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The Marc Andreessen and Bill Gurley schools of pricing

5-6 minutes

Why do two of the clearest thinkers in tech seem to present polar opposite points of view on pricing?

Marc Andreessen, on Tim Ferriss' podcast:

"It has become absolutely conventional wisdom in Silicon Valley that the way to succeed is to price your product as low as possible under the theory that if it's low-priced everybody can buy it and that's how you get the volume. And we just see over and over and over again people failing with that because they get in the problem we call too hungry to eat. They don't charge enough for their product to be able to afford the sales and marketing required to actually get anybody to buy it."

Bill Gurley, in A Rake Too Far:

"Most venture capitalists encourage entrepreneurs to price-maximize, to extract as much rent as they possibly can from their ecosystem on each transaction. This is likely short-sighted. There is a big difference between what you can extract versus what you should extract. Water runs downhill."

So, do high or low prices drive the greatest long term growth?

It's tempting to say Gurley is just taking the long view. A value extraction approach will ultimately be competed into the ground because, as Jeff Bezos says, "your margin is my opportunity".

But I think that take would be wrong. Gurley and Andreessen are not articulating different pricing strategies as much as they're making different assumptions about the characteristics of a business and as a result, coming to two different (and valid) conclusions about how to use pricing to most effectively support growth.

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Another quote from Andreessen in Elad Gil's High Growth Handbook:

"If you price it high, then you can fund a much more expensive sales and marketing effort, which means you're much more likely to win the market, which means you're much more likely to be able to do all the R&D and acquisitions you're going to want to do. And so we always try to snap people into a two-dimensional mindset, where higher price equals faster growth."

The growth engine he's describing is investing margin in sales and marketing to acquire customers, in R&D to deliver value to customers, and maybe even in M&A to buy growth outright.

Gurley is describing something pretty different:

"If your objective is to build a winner-take-all marketplace over a very long term, you want to build a platform that has the least amount of friction (both product and pricing)."

He's not talking about things you can do with margin, but instead what you stand to gain by giving it back to users – namely, reduced friction to signup and use.

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Setting the growth-optimizing price hinges on finding the point at which a business can no longer invest an incremental dollar to drive growth more effectively than by just reducing price. Jeff Bezos, as quoted by Gurley, helps illustrate:

"About three years ago we stopped doing television advertising. We did a 15-month-long test of TV advertising. And it worked, but not as much as the kind of price elasticity we knew we could get from taking those ad dollars and giving them back to consumers."

Marketing and sales are perhaps the most common ways to invest a dollar of margin in growth, but the list could include any capital-intensive method of acquiring or adding value for users. Netflix's recent price increases will help fund growth, but more through content creation than marketing.

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What characteristics of a business impact the point at which you should stop charging and keep a dollar in your customer's pocket?

Price elasticity is central because it determines the leverage of each dollar given back to the user.

Factors like high network effects or virality imply you should charge less as users start to do the value creation and customer acquisition more efficiently than you can. And others like high purchase consideration push you in the opposite direction because of the marketing and sales budget you'll need to win.

When you start to add these factors up it becomes clear how you might land on very different pricing approaches.

Gurley is referring to marketplaces like Uber and OpenTable, which are often price-sensitive, high network effect, viral businesses. Price low.

But if you're talking about an enterprise SaaS business with very different traits, it may be appropriate to aim for higher margins.

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Clearly getting to a real-world answer on pricing is not that simple. For one thing, it's worth exploring ways to break the tension between having a low friction product and having margin to invest in growth. You could use VC as steroids to keep prices low while still spend heavily on growth. Or you could segment what different users pay through tiered pricing, freemium, or optional purchases like paid placement for suppliers in a marketplace.

But as a starting point, it's helpful to consider what kind of growth engine you're building. Does it look like the one Andreessen is describing, fueled by marketing and sales and capital-intensive investments in customer experience? Or more like Gurley's, fueled by network effects and virality?

Then, give that engine as much margin as you can.