DEFINING A WINNING SUBSCRIPTION PRICING MODEL

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# PRICE MODELS: EFFECTIVELY MONETIZE PRODUCTS IN YOUR SUBSCRIPTION BUSINESS

It is crucial for you to create the right price model for your recurring revenue business regardless of whether you are launching a new subscription-based offering, transitioning from a perpetual to a subscription model, or wondering why you are not monetizing as well as you should be on your current subscription product.

Zuora partner Simon-Kucher & Partners has worked on hundreds of projects helping companies determine their subscription pricing, and there are two aspects of determining price that are often marginalized as effective monetization levers:

Price metric
Define how cost is measured for customers (e.g. per seat, per concurrent user, by a usage measure)
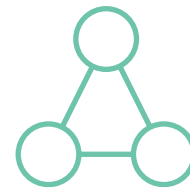
Price structure
Define how the price level changes over time / usage / etc. (e.g. flat fee, variable, tiered)

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SYSTEMATICALLY EVALUATE AND CHOOSE YOUR PRICE

The first step in identifying the right price metric is to understand the possibilities – what metrics align with customer value? What are competitors using for their price metrics?

Price metrics for subscription products typically fall into the following categories:

- **User-based:** named user, concurrent user, etc.
- **Activity-based:** number of transactions, number of reports, etc.
- **Business scale:** size of business, number of customers, etc.
- **Performance-based:** against key performance metrics or client performance, etc.

Create a list of metrics in a workshop or through email threads to brainstorm possibilities. Discussing even seemingly odd metrics can spark good ideas.

Once you have a list of 10-20 possibilities, you should evaluate the performance of each metric on its benefits to customers:

✓ **Fairness / acceptability:** The metric is tied to the intrinsic value of the product, enables competitive comparisons

✓ **Flexibility:** The metric allows customers to scale service with their willingness-to-pay, overcome budget constraints, and scale with future usage & growth

✓ **Predictability:** Costs can be estimated and forecasted

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The metric should also have a positive impact on your internal goals and be rated on its **benefits to your business**:

⭐ **Customer adoption:** The metric drives adoption, enables up-sell & cross-sell

⭐ **Ability to capture full customer value:** The metric covers all customer segments, scales with customer growth, and allows future price increases

⭐ **Ease of Implementation:** The metric makes it easy to administer, monitor, control and enforce prices; it is easy to sell and communicate

Create a single score for "benefit to customers" and another for "benefit to your business", and plot the score for each metric on a matrix (as shown in the Metric Evaluation Matrix). The metrics you should use are the ones in the top right "Ideal" corner of the matrix.

EXAMPLE METRIC EVALUATION MATRIX
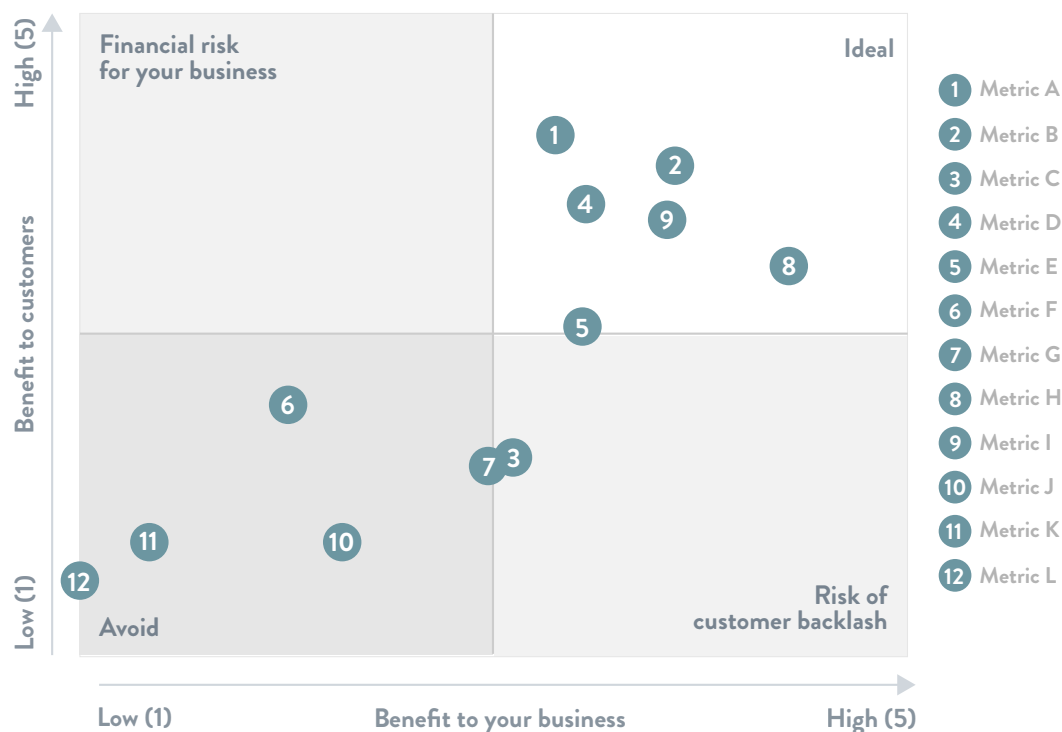
It is likely you will find that a few metrics land in the ideal quadrant. As you are choosing the metrics to move forward with, keep in mind:

- It is alright (and typical) to use multiple metrics together
- It is possible to have different price models for different customer segments – like Carbonite did
- Align the simplicity or complexity of the price metrics you use with your company goals – just because a competitor or even the market leader is using a metric does NOT mean it is the best metric for your company.

DEFINING THE RIGHT PRICE STRUCTURE

Why do the best price metrics and price models fail?

You use a price structure that does not align with your brand.

When building your price structure, you should evaluate whether the intended price structure aligns with the firm's brand positioning. (See exhibit 1). For example, a company that operates with a brand positioning of sincerity should have fewer multi-dimensional prices/surcharges. Doing so may drive the perception of nickel-and-diming customers, which would contradict the projected image of Sincerity.

Exhibit 1: Price structure should align with brand positioning
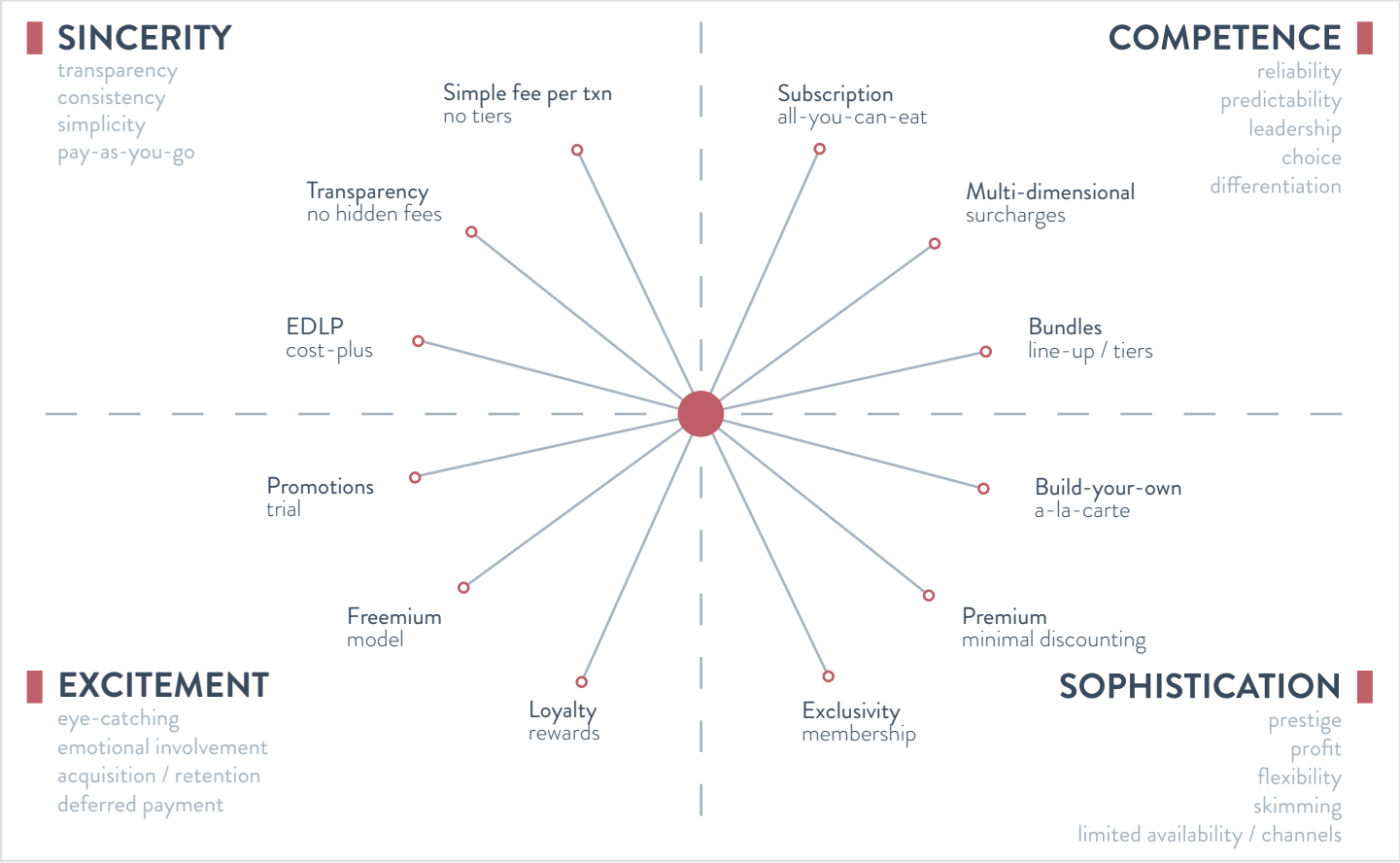
SINCERITY
transparency
consistency
simplicity
pay-as-you-go

COMPETENCE
reliability
predictability
leadership
choice
differentiation

Simple fee per txn
no tiers

Subscription
all-you-can-eat

Transparency
no hidden fees

Multi-dimensional
surcharges

EDLP
cost-plus

Bundles
line-up / tiers

Promotions
trial

Build-your-own
a-la-carte

Freemium
model

Premium
minimal discounting

EXCITEMENT
eye-catching
emotional involvement
acquisition / retention
deferred payment

Loyalty
rewards

Exclusivity
membership

SOPHISTICATION
prestige
profit
flexibility
skimming
limited availability / channels

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You use a price structure without understanding your customer's needs & expectations

When building a price structure, you should consider customer preferences when choosing among the various permutations of flat & variable components.

Flat components increase predictability for the customers as they can estimate spend and budget accordingly. Typically, predictability is more important for larger customers with formal budgeting cycles. Higher predictability also benefits the firm by offering a consistent revenue stream to continue operations

(smaller firms would oftentimes link this component with fixed costs in their business).

Companies with greater revenue coming from subscription pricing, which affords customers with higher predictability than transactional pricing (e.g. software license and implementation), get a higher revenue/EBITDA multiple in the market compared to their peers.

Variable components increase value-sharing. Customers like such components since the fee scales with their usage. Smaller customers also prefer higher variable components as their fee commitment increases as their business scale increases. When

using such components, the firm is willing to position itself to succeed when their clients use their product. This increases the variance in revenue from month to month but the upside is oftentimes higher.

In some cases, one can also link **variable components to business outcomes.** The biggest challenge to adoption usually is the **ability to measure & attractiveness** of such a component to the firm. Such metrics are often not tracked directly through the firm's products and the burden of reporting usage is the prerogative of the customer. For example, a firm that makes enterprise management software for insurance agents may not be able to measure the value of the insurance policies written by the agent (directly through the software).

A second aspect is if the business outcomes are not attractive. In the example above even if the firm can track policy premiums it still may not wish to use it in their pricing model as the overall premiums in the market may have remained flat or even have declined year over year.

The firm can also use a hybrid model by using structural modifiers. Establishing a **floor** (minimum commitment) can get predictability in a variable structure for the firm. **Caps** (maximum possible commitment) can help large customers address concerns that their risk is not unconstrained with a transactional model.

Tiers and **breakpoints** can be used to charge a different fee at different levels of usage. These components are used by firms to provide volume discounts to the customers with higher usage in a variable-component based model.

Price structure in action

A great example of using the right price model is a recent Simon-Kucher customer that sells trading software in the financial market space. The customer had been using multiple different metrics but had not seriously thought how that was affecting their customer base. They decided to focus on a "Sophistication" positioning and created a price model that had an upfront fixed fee and a tiered transactional charge that was capped. The company has since implemented and has received feedback from its customers that the new model is elegant (simplifies the unnecessary pricing complexity), scales well with growth and offers predictability as well.

Next: Price levels

Once you have the right price structure and metric, how do you set price levels? Stay tuned for articles this process and how to utilize price testing and customer research to make data-driven decisions.