underestimate the power of this page, and end up treating it as an afterthought. However, it's one of the most important steps in this process. Everything before this step can be successful, but if the pricing page is poorly designed then you won't convert leads into paying customers.

Prospects visit your pricing page for many reasons. They want to explore the potential, compare the price with their budget, or seriously evaluate whether or not to purchase. But they have shown interest, and you can use this to your advantage. Your goal with the pricing page is to turn that interest into action — either with a purchase or a free trial.

Your pricing page should communicate the value of your product and convince visitors to take action.

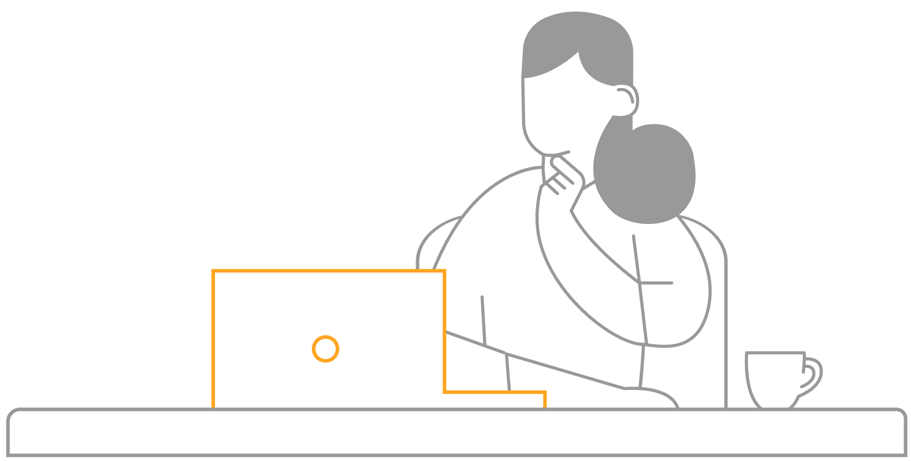
There are a few crucial elements to consider when creating your pricing page.

1. Leverage pricing psychology

You not only need to understand why prospects are visiting your pricing page, but how they think about the information presented to them.

Your pricing page should be simple, clean, and easy to understand. When there are too many options or the information is complex, visitors can experience decision fatigue, or even worse, analysis paralysis. Decision fatigue occurs when an individual's quality of decision decreases when the decision-making process is too long.[10] This can lead prospects to make a poor decision in the purchase process. Analysis paralysis happens when an individual is overwhelmed and overanalyzes the decision, leading to no decision at all.[11]

To combat these issues, remove all clutter from your pricing page and only include what is absolutely necessary. The average number of packages is 3.5.[12]



How:

- **Stick with a simple and clean design.**
- **Offer fewer plan options.**
- **Remove unnecessary navigation.**

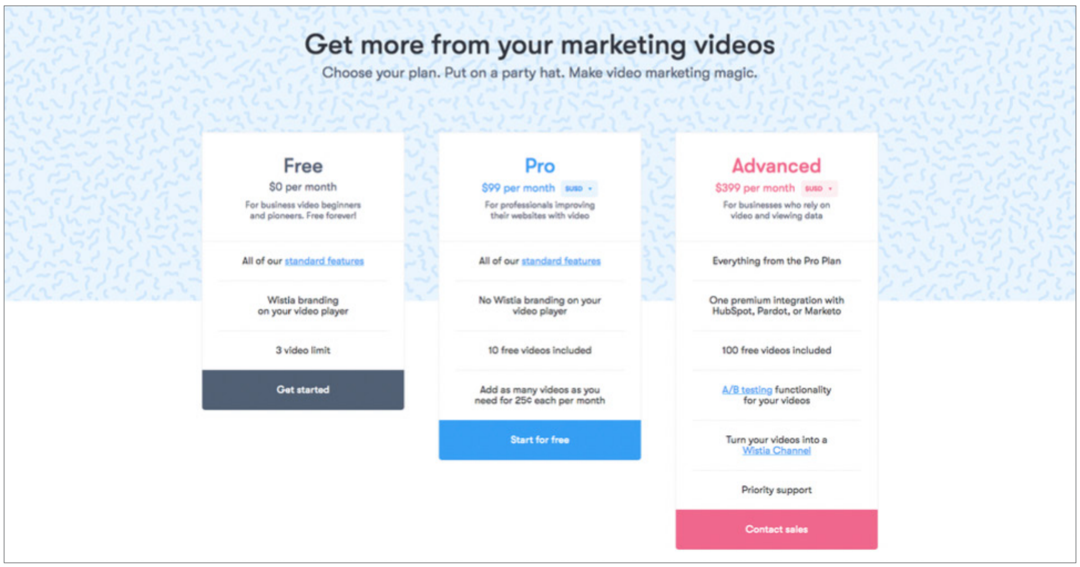
[10] https://www.psychologytoday.com/files/attachments/584/decision200602-15vohs.pdf

[11] https://www.sciencedirect.com/science/article/pii/S2212567114002007

[12] https://www.process.st/saas-pricing-pages/

2. Design should communicate value

Every element of your pricing page should convey the value of your offer. The easiest way to accomplish this is to segment each pricing package by buyer persona. You already understand each of your buyer personas, their objectives, and their willingness to pay. Each pricing option should speak directly to each persona to make it immediately clear what they are paying for. The copy, color choices, and feature list all play a part.



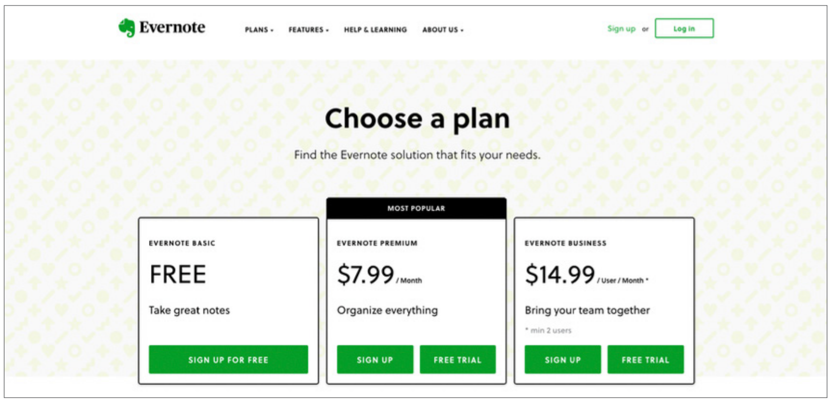
Take Wistia's pricing page, for example. They offer three packages and clearly indicate the buyer persona for each package: video beginners, video professionals, and video experts. This makes it easy for a prospect to self identify which plan would work best for their business. The page also displays the amount of features included within each package to easily compare plans.

How:

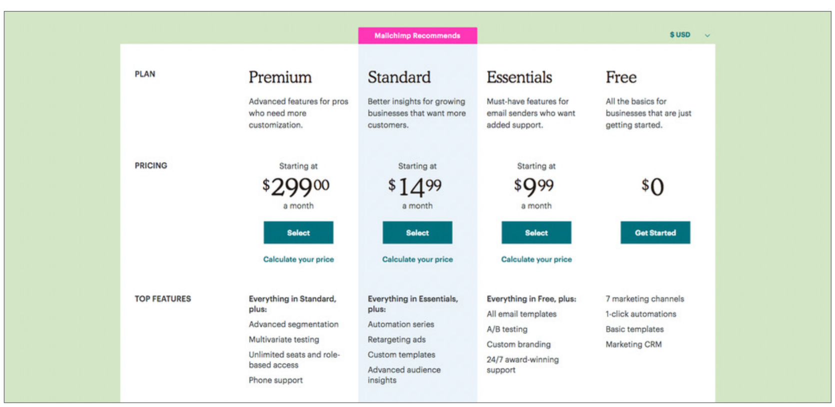
- **Segment your packages by buyer persona.**
- **Include a benefit statement to communicate value.**
- **Highlight benefits with a feature comparison.**

3. Boost customer conversions

The purpose of your pricing page is to guide users to take action. Like Wistia, Evernote's pricing page has bold header copy. While Wistia's is more of a value statement, Evernote takes a more straightforward approach with an explicit call-to-action (CTA). Evernote does offer a breakdown of the features included in each plan, but they focus on driving conversions with clear, bright CTAs.



Another technique to drive customer conversions is with anchor pricing. Both Evernote and Mailchimp's pricing pages highlight a specific plan as "most popular" or "recommended" to drive prospects towards that package.



How:

- **Make a statement with bold header copy.**
- **Use clear call-to-actions to drive conversions.**
- **Employ the anchor pricing technique.**

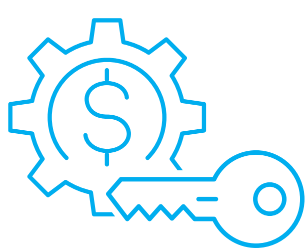
11 KEY TAKEAWAYS

11 **KEY** TAKEAWAYS

There's no magic formula or exact path to successful pricing. But once your organization embraces this experimental mindset, you're one step closer to finding the optimal price for your product.

As you embark on your journey to pricing experimentation, keep these key takeaways in mind to guide your pricing decisions:

1. **Customer value is a top priority.** Your company will not be able to effectively maximize revenue and increase growth if your product and price does not reflect customer value.
2. **Pricing doesn't need to be perfect.** More often than not, you won't get your pricing right the first time around. When you tap into those growth metrics we discussed, there will be many opportunities to improve your pricing strategy.
3. **Don't be afraid to test your pricing.** Pricing requires consistent experimentation to drill down to the optimal pricing for the current market. Implement incremental tests to work towards your pricing goals.



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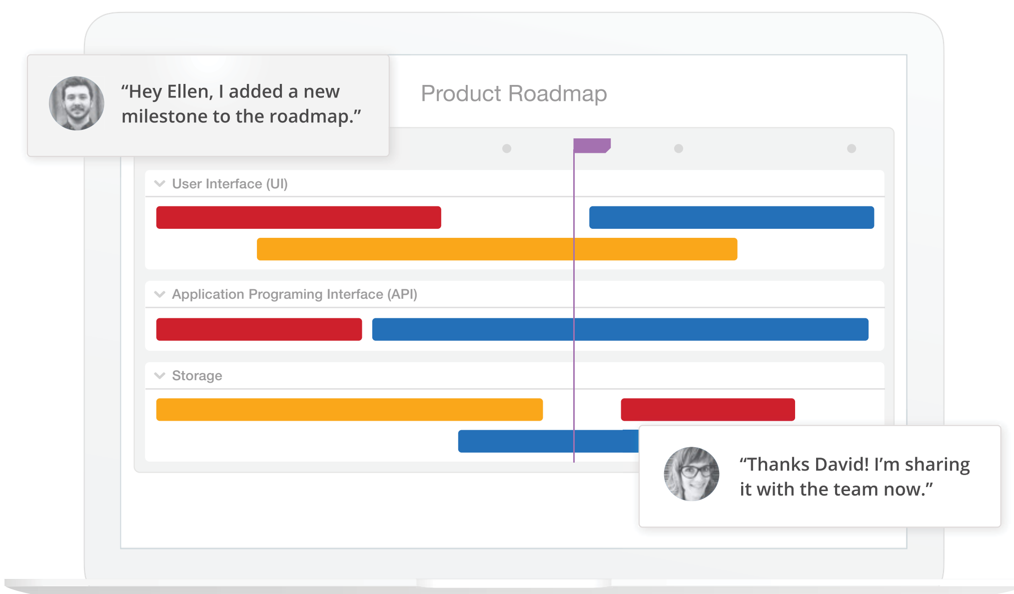

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