



The Anatomy of

SaaS PRICING STRATEGY





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WHY YOU NEED A PRICING STRATEGY

Every SaaS company is different, but almost every single one makes a mistake that puts the company in jeopardy.

They don't understand their pricing.

Companies pour blood, sweat, and tears into making a great product. They spend countless hours and scarce resources to bring in new customers. Yet most SaaS companies don't know what they are worth to their customers or how to best to communicate this.

If your company doesn't have a pricing strategy, you don't understand who your customers are. You have no idea whether you're driving them away with poorly framed pricing and packaging system, or missing the chance to exponentially grow your revenue

with higher but more accurate prices. You're leaving huge revenues on the table, which makes you vulnerable to sudden disruptions that can sink your business.

In the *The Anatomy of SaaS Pricing Strategy*, we'll walk you through creating a pricing strategy for your business. If you haven't put thought into your pricing before, this first chapter will show you why an effective pricing process is one of the most efficient levers of growth to maximize value from each customer.

Pricing is the Untapped Growth Lever

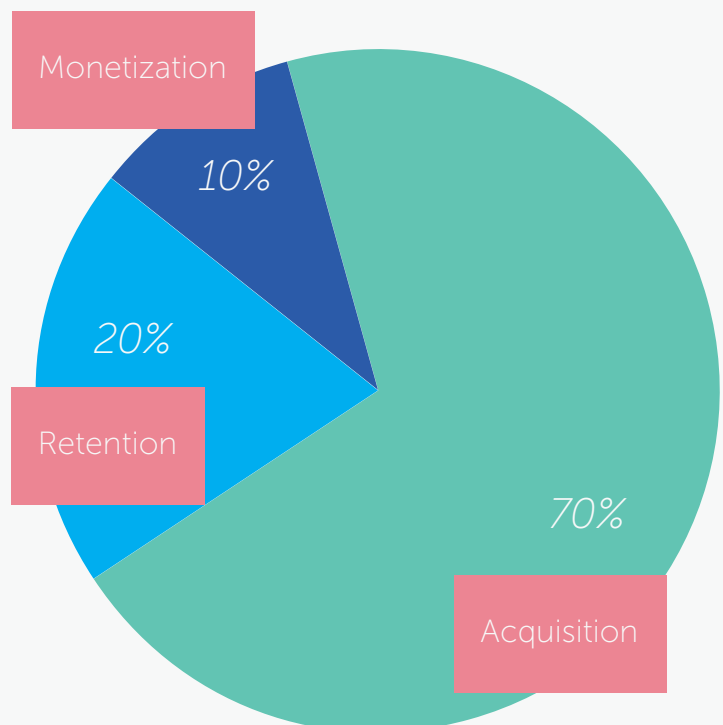
When companies think growth, they think customer acquisition. Yet, pricing is the crucial part of your business, which has the highest impact on growth.

We studied 10,342 blog posts across hundreds of SaaS companies and found that pricing is the most-often overlooked way to drive growth.

➔ *People in SaaS are writing and thinking about customer acquisition seven times as often as monetization.*

Growth is more revenue, not more customers. How you monetize those customers is vital. Yet, out of every 10 blog posts on growth, 7 are focused on acquisition, 2 are centered on retention, and only 1 is about pricing.

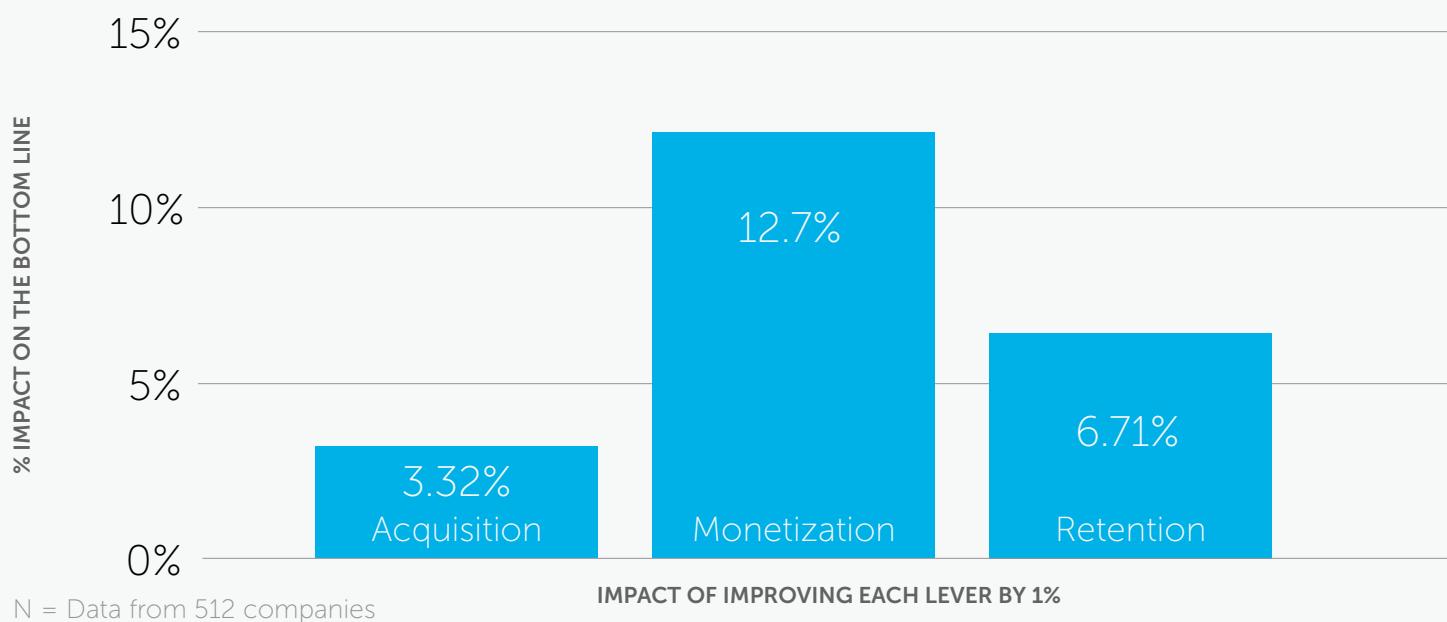
Topics of Blog Posts About Growth



Ironically, the frequency with which people write about each growth lever is inversely related to its effectiveness in driving growth. People write about acquisition, retention, and monetization in that order, but monetization has the biggest impact on the bottom line, followed by retention and then acquisition.

In our study of 512 SaaS companies, we found out that monetization had the largest impact by far on your bottom line. This could mean targeting better customer channels, or raising prices to better fit value.

Impact of improving each growth lever



Data shows that pricing is:

➡ **2x as efficient**
as improving retention

➡ **4x as efficient**
in improving as acquisition

By concentrating on pricing, and looking for all possible improvements, you have the chance to use this most effective lever to maximize your profits.

Pricing's Impact on Efficiency

➔ *When you don't optimize your pricing, you're throwing off the math, which powers the fundamental economics of your business. On the other hand, pricing is such a great growth opportunity because optimizing pricing makes a company incredibly more efficient.*

In our survey of 96 SaaS companies with annual recurring revenue (ARR) greater than \$5 million, the companies that adjust their prices continually exhibited extremely robust unit economics.

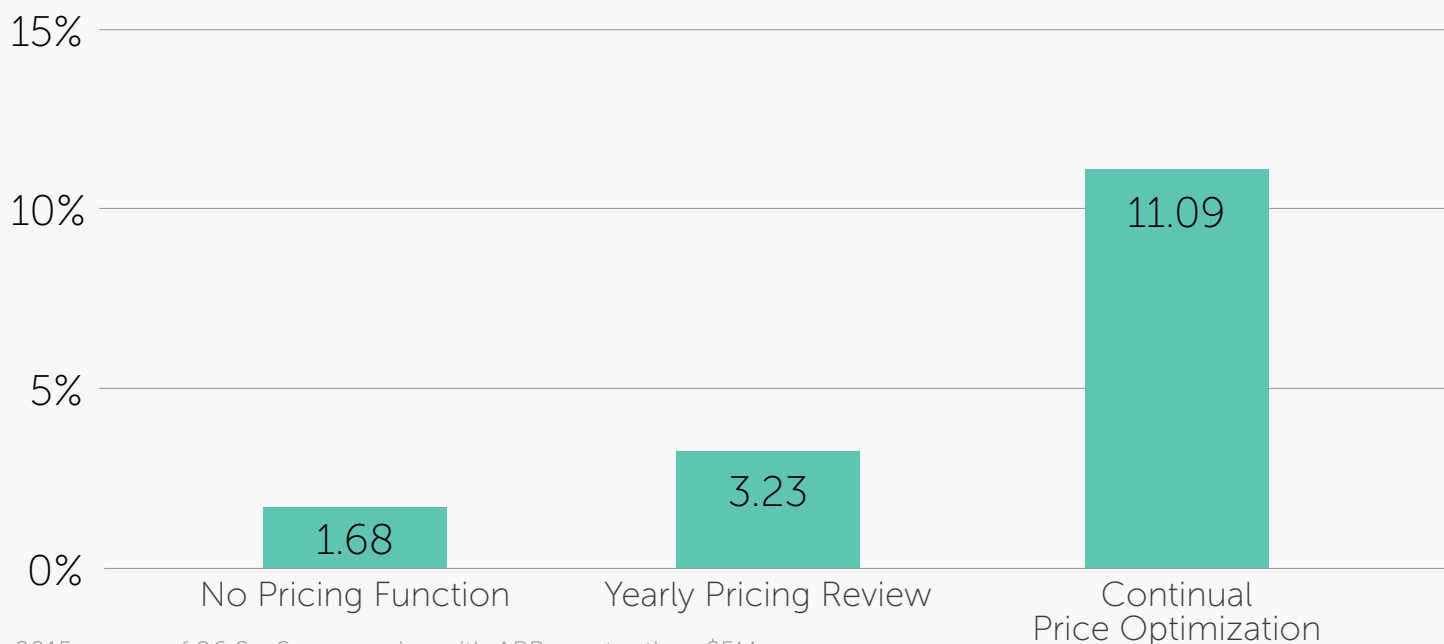
In order to understand whether your unit economics add up to a profitable business model, you need to look at the ratio between

two numbers: lifetime value per customer (LTV) and customer acquisition costs (CAC). The ratio between these two has to be greater than 1—otherwise, you're losing money on each and every new customer.

Companies that don't think about their unit economics tend to hover in the danger zone, just above break-even:

Impact on efficiency

LTV/CAC VS. PRICING COMMITMENT



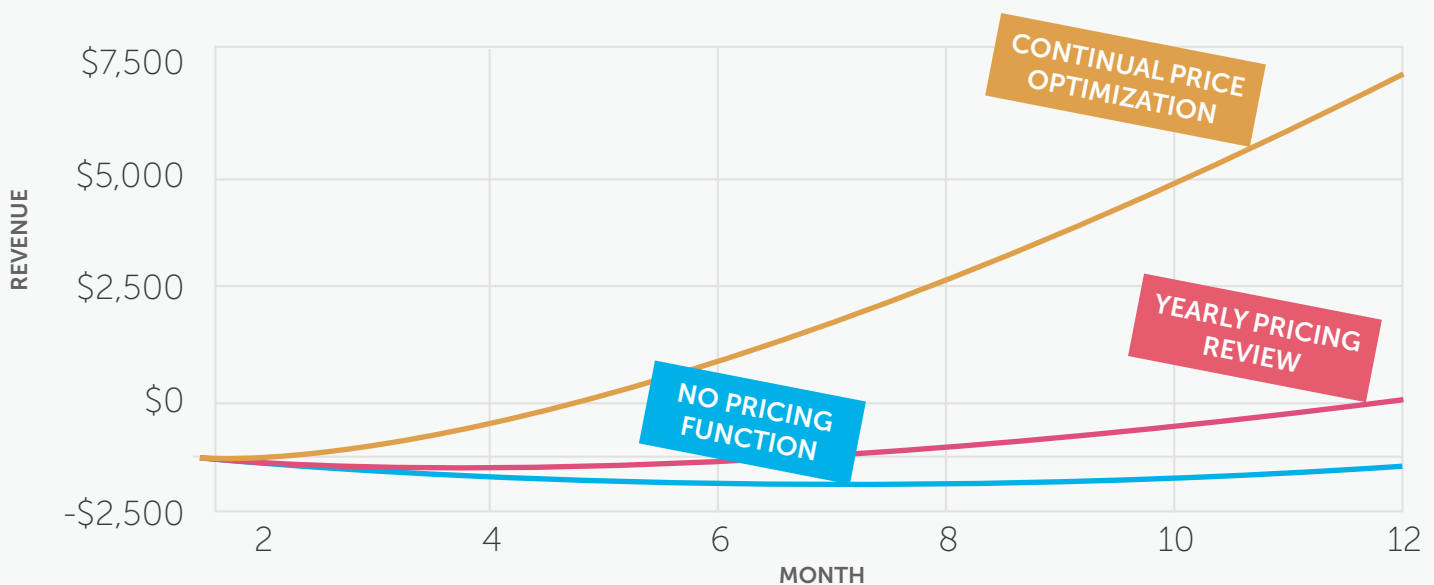
2015 survey of 96 SaaS companies with ARR greater than \$5M

Companies who at least had a yearly review had a solid foundation for growth. But companies that made price optimization a continual focus realized far more lifetime value from their customers than it cost to acquire them.

A lower ratio means it takes longer to achieve growth. As CAC spending is upfront while LTV gets paid over time in SaaS, the weaker your LTV/CAC ratio, the longer it takes for each customer to pay back their costs.

➔ *Looking at the payback period of each of these options, you can easily see the difference a continually optimized pricing strategy has on the growth of a company:*

Payback periods for different pricing commitments



With continual price optimization the LTV/CAC ratio skyrockets and CAC is paid back almost immediately. Profitability occurs in the second month, and the growth trajectory shoots up from there. Almost immediately, a company in this scenario would be able to finance more growth (and more efficient growth).

➔ *Rather than throwing money at customer acquisition, iterations to pricing can produce huge revenue gains that means the difference between a failing company and exponential growth.*

Pricing is at the Heart of Your Entire Business

It's counterintuitive, but because pricing touches on every single part of your business, it's often ignored. That's because it's at the intersection of marketing, sales, and product—so nobody in the organization owns it.

The problem this creates is that all of your marketing, sales, and product have to be developed with the eventual positioning, packaging, and pricing of your product in mind. These three aspects are inextricably

linked. If we look at an ideal pricing page, such as Wistia's, we can see how each of these come together to demonstrate the company's core value to each buyer persona.

WISTIA'S PRICING PAGE

The diagram illustrates Wistia's pricing page layout. A red arrow labeled 'Packaging' points to the first four plans (5, 25, 50, and 500 videos). A red arrow labeled 'Pricing' points to the price per month for the 50 and 500 video plans. A red arrow labeled 'Positioning' points to the 'Premium' plan. The 'Premium' plan is highlighted in orange and includes features like 'All features', 'Marketing automation integrations', 'Account management, SLAs, Priority Support', and 'Large number of videos, APIs, millions of views'. The other plans are blue and include 'All features', 'No Wistia branding on player', and 'Start for Free. Upgrade at any time.' buttons.

5 videos	25 videos	50 videos	500 videos	Premium
\$0 per month	\$25 per month	\$50 per month	\$100 per month	All features ?
All features ?	All features ?	All features ?	All features ?	Marketing automation integrations
Wistia branding on player	No Wistia branding	No Wistia branding	No Wistia branding	Account management, SLAs, Priority Support
Get started	Start for Free. Upgrade at any time.	Start for Free. Upgrade at any time.	Start for Free. Upgrade at any time.	Large number of videos, APIs, millions of views
				Get in touch

Here we can see all three aspects of a pricing strategy at work:

➔ **Positioning**

Aligning your product to attract the right customers. This is along the horizontal axis. Wistia is positioning itself to attract a wide range of possible customers, from small one-person shops all the way to big enterprises, and segments them by buyer persona.

➔ **Packaging**

Having the right feature mix in your plans. Videos are the value metric for Wistia and how it separates different packaging options. This allows companies to start small, but grow over time.

➔ **Pricing**

Finding the right price points that represent value and customers are willing to pay. The pricing on the page reflects the value metric (the number of videos included in the plan). Wistia offers a free tier to convert interested customers, but then the pricing follows a logical pattern of more videos = more cost.

You can also see a logical transition for users from one plan to the next. Starting out on the small plan and moving progressively up in scale. Changing one alters the others, and your pricing strategy is a delicate balance of all three, one that it is imperative that you get right. Keeping the Premium plan open-ended leaves room for any customer too big for the standard pricing.

Fundamentally, this is why your pricing page is the most important page on your entire site. Every other page on your site funnels to this page, which ties it all together—positioning, packaging, and pricing—and sets the prospect up to buy

.....

➔ *Determining each of these and the correct pricing strategy doesn't happen by accident. To do it right, you need to get input from all members of your team.*

Bringing the Different Teams in your Company Together

Because pricing touches on all parts of your business, all parts of your business have to touch on pricing. To get pricing right, you need input from every group in your company.

➔ *In our survey of over 270 SaaS businesses, we found that only 17% defined their pricing strategy as a team, with input from four key departments.*

Building a pricing committee from these core departments helps make sure that people are always working on pricing.

➔ **Marketing**

The marketing department understands the buyer personas you are targeting, so they should be particularly involved with positioning. In turn, this helps them identify the messaging that resonates with the target market, and communicate any pricing changes.

➔ **Sales**

Your pricing needs to convert customers and close sales. The sales team can help you walk through common questions and objections. Being familiar with your pricing helps them develop better pitches and more accurate sales forecasts, which deeply impact your revenue and final profits.

➔ **Management**

It should be the job of the executives at the company, from the CEO down, to coordinate the pricing strategy, bringing in knowledge and information from each of these departments to arrive at a pricing decision.

➔ **Product**

Your product developers are the people that build the features based on their deep knowledge of what users need. This contributes to the packaging of your product.

➡ Here, each of the departments can own one of the three aspects of pricing. As you grow and take on Finance and Ops roles within your company, these also need to be included to make sure that the pricing strategy is optimized for profit and growth.

One of these departmental leaders should act as coordinator. In particular, marketing is constantly aware of the coordinated efforts of product, sales, and marketing to attract just the right customers, so they are going to be the most absorbed in this process.

Finally, the main decision maker should be the CEO. She should be working in tandem with the coordinator to continually optimize pricing, as is needed for exceptional growth.

You need all of these people involved because your company exists solely to make money. It is fundamental that everyone understands this and is interested in getting the most value to the customer, but also the most value to the company. Pricing is vital to the unit economics that underpin a company and support its growth.

And because of the way pricing feeds back into and invigorates every department, you'll build and sell better, and that's a huge competitive advantage.

Your Pricing Committee

**Product
Leadership**

**Corporate Dev/
Finance**

**Sales
Leadership**

**Marketing
Leadership**

Main Coordinator

Typically in Product or Marketing



Main Decision Maker

Could be a member of the
committee, as well

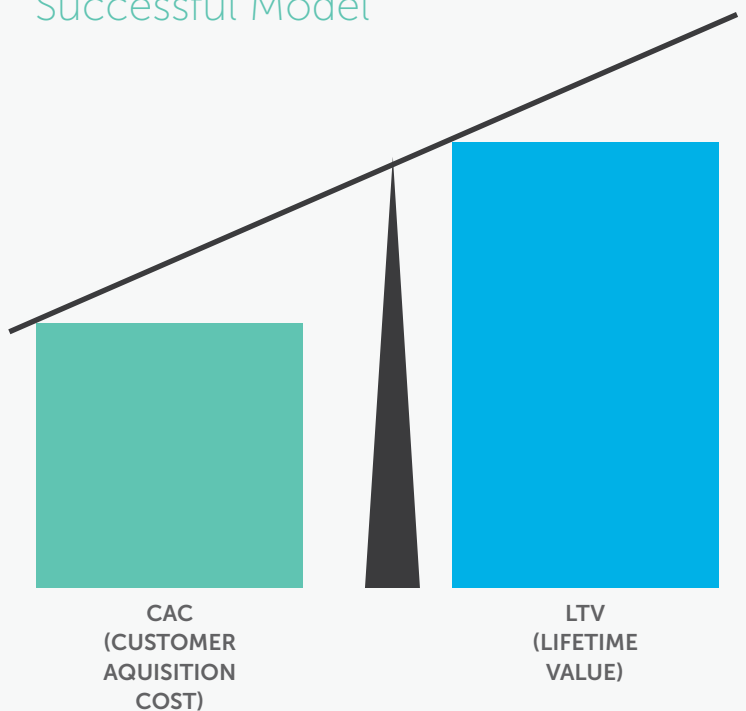
Pricing is the Foundation of Your Unit Economics

Pricing optimizes for growth and is so intrinsic to your business because of its ability to drastically improve the foundational numbers of your business: your unit economics.

Increasing your customer lifetime value (LTV) and decreasing your customer acquisition costs (CAC) are fundamental to achieving high growth as a business, and the ratio of these, LTV/CAC , is the math your entire business is based upon.

➡ *CAC is the cost of your sales and marketing efforts to acquire a new customer.*

Successful Model



➔ *Your CAC is the sum of your marketing and sales spending across all channels divided by the number of new customers acquired.*

You can see how CAC is affected by an efficient pricing strategy. An optimized pricing strategy leads to an optimized funnel. If you position, package and price effectively, then a significant part of your sales and marketing job

Equation for
Customer Acquisition Cost (CAC)

$$\text{CAC} = \frac{\text{TOTAL COST OF SALES \& MARKETING}}{\text{\# OF CUSTOMERS ACQUIRED}}$$

is already done. **Without this pricing strategy it's more expensive to acquire customers as you will be attracting the wrong prospects that don't fit with your value.**

➔ *LTV is how much you will earn from each customer over the time they spend with your product.*

At a basic level, that means dividing your monthly average revenue per user (ARPU) by the rate of customer churn for that same time. Dividing your ARPU by the rate of churn gives you their lifetime value.

With good pricing you can both raise ARPU and reduce churn. Raising ARPU

Equation for Lifetime Value (LTV)

$$\text{LTV} = \frac{\text{ARPU}}{\text{CHURN RATE}}$$

comes through upselling and cross-selling customers as they scale up with your value metric. Reducing churn comes from giving customers true value, which they will get if the positioning is precise. Achieving an LTV/CAC ratio of >1 is good, but not enough. **You need a substantially higher LTV than CAC, because otherwise you're not going to grow.**

Based on the experiences of successful (and unsuccessful) SaaS companies, you need an LTV/CAC ratio of at least 3:1 to run a successful business. But with continual pricing optimization, you can push that ratio to 11:1 and beyond. This is because

with effective pricing, you can reduce your CAC through better positioning and packaging targeting ideal customers, and increase LTV through higher prices and better retention. This leads to increased growth and increased revenues.

CASE STUDY

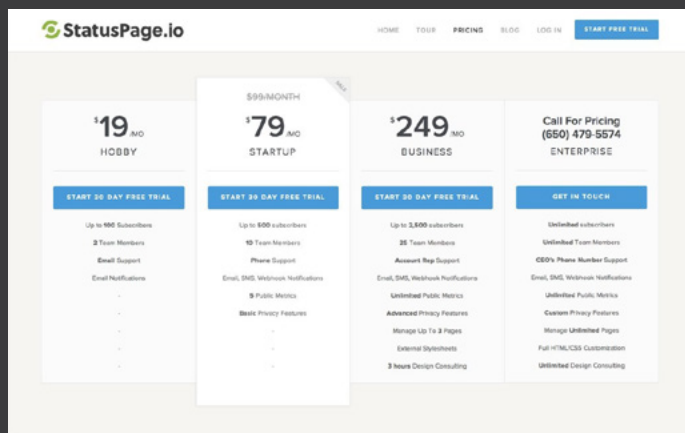


Here is how StatusPage, the service status communication platform, optimized pricing and improved their unit economics and growth altogether.

They initially had just two plans, but as they got to know their customers better, they realized that their pricing strategy was wrong.

Their second iteration of pricing looked drastically different. Gone was the free plan, as it was evident that the majority of customers were willing to pay, and they went from two plans to four, allowing for significant differentiation in packaging for different buyer personas.

When they optimized their prices to reflect the true value they provided to customers it was a fundamental step in increasing ARPU and reducing churn. That's how they increased their LTV by a whopping 2.4x.



StatusPage.io's new pricing page

CASE STUDY

Positioning

INITIAL



They had only positioned for two customer types. Startups/individuals with zero cash, and startups who could afford \$600 per year.

OPTIMIZED

One group was willing to pay more than \$0 but less than \$50/month for a few extra features, and a second group that was willing to pay far more than \$50/month for added functionality.

Packaging

INITIAL



With only two tiers, either customer got only a bare bones service, or they got everything.

OPTIMIZED

There was room for a finer gradation of services, both along their value metric (subscribers) and added functionality.

Pricing

INITIAL



In their own admission, free and \$50/month "sounded like a good place to start."

OPTIMIZED

Customers were actually willing to pay more for the core product and extras.

➡ *They have gone on to optimize prices further, increasing ARPU and multiplying their LTV/CAC ratio as the foundation for massive growth. Over two years, they went from nothing to just short of \$2.5 million in ARR.*



The average SaaS company spends 6 hours over their whole lifecycle on pricing.

Less than one work day goes into thinking about whether or not they're actually valuing your product as much as their customers are. That puts the average company in a position where even as they grow, they're doing so on unsteady foundations.

The best companies, however, are the ones that are making those improvements to their pricing strategy that optimal for growth. They are monetizing their product efficiently, constantly iterating on their positioning, packaging, and pricing, and optimizing for the underlying unit economics. By constantly optimizing and aligning your pricing with what your customers want, you can hit those high LTV/CAC ratios while offering those customers the best possible value you can give.

In the rest of this guide, we are going to take you in-depth into how you can monetize your SaaS effectively, build a concrete pricing strategy, and offer more value to better customers. All this will lead to exactly the type of gains here, with great unit economics leading to huge growth gains.

WHY VALUE BASED PRICING IS THE BEST PRICING STRATEGY

How do you decide the price of your product?

Some will say you should go with your gut. Others say that you should go with your gut, then double it. Either way, it seems most pricing advice out there is gastrointestinal-based rather than brain-based.

This gets to the heart of the problem with SaaS pricing. Not enough thought goes into it. Pricing is a process, with the ultimate goal of defining a strategy that will maximize your revenue. Picking numbers out of the air — or out of your gut — doesn't count as a process or a strategy.

In *The Anatomy of SaaS Pricing Strategy*, we are looking at exactly the decisions you need to take to arrive at the right pricing strategy for your SaaS business.

In this chapter we detail the three common strategies businesses use to define their pricing process—cost-plus, competitor-based, and value-based—the advantages and dangers of each, and show why value-based pricing is what every SaaS business should be using.

Cost-Plus Pricing

“A pricing method in which the selling price is set by evaluating all variable costs a company incurs and adding a markup percentage to establish the price.

- Price Intelligently Dictionary

Cost-plus is what people automatically think of when they think of “pricing strategy.”

This is the most basic form of pricing: selling something for more than its cost price. You add up all of the costs of providing the service and then add a profit margin on top to represent the value you are giving your customers. In SaaS, the costs might be product development and design, the company's own SaaS providers, and the costs of the team. Then add a 5%, 10%, or healthy 20% margin on top for profit.

➔ Calculating price from costs has two main benefits:

1. It's simple

As long as you know how much your costs are, it's trivial to work out your price. No market research, no data analysis, no strategizing. Just some addition and percentages.

2. You will cover your costs

As this is cost-plus pricing, you know that you will be adding a certain margin on top of your costs as pure profit.

Taking those advantages at face value, cost-plus pricing seems like a great idea and certainly a good starting point, with little overhead and definite profits.

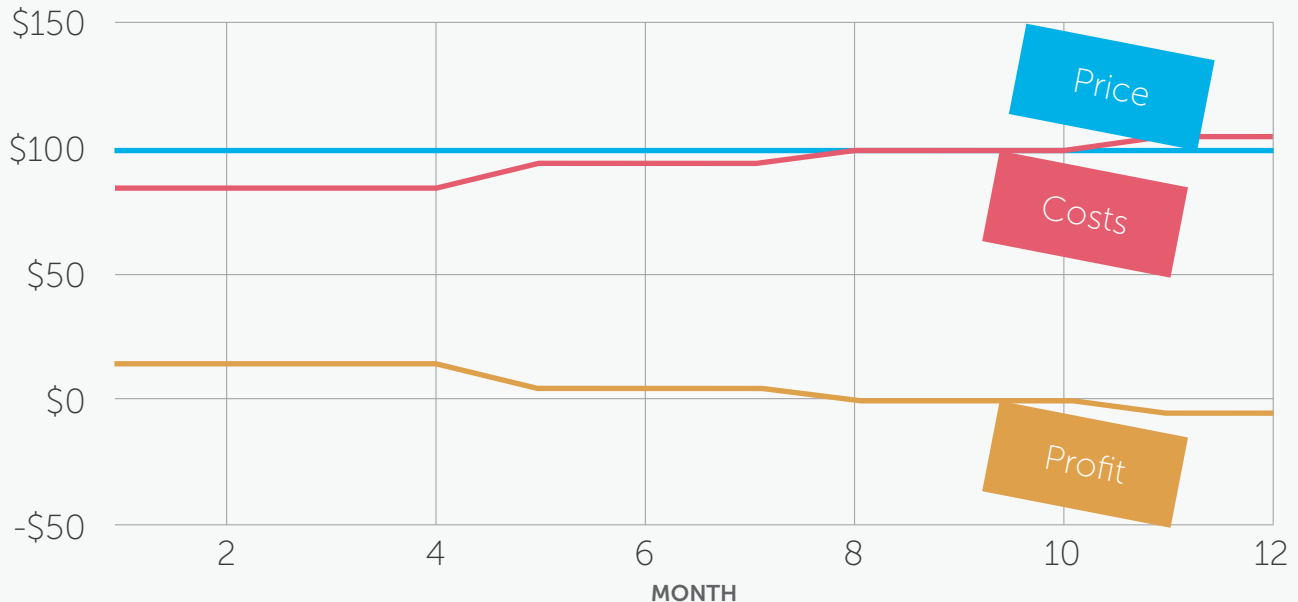
But cost-plus pricing is anything but a sure win. You won't necessarily know all your costs, and therefore can't know if you're going to cover your costs. Your initial costs might include only hosting and some development, but as you grow you'll have to factor in sales, marketing, and a number of other previously unknown costs. You can't

change your prices to account for every new hire, which means your profits will take a hit.

Also, costs fluctuate over time. If a SaaS provider is using value-based pricing and has changed their prices, you can't constantly change the price of your product to maintain the same margin. That might work for a gas station, but it won't work for a SaaS company. Again, profits take a hit.

➔ *This is what happens when you use cost-plus pricing:*

Profit with Cost-Plus Pricing



➔ *In this example, the company calculates costs, and then adds a healthy 15% margin on top. This works well for a few months, until some unexpected costs crop up. Then the margin is cut to 5% and then 0%, where the company is only breaking even. Then all it takes is for one of their own SaaS suppliers to raise prices and they are losing money on every sale.*

THE BIG PROBLEM WITH COST-PLUS PRICING

Customers don't care about cost, they care about value.

You have no idea how much it costs for Starbucks to make your Frappuccino. You have no idea how much it costs for Honda to make your Accord. The price of these items is tied to the value they represent to you, not their internal cost. Sure, Starbucks and Honda are pricing their products over what it costs to make them, otherwise they'd be in trouble, but how much over is not determined by the cost of the coffee beans or the engine parts.

➔ *For SaaS in particular, the unit cost of delivering one account can be very low. It is the value that your customers will get out of using your product that really matters to them, not how much you paid your developers.*

Competitor-Based Pricing

“A pricing method that utilizes competitor prices as a benchmark, rather than setting a price based on company costs or customer value.

- Price Intelligently Dictionary

For a SaaS company starting out in a new industry, competitor-based pricing will seem the logical way to go. Unsure of the initial value of your product, and not wanting to go too high or too low, it seems obvious that you should look at the other companies selling similar products to decide your own price point.

➡ Again, calculating price from competitors has two main bonuses:

1. *Simplicity*

By spending 30 minutes on competitors' sites finding all their pricing information you can have a "pricing strategy." It's also unlikely to go wrong. By placing yourself in the middle of the pack, you'll be anchoring yourself for any future customers and they won't think your product is too cheap or too expensive.

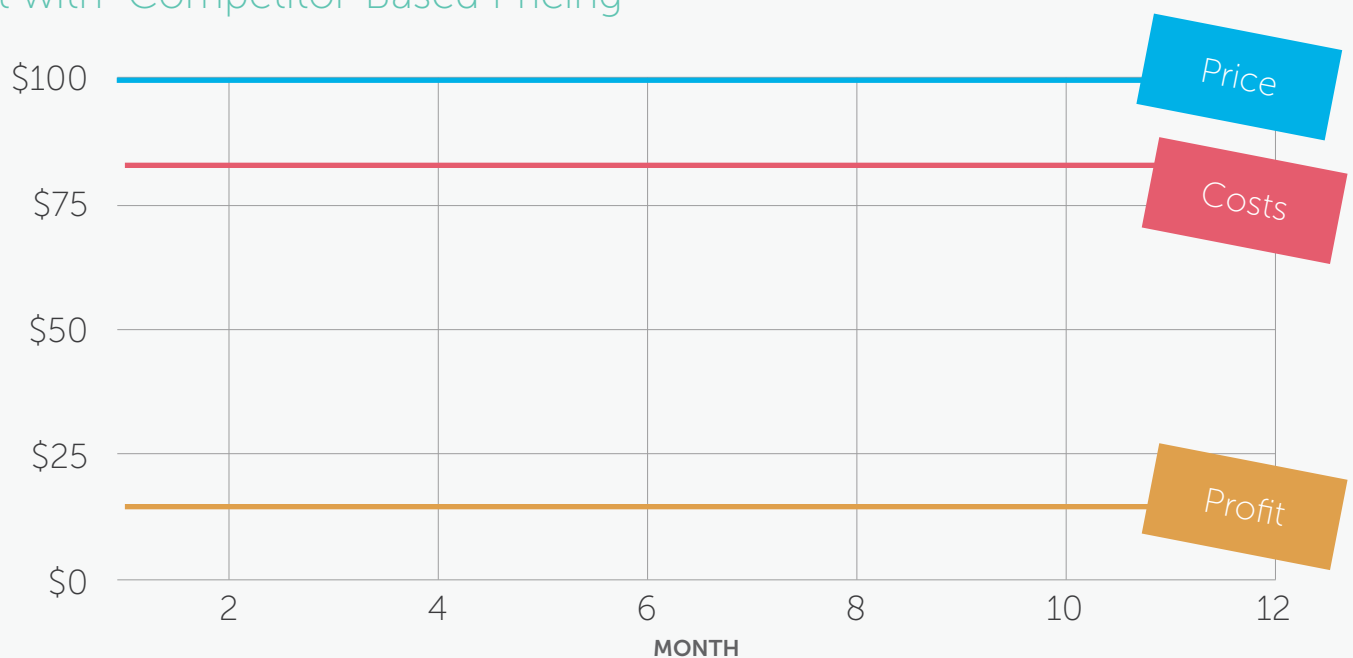
2. *It might be close*

If you're in a competitive market, pricing for the companies involved should be close to what the market can reasonably sustain.

But the biggest downside of competitor-based pricing should be obvious. You don't have *your* pricing strategy, you have *their* pricing strategy. Your company exists to offer customers something different to what is already on the market. You are offering more value and a better product, otherwise you shouldn't be building it.

➡ *That is why you have to find your own space within the industry, both for your product and your pricing. If you don't, your profits will end up like this:*

Profit with Competitor-Based Pricing



Flatlined. OK, this looks a lot better than the cost-based pricing, with a profit throughout the year. But it is also static, with no chance of adding value by raising prices without pricing yourself above your competitors.

➡ ***The moral of the competitor-based story is look, but don't touch.***

You want to know where your competitors are pricing their products so that you're in the same ballpark, but they should not be guiding your decisions.

THE BIG PROBLEM WITH COMPETITOR-BASED PRICING

Customers don't care about your competitors, they care about you.

As before, this is missing the point for your customers. Instead of focusing on what you can give them and how you can put together the right features and plan for them at the right price, you are offering them something that they could literally get elsewhere.

➔ *If a potential customer is on your site, it is because they are interested in what you have to offer. If it's just a regurgitation of what they have already seen elsewhere, then they will just use the original instead.*

Value-Based Pricing

➔ *Basing a product or service's price on how much the target consumers believes it is worth.*

- Price Intelligently Dictionary

This could easily be called "Customer-Based Pricing" because that is effectively what it is. Instead of looking inwardly at your own company, or laterally towards your competitors, with value-based pricing you look outward. You look for pricing information from the people who are going to make a decision depending on your price: your customers.

➔ *Three great reasons to base your pricing on customer value:*

1. ***Willingness to pay***

This is the main reason you have to go out and ask your potential customers the value they see in your product. You need to know what customers will actually pay for your product. Competitor-based pricing does this in a roundabout way. If they are willing to pay \$100 for your competitor, then they must be willing to pay \$100 for your product as well. But this misses the fundamental point that your product should be different to your competitors. It should offer more value, and therefore priced differently.

2. *Build the best product*

Pricing also isn't just about the number on the page. It is about how you package and offer your selection of products and features, and to whom. This approach to pricing will help you understand what your customers truly want, and what features should be developed over time. Once you have developed your minimal viable product, your features and product updates should be driven by consumer demand.

3. *You get to know your customers*

By placing a premium on the opinions of your customers, you are focusing on the people who will be making the buying decisions. They are the ones that will eventually be deciding whether your pricing and packaging is correct. If not, they won't be buying.

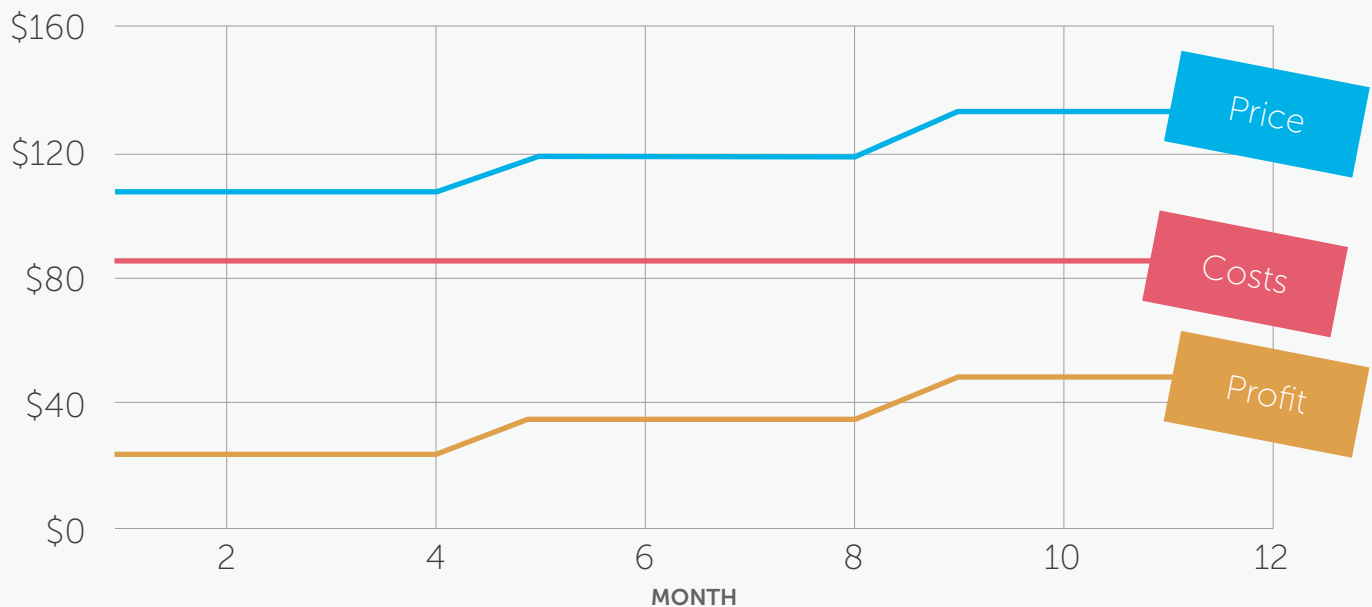
The downside: all this takes time, and is the basis for quantifying your buyer personas.

It's also not going to be 100% reliable. With price sensitivity measurements and feature analysis you are only going to get approximations of the right pricing, packaging, and positioning for your product.

But this is still much closer to the truth than using just costs or competitors to set your price. It's also based on your product and your value, so it gives a much more truthful representation of where your pricing should be set.

➔ *You have to be dedicated to finding out about your customers and your product to perform value-based pricing effectively.*

Profit with Value-Based Pricing



➔ *When you start using value-based pricing, amazing things can happen with your profit.*

With value based pricing, two things are different. Firstly, you can start at a higher price point if you have shown that there is a willingness to pay among your customers. Secondly, you can raise prices as you add

more value to your product and find out more about your customers. This example has an aggressive pricing strategy, with two raises within a year. But this is entirely possible in SaaS.

➔ *You should definitely be re-evaluating your pricing strategy every 6 months, and if there is room to raise prices you should.*



Each of these pricing strategies has its place in business.

If you're running a gas station, you're probably cost-plus pricing. If you are in the ultra-competitive retail space, pricing in line with competitors will be close to the price the market can sustain.

But in SaaS, the only viable option is value-based. Your SaaS company exists to offer value to your customers. By finding out how much they are willing to pay for your product and what features they want to see you develop, then you will be able to not only give customers what they want, but you'll also be able to attract and retain these customers better. All while making more profit.

THE IMPORTANCE OF QUANTIFIED BUYER PERSONAS

Most companies are sure they know their customers. But the truth is the majority of businesses have no idea who their customers really are. Even worse, they are not putting real effort into finding out.

In fact, our experience with SaaS companies has shown us that almost none are using market research or internal data to build quantified buyer personas that can be used to implement an effective pricing strategy. Even fewer companies include key information into the personas, which actually makes them useful for marketing, sales and product.

Quantified buyer personas are the foundation of your entire pricing strategy.

In this chapter of The Anatomy of SaaS Pricing Strategy, we're going to show you the importance of buyer personas, how to collect data on what they truly value in your

product, what they are willing to pay for it, and how much it will cost you to get these ideal customers.

Quantify Your Qualitative Buyer Personas

We've seen inside more SaaS companies than just about anyone else. 99% of them are unable to describe their buyer personas beyond a few generalities.

➔ ***Without data-driven buyer personas, companies cannot succeed in SaaS.***

The 1% that have drilled down their buyer personas using data are what we call “LTV Beasts.” Crazy efficient and crazy profitable. Quantified buyer personas allow you to take real action in your pricing strategy, making the

constant improvements necessary to your pricing to massively increase your revenue.

Too many companies develop buyer personas like these and leave it there.

These make companies think they have succeeded in building well-rounded, three-dimensional buyer personas. But if they are just some vague adjectives and nice photos they are only good for decoration.

Mailchimp buyer personas



No matter what you've seen before, buyer personas are really about numbers not words. Buyer personas such as these don't have any actionable data associated with them. It's not clear what features of a product each would find most valuable, or least valuable, or what they would be willing to pay for them. There is no way to calculate the unit economics of these supposed ideal customers. Neither can

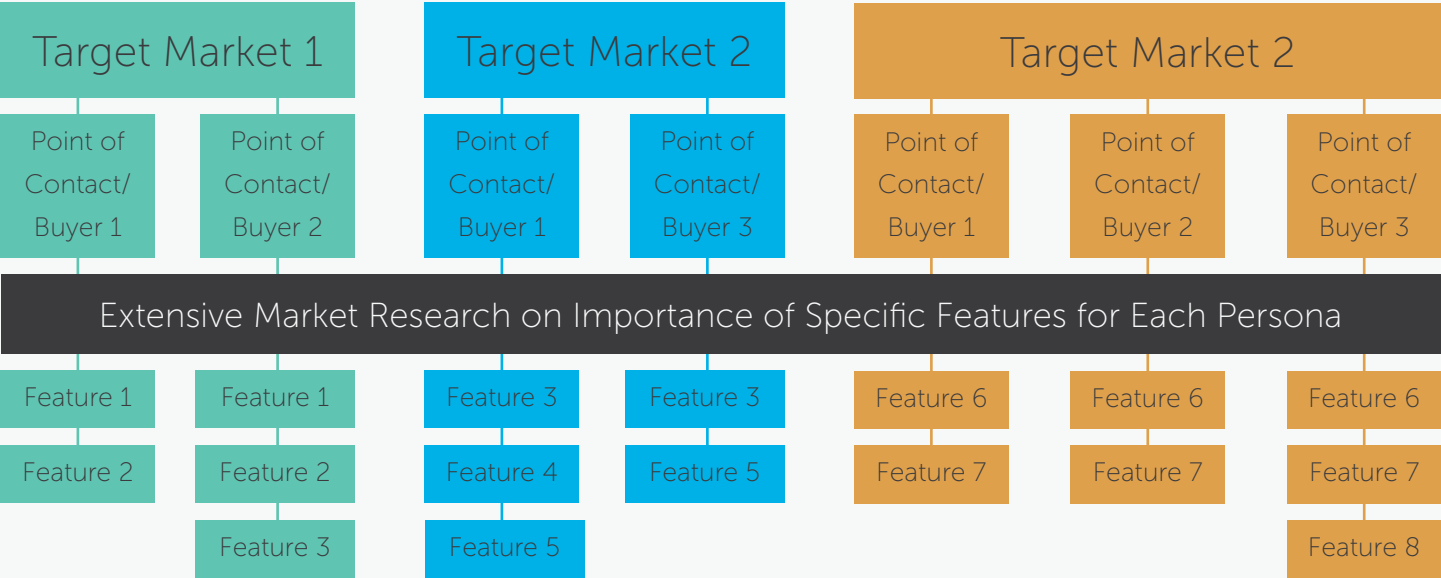
you work out where they sit in the company, whether they are key decision makers or who they report to.

➔ *All this key information is missing. Without it, you are reduced to "guess and check" marketing and development.*

WHAT GOES IN TO YOUR QUANTIFIED BUYER PERSONAS

➔ *Qualitative buyer personas take the target market and break it down by point of contact. Then, they describe the point of contact with different features, like what their needs are, what their budget is and more.*

The problem is that those conclusions are drawn from anecdote and gut impression. They should come from extensive market research and internal data from existing customers. By doing this, you will be basing your buyer personas on actionable data that fully describes who they are, what they want, and how much they'll pay. That's what it means to quantify your buyer personas.



Persona-Pricing Fit



Table Stakes Tony

Valued features:

- SFDC Integration
- Chrome extension

Least valued features

- Analytics
- API access

WTP = ~\$10/month

CAC = ~\$22

LTV: \$160



Advanced Amie

Valued features:

- Analytics
- API Access

Least valued features

- Chrome extension
- Premium support

WTP = ~\$25/month

CAC = ~\$56

LTV: \$325

Gone are the adjectives (and unfortunately the sharp photos), but they have been replaced by actionable data: valued features, willingness to pay, and unit economics.

➔ *This is what your buyer personas should really look like. Yes, you can enhance with photos, and you do want to add demographics to make them into lifelike people. But the real characteristics that matter are the ones that are based on data.*

You need to know:

➔ *How to identify your highest-value customers so you can position effectively?*

➔ *What are the valued features of your packaging that different subsets of customers really want?*

➔ *What are these types of customers willing to pay for the right product for them?*

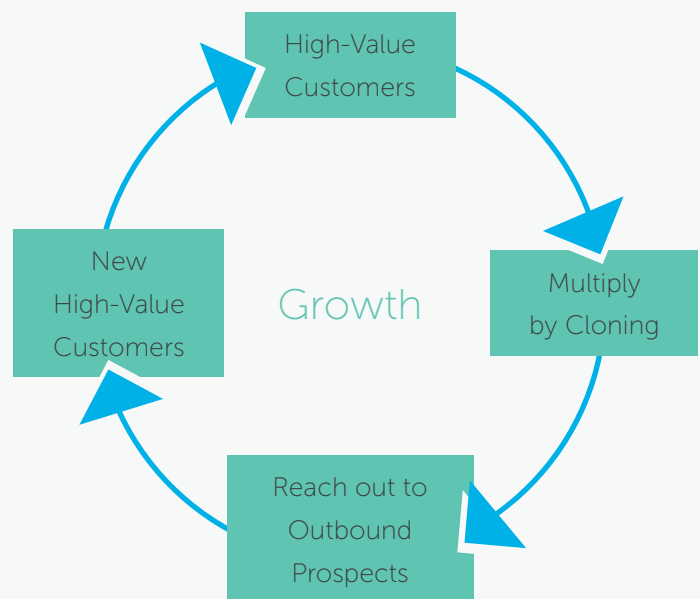
➔ *Are the unit economics, such as customer acquisition cost, of these customers profitable for your company?*

For each of your buyer personas, you need to have this data. It doesn't come easy and will have to be constantly updated as you change your product and company.

➔ *Here's how to quantify your buyer personas to make this happen:*

Break Down Your Customers into 3-5 Identifiable People

To grow your SaaS business you need to find more of your highest value customers. Cloning these customers act as a bedrock for the rest of your SaaS growth. These are the customers that will drive your company forward and provide the foundation for everything else that you can do.



You clone your customers by finding out as much information as possible about them, then reaching out to similar people or organizations through your outbound sales process. But you can't do this if you have no idea who your customers are in the first

place. Finding out as much detail as possible about them is crucial to segmenting and replicating them. Once you have that, you can position your product to appeal to each of these buyer personas.

This helps everyone on your team nail down who they are working for. Product knows who they are designing for, marketing knows who they are talking to, and sales knows the best

customers to reach out to. This information from these departments then feeds back so you can continually optimize your personas for the highest-value customers.

Getting the data on your best customers

➔ *The first part of building buyer personas is to tease apart the amorphous idea of “customer” into 3-5 identifiable people. You need to find out who these people are in real life:*

➔ *What industries are they in?*

➔ *What is the size of their company?*

➔ *What is their role within their company?*

These are the building blocks that you need to start profiling customers. You probably already have this data in your current customers. By identifying your best customers and working backwards, you find which buyer personas you currently have and which ones you still want to obtain.

To get this information, you can look at your current customers and build profiles from there. If you’re using ProfitWell, you can pull up the payment information for each of your customers and sort by monthly recurring revenue (MRR).

ProfitWell

Showing 213 customers with a total MRR of \$11,575				
USER	SIGNED UP	PLAN	MRR	
Emily	03/18/15	Starter Plan	\$0.0	
David	03/18/15	Professional Plan	\$700.0	
George	03/18/15	Growth Plan	\$700.0	
James	03/18/15	Power User Plan	\$100.0	
Kyle	03/18/15	Starter Plan	\$700.0	
Sarah	03/18/15	Professional Plan	\$700.0	
Laura	03/18/15	Starter Plan	\$50.0	
Jane	03/18/15	Grwoth Plan	\$0.0	
Aaron	03/18/15	Power User Plan	\$300.0	
Eric	03/18/15	Professional Plan	\$300.0	

Clearbit BOT 16:13 Only visible to you
Looking up [chris@wistia.com...](#)

Chris Savage
Co-founder and CEO of @wistia. Learning how to be a new dad. I love building companies with great people.

Email chris@wistia.com - Chris Savage	Location Cambridge, MA, US
Employment Wistia	Title Co-founder & CEO
Role ceo	Seniority executive
LinkedIn in/cjsavage	Twitter csavage (9,...

Wistia
Wistia makes it easy to control and customize the experience. You can bring more viewers back to your site, learn how to integrate video into all of your marketing campaigns.

Location 17 Tudor St, Cambridge, MA 02139, USA	Website https://www.wistia.com/
Type private	Raised \$1,625,000
Employees 60	LinkedIn company/wistia
Twitter wistia (30,899 followers)	
Tags Internet, SAAS, B2B, Information Technology & Services, Technology	

Clearbit Slack integration

➔ *If you don't already have good demographic information on these customers from conversations or signup questionnaires, you can enrich their data with services such as Clearbit.*

You can run new signups through Clearbit's Enrichment API to find out more information. For instance, if Chris Savage from Wistia was one of your early sign ups, you could run his email address through the service to find out more about him and Wistia:

From this you know the answer to the three questions above:

➔ **What industries are they in?**
Internet generally, B2B video marketing specifically

➔ **What is the size of their company?**
60 employees

➔ **What is their role within their company?**
CEO

NAME	DOMAIN
Wayfair	wayfair.com
LogMeIn	logmein.com
LiveChat	livechatinc.com
join.me	join.me
GNU	gnu.org
Help Scout	helpscout.net
PDFfiller	pdffiller.com

Discovery API from Clearbit

➡ If you do this for all current customers, you can segment them along this axis, finding the types of people and companies that are already finding value in your service and bootstrapping off those. From there you can use the Discovery API from Clearbit to find other companies with similar profiles.

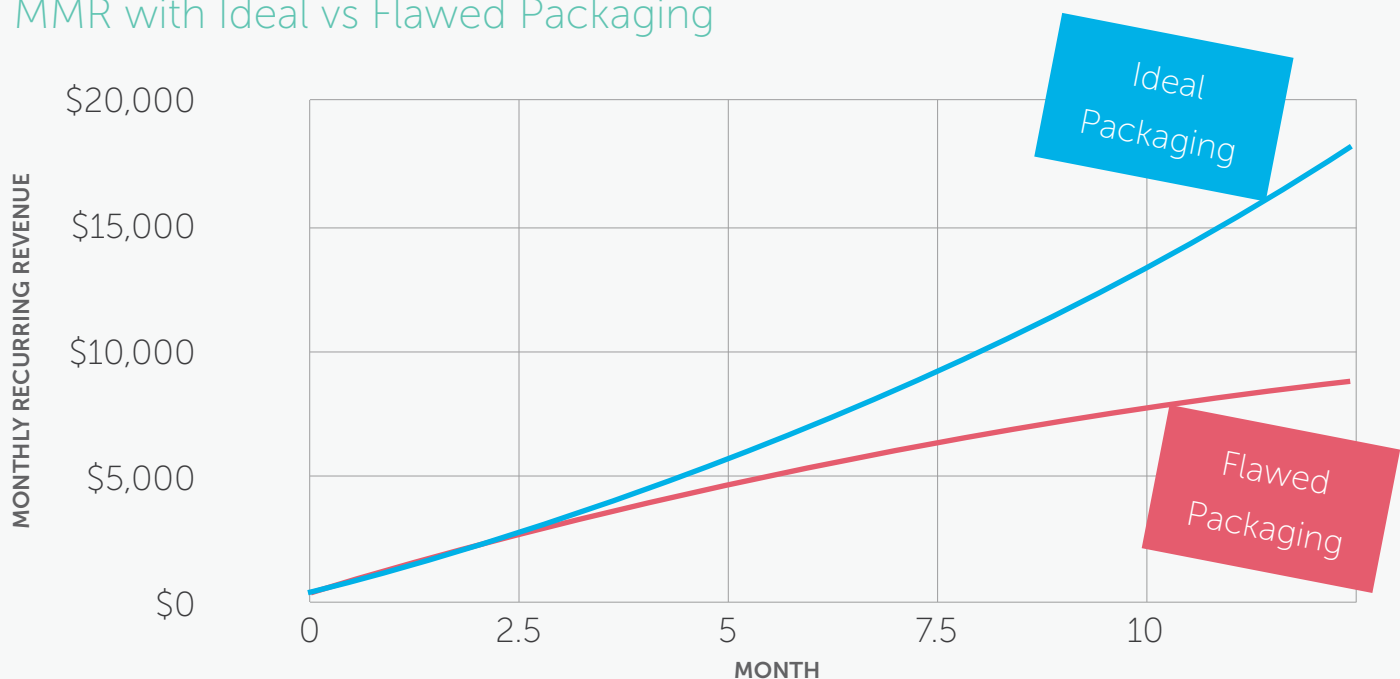
In this case, these are other internet companies in the Boston area, but you could look for company size, or more specific tags. Then you can use the Prospector API to find the right contacts to reach out to in each company.

➡ You want this contact information because the real value in buyer personas comes in talking to these customers, either current or potential. You want to reach out and start asking questions about what they want and how much they'll pay.

Understand What Your Customers Value

We've seen inside more SaaS companies than just about anyone else. 99% of them are unable to describe their buyer personas beyond a few generalities.

MMR with Ideal vs Flawed Packaging



➔ *In the graph above we've shown a scenario that demonstrates what can happen with incorrect packaging fit.*

Ideal packaging represents features optimally aligned with what each buyer

persona values most. Flawed packaging is where the features in each tier are mixed and don't correspond to what specific customer profiles want.

➡ *A valid assumption is that flawed packaging will lead to high churn (10%) and low upsell to a second \$200 tier (3%). Then even with 10 new customers joining a \$100 plan each month, growth will eventually plateau, then start to fall.*

Ideal packaging can reverse these numbers, leading to low churn (3%) and high upsell (10%). With the same 10 new customers joining the \$100 plan each month the difference quickly becomes obvious. With fewer customers leaving and more upgrading their plans, the

growth curve starts to bend the other way, with more and more revenue each month.

Even if it doesn't entirely reverse the trend, better packaging will always lead to higher upsell and lower churn.

To package your features effectively on your pricing page you need to know what each buyer persona most values.

Then you can target these customers' pain points directly within each of your tiers, and display them effectively. Finding what features customers really want also ties back into your product development, allowing you to prioritize your roadmap around customer value.

The challenge of finding what your customers value

Never ask people to rank features on a scale. You won't get any differentiation. The most used method is to ask people on a scale, 1-10, what features they would like to see most in your product.

People will rank features they really want as a 10, the features they are kind of interested in as 9, and the ones they don't care about as 8.

➡ *People say they want everything, and it will be impossible to really separate out what they truly care about and what they really value.*

1. Please rank the following features on a scale of 1-10:

	1 - Least interested	2	3	4	5	6	7	8	9	10 - Most interested
Analytics	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Premium Support	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Integrations	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
SLA	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Customizations	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Single Sign On	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

1. Please rank the following features on a scale of 1-10:

	1 - Least interested	2	3	4	5	6	7	8	9	10 - Most interested
Analytics	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>
Premium Support	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>
Integrations	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
SLA	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Customizations	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>
Single Sign On	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>

1. In terms of [COMPANY] pricing, which of the following when it comes to pricing is most preferred? Least preferred?

	Most Preferred	Least Preferred
Analytics	<input checked="" type="radio"/>	<input type="radio"/>
Premium Support	<input type="radio"/>	<input type="radio"/>
Integrations	<input type="radio"/>	<input type="radio"/>
SLA	<input type="radio"/>	<input type="radio"/>
Customizations	<input type="radio"/>	<input checked="" type="radio"/>
Single Sign On	<input type="radio"/>	<input type="radio"/>

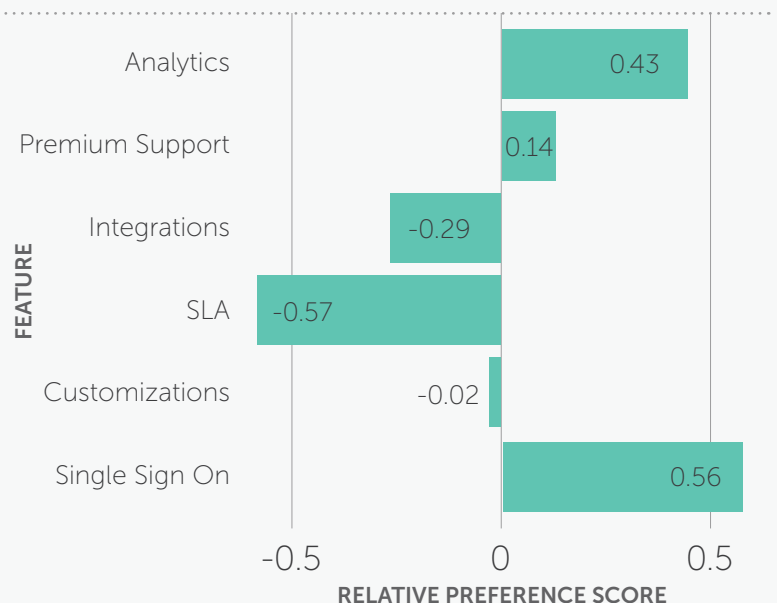
To do that you need to use relative preference analysis. This is a statistical method that you can use to measure value in your product. These questions simply ask people what they most want and least want out of all the options. It forces people to make a decision.

This is like asking “What is the one thing you couldn’t live without and the one thing you could live without?” to your customers.

Once you’ve asked enough people, you can calculate a score for each feature using:

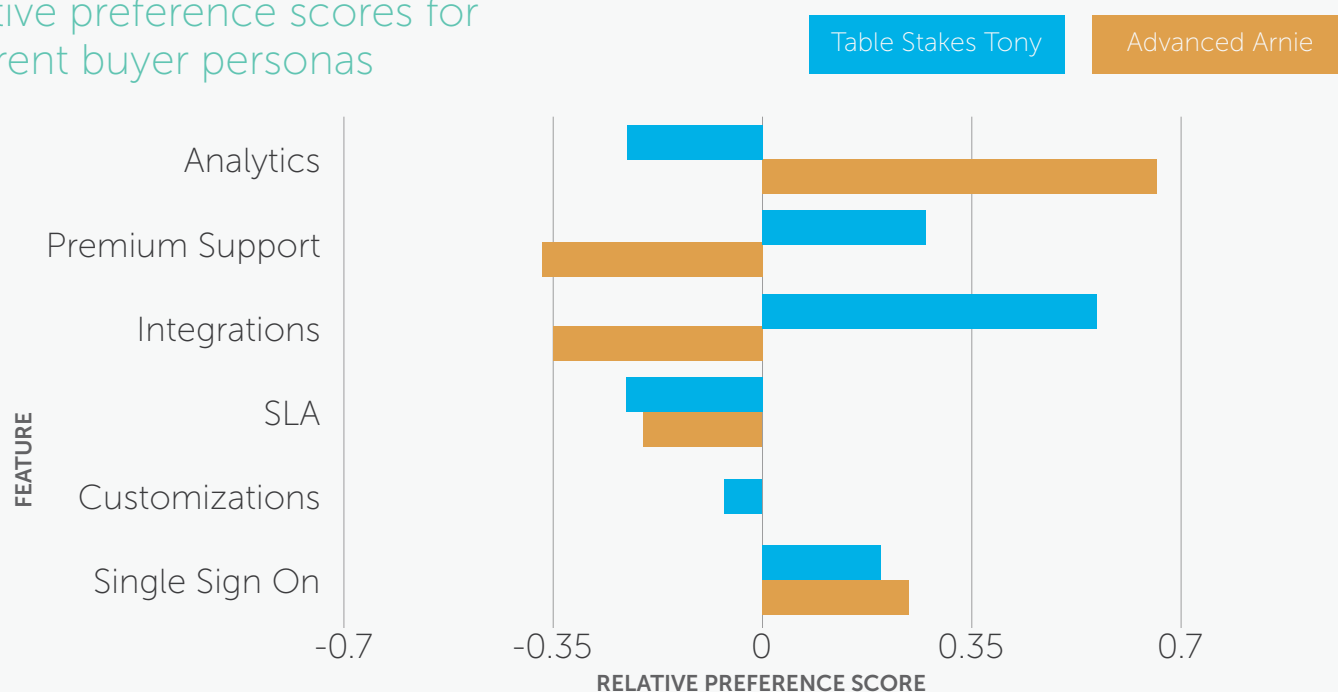
$$\frac{\begin{array}{c} \text{\# TIMES FEATURE IS MOST WANTED} \\ - \\ \text{\# TIMES FEATURE IS LEAST WANTED} \end{array}}{n}$$

➡ *Plotting these scores shows you exactly what features your customers are after, and which they can live without.*



➡ Once you have this information you can break it down by different personas. Using the examples from above, a relative preference graph for Table Stakes Tony and Advanced Arnie would look like this:

Relative preference scores for different buyer personas



It's at this point that a picture starts to emerge from your packaging. If one buyer persona cares more about analytics and another about integrations, then you have a natural delineation for your packages. You shouldn't just stop at the large features; you can break it down into components:

➡ *What type of analytics do the Arnies want?*

➡ *What is the best integration for Tony?*

You can go back to these customers and ask more questions, finding out where the value really lies within your product and your company in the minds of your customers.

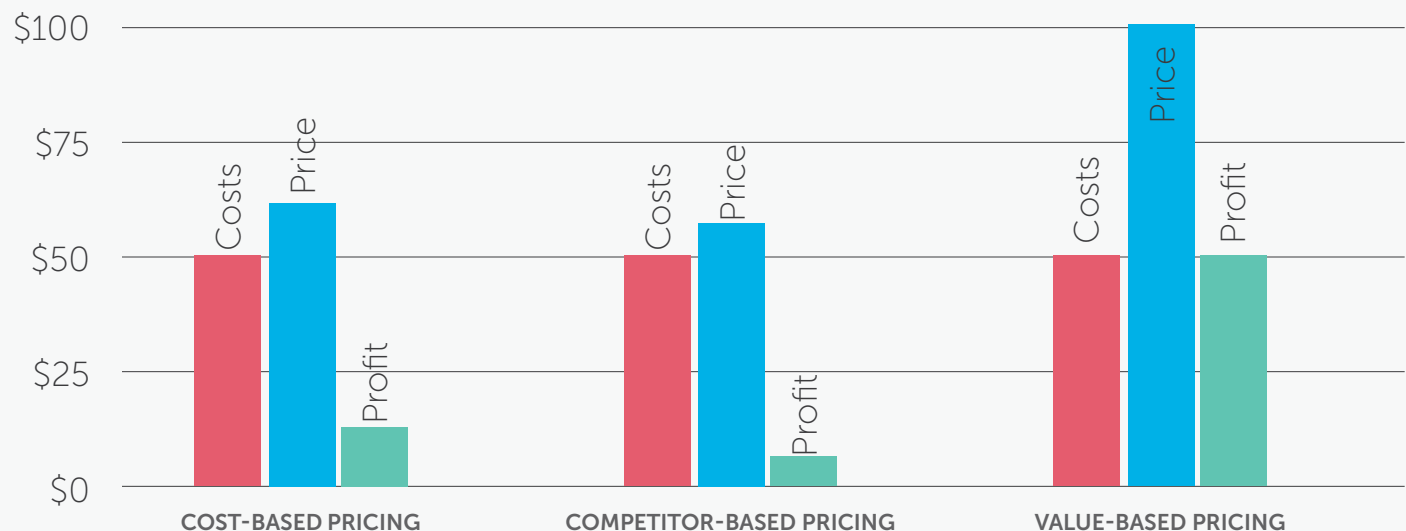
Never be afraid to talk to your customers. They are the ones that know what they value, and what they'll pay for it.

Your Customers' Willingness To Pay

It's useless to build a product if no one is willing to pay your price. Equally, you're losing revenue if you set your pricing bar too low. Finding the optimal point to set your pricing allows both you and your customers to derive the highest value from the relationship.

Finding this sweet spot is the foundation of value-based pricing, a far stronger method than either cost-based or competitor-based.

Profit from different pricing strategies



➔ With **cost-based** you are only taking your own internal costs into account and adding a margin.

It's entirely inwardly focused and doesn't represent what any of your customers think or feel.

➔ **Competitor-based** is equally flawed and through a race-to-the-bottom, can lead to even lower margins.

This method bases your prices on other businesses in your industry. But you should be offering different value and a better product

than they are. If you use this method, you are ignoring your own product and the value you represent to your customers.

➔ In this scenario pressure from competitor prices only leads to a 10% margin, and a \$5 profit per customer.

➔ **Value-based** pricing takes into account what value you offer and what each of your buyer personas is willing to pay for that value.

It is a pricing strategy unique to your company and therefore returns the maximum value for your product and customers.

➔ With this pricing, the customer sees \$100 of value in the product, leading to 100% margin and \$50 profit per customer. 5X cost-based pricing, and 10X competitor-based pricing.

➔ You are driving people to your pricing page so you have to know the price they are looking for before they get there.

Discovering what your customers are willing to pay

➡ *People aren't very good in thinking about specific price points. They won't be able to tell you if your product is worth \$99/month or \$79/month.*

This is the understanding behind Van Westendorp's Price Sensitivity Meter developed to determine the pricing landscape for a product. It relies on 4 questions:

➡ *At what price would you consider the product to be so expensive that you would not consider buying it? (Too expensive)*

➡ *At what price would you consider the product starting to get expensive, so that it is not out of the question, but you would have to give some thought to buying it? (Expensive/High Side)*

➡ *At what price would you consider the product to be priced so low that you would feel the quality couldn't be very good? (Too cheap)*

➡ *At what price would you consider the product to be a bargain—a great buy for the money? (Cheap/Good Value)*

Willingness To Pay

At what price would you consider the product to be so expensive that you would not consider buying it? (Too Expensive)

\$100 \$200 \$300 \$400 \$500 \$600 \$700 \$800 \$900 \$1000

\$800

At what price would you consider the product to be priced so low that you would the quality couldn't be very good? (Too Cheap)

\$100

At what price would you consider the product starting to get expensive, so that is it not out of the question, but you would have to give it some thought to buying it? (Expensive/High Side)

\$500

At what price would you consider the product to be a bargain—a great buy for the money? (Cheap/Good Value)

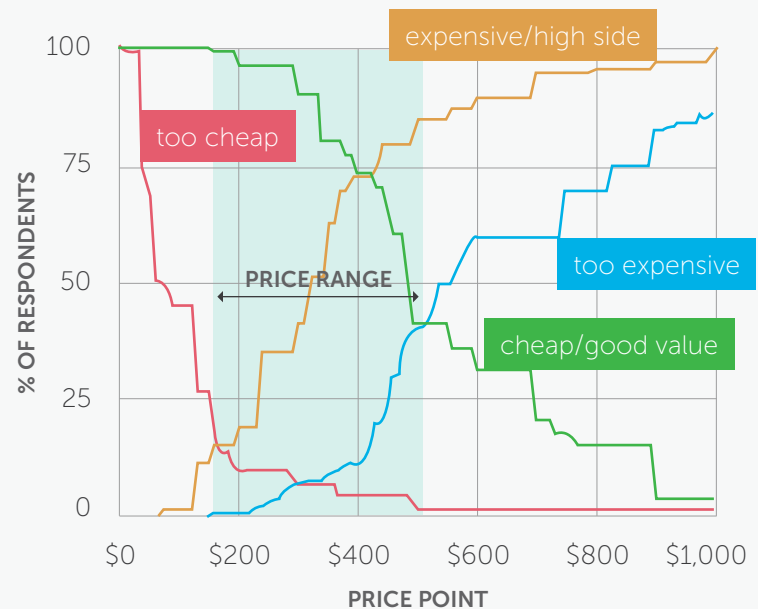
\$300

By surveying current and prospective customers with these questions, you can plot the cumulative frequencies for each of these categories:

➔ *The optimal price here lays in that middle price range. You want your pricing to be within that center mass where customers find value from your product, don't consider it too cheap, but still consider it a good deal.*

Just as with feature analysis, you can then break these numbers down by buyer personas, finding the optimum price point for each potential customer.

Price Sensitivity Analysis

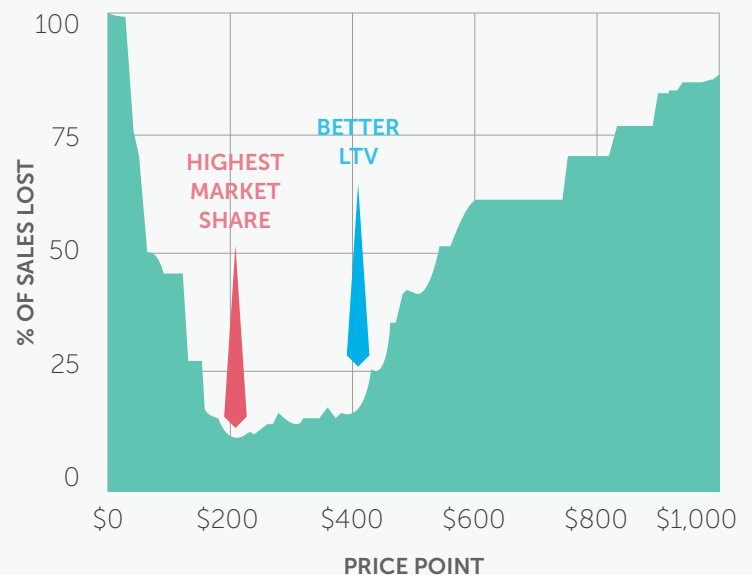


From this data, you can also plot price elasticity to determine where the optimum market share is found:

➔ *The highest share of the market is found in the trough at the bottom. This is the price point where the maximum percentage of sales can be found.*

If you want to capture the bulk of the market, this is where you should set your prices.

% of sales lost at different price points



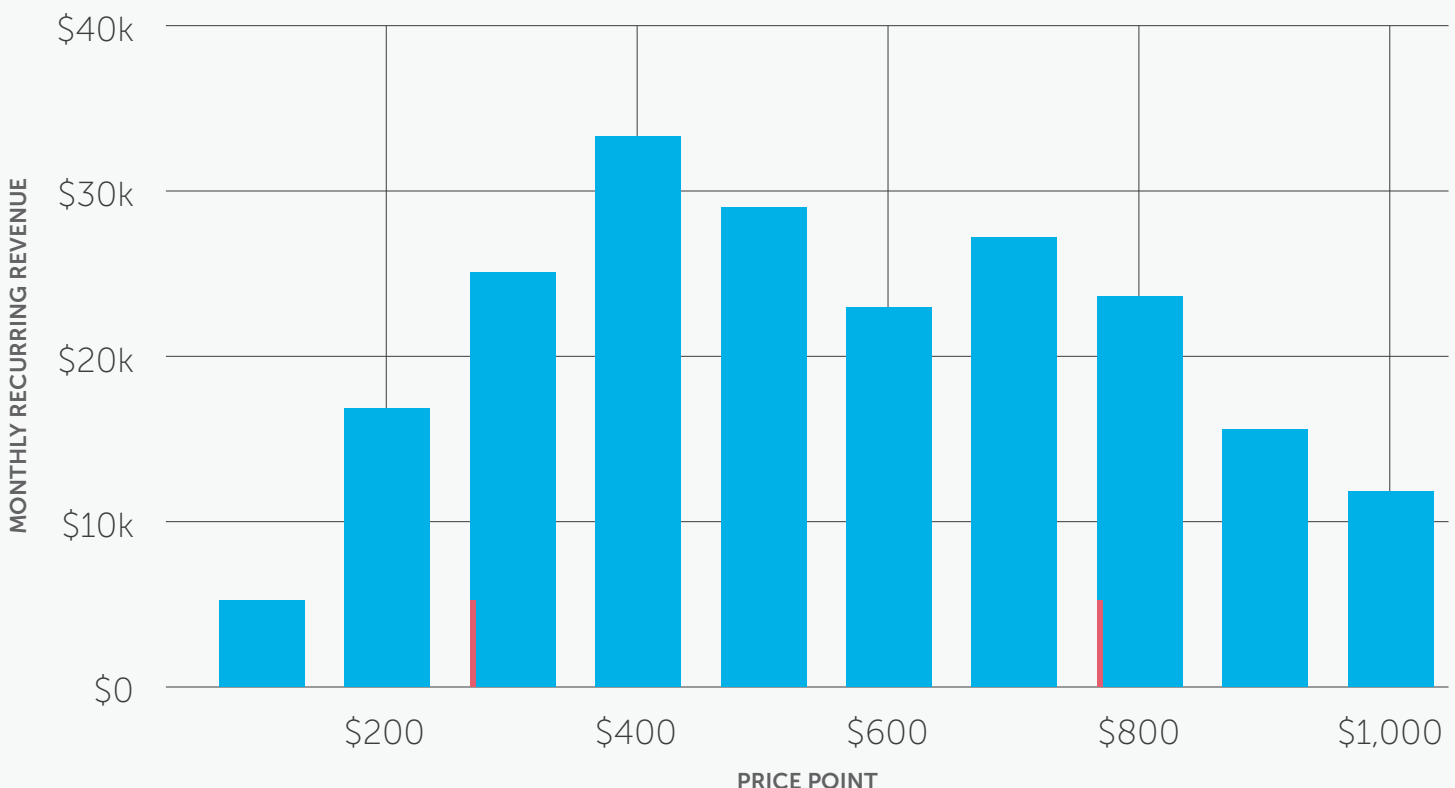
➡ However, using this data, you can also see other pricing points that may return higher profits. In this scenario, shifting the price point higher, from \$200 to around \$400 sacrifices barely any market, but for potentially far better LTV per customer.

This can be seen by plotting out potential MRRs for each price point:

Here, we're looking at the maximum revenue we could get at each price point from 100 potential customers. If at \$200 we have 89% of the market, 89 potential customers, then MRR is \$17,800. However, at a price point of \$400 we still have 84% of the market, so we can get an MRR of \$33,600, an increase of 1.8x even with a smaller share of the market.

➡ Using this data, your pricing committee can see that the sweet spot is at \$400, where you can capture plenty of the market but with a higher LTV.

Potential MRR at different price points



How Much Your Customers Cost

It's obviously great to have high-value customers, but without knowing how much it's going to cost to acquire them, you can't know if the underlying unit economics of your pricing strategy are sound.

Calculating the customer acquisition cost (CAC) for each of your buyer personas brings together all aspects of your pricing.

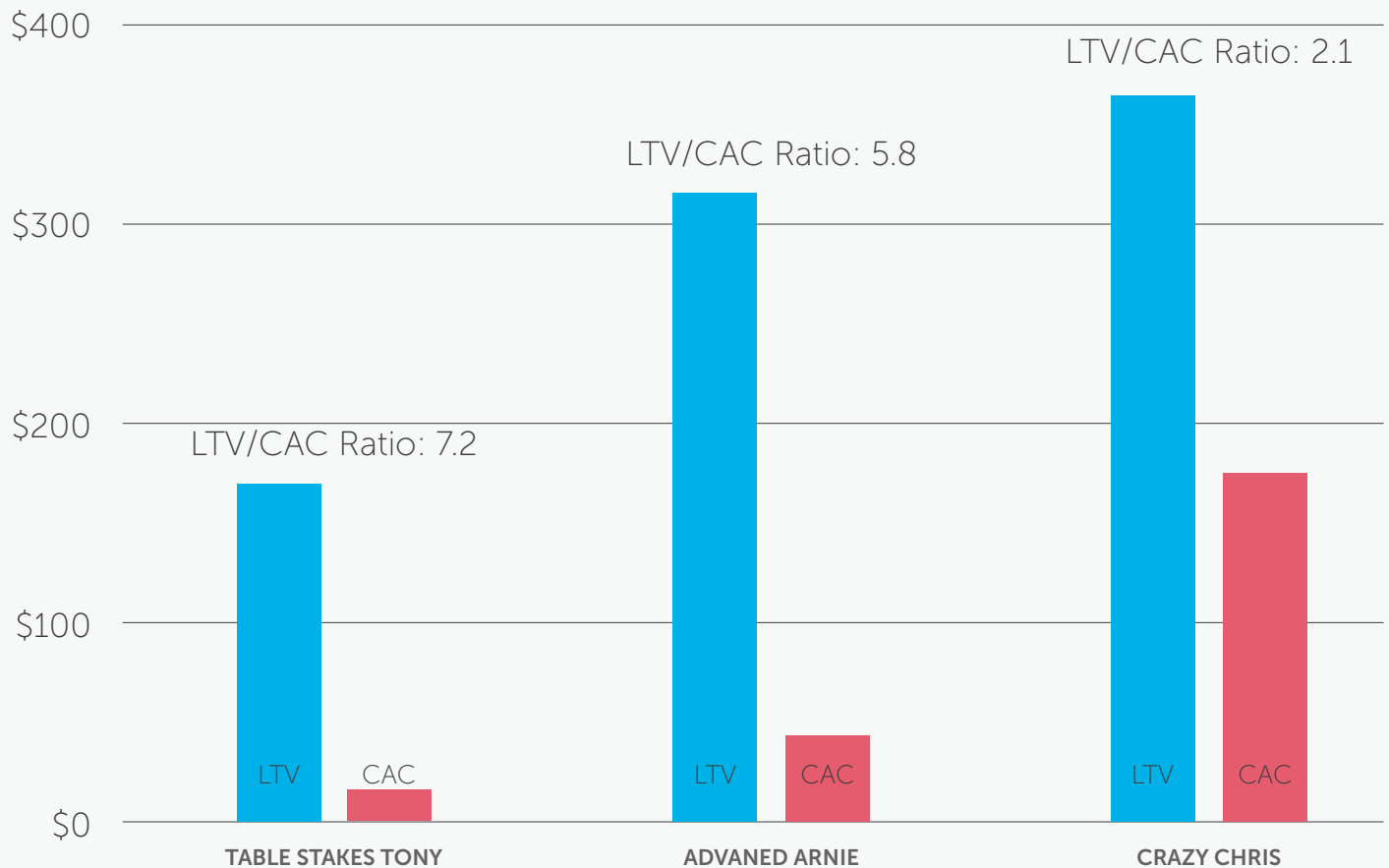
If we go back to the buyer personas from the initial Pricing-Persona Fit data, we can see why this is so important.

➡ *CAC will show whether you have positioned your company towards realistic customers you can afford.*

➡ *It shows you whether the packages and personas you have put together are viable.*

➡ *Calculating CAC allows you to align your funnel so your marketing department can acquire the right leads through the right channels for each persona.*

LTV vs CAC for different buyer personas



➡ For ideal growth, your lifetime value (LTV): CAC ratio should be over 3:1.

For both Table Stakes Tony and Advanced Arnie it is. You will get much more value from these customers than it cost to acquire them. They add to your growth engine.

But if we imagine another buyer persona, Crazy Chris, we can see this isn't always true. Crazy Chris could have a higher willingness

to pay and therefore higher LTV, but he also has a higher CAC. It costs to acquire Crazy Chris. With an LTV:CAC ratio of just 2.1:1, Chris is going to be slowing down the growth of your company, therefore, you would need to decide whether this was a customer worth pursuing.

➡ ***This is the final piece on the puzzle of your buyer personas. If you've got high-value, low-cost customers, you've got outrageous growth.***

CALCULATING YOUR BUYER PERSONA CAC

➡ You can calculate your customer acquisition cost (CAC) for each persona using this formula:

When you are initially developing your buyer personas, this is difficult to do. You probably won't have reliable data of sales

If you don't have this information, then market research can come to your aid again. Ask your potential customer what products and services they are using at the moment. You can then guesstimate the CAC of these products and companies by looking at where they are advertising, how they are marketing, and how they are selling.

CAC can also be estimated from the type and size of your potential customers. Large, high-value customers are going to have higher

Equation for
Customer Acquisition Cost (CAC)

$$\text{CAC} = \frac{\text{TOTAL COST OF SALES \& MARKETING}}{\text{\# OF CUSTOMERS ACQUIRED}}$$

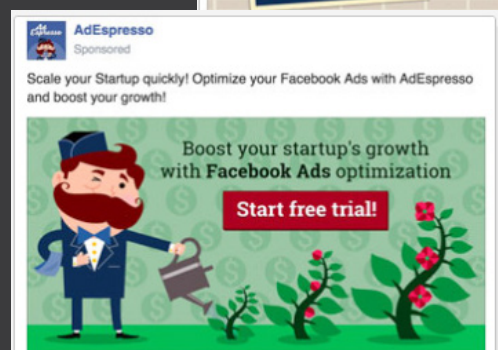
and marketing costs, and the number of customers acquired might be too low to produce a stable CAC.

CACs compared with the small companies using your product. It's not important to have these numbers nailed down, but to start adding them to your personas and iterating from there when you get the right data.

If you do already have customers that fit your buyer personas, or that are in your funnel, start looking closely at how much it is costing for each acquisition. These analytics should be readily available through any of your channels.

➡ AdEspresso, a Facebook ad optimization service, segments their customers using buyer personas in their own Facebook ads:

The first ad here is targeted towards media agencies (main value: saving time), whereas the second is targeted towards startups (main value: growing user base).



In this channel, the cost per click (CPC) for different ads along with the conversion rate will give you an approximation of the CAC. In this scenario, let's say the CPC for these is \$1.68 and \$3.13 respectively, suggesting startups are more costly to acquire.

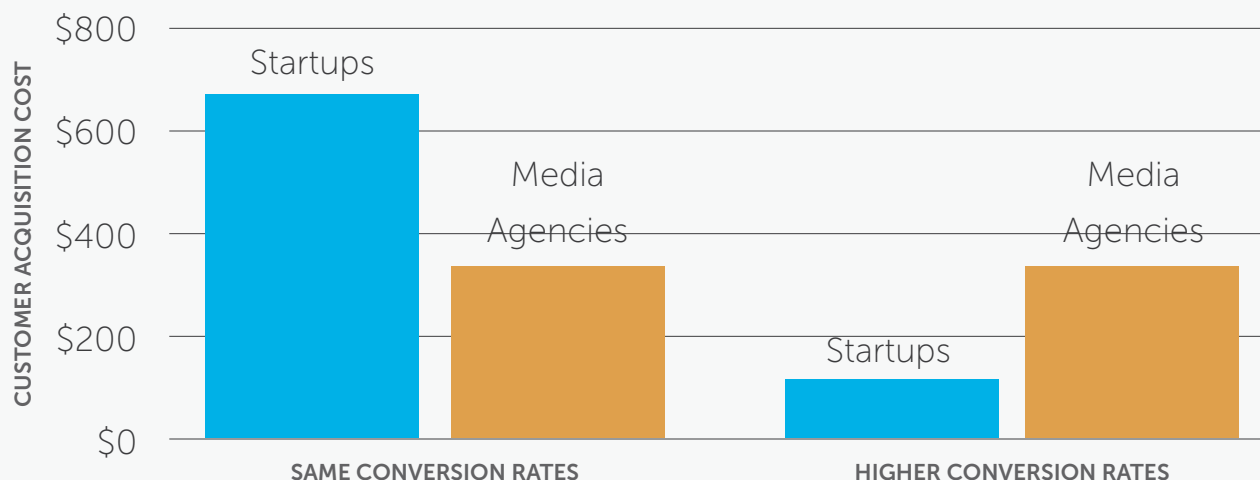
➔ *As AdEspresso has a free trial, we can then use Andrew Chen's formula for converting CPC to CAC for paid acquisition channels.*

Cost per Click (CPC) to Customer Acquisition Cost (CAC)

$$\text{CAC} = \frac{\text{CPC}}{\% \text{ TRIAL} \times \% \text{ PAID}}$$

Where "%trial" and "%paid" are the conversion rates from visit to trial, and from trial to paid plan, respectively. Though from the CPC alone it might seem that startups are a bad bet, that drastically changes when different conversion rates are taken into consideration:

CAC from paid acquisition

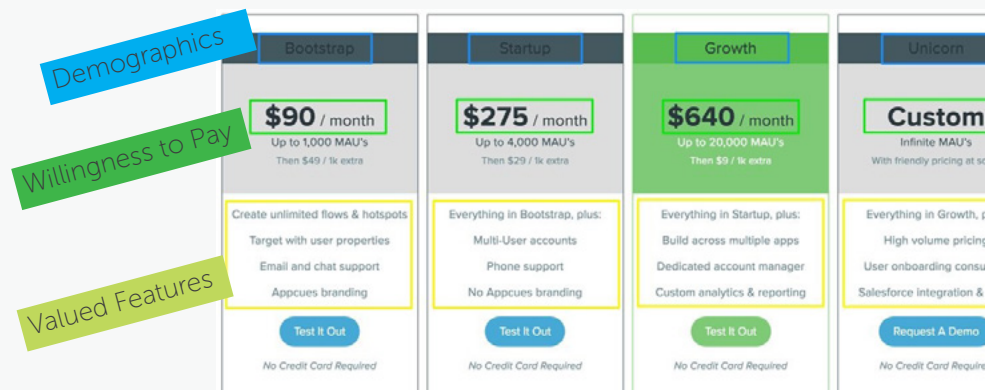


This is why it's important to understand all the data and metrics behind your customers. Startups could be more willing to try SaaS and convert than media agencies. Without quantifying your buyer personas and only thinking about them in abstract, this is data, and revenue, you would be missing.

This information can be added to the buyer persona and linked to the willingness to pay, and through that lifetime value (LTV). You can then determine whether the unit economics for each of these buyer personas, and therefore the whole persona itself, is realistic and sustainable.

Translating All This To Your Pricing Page

Once you have all this data you have to do the hardest and scariest part, put it into your pricing page. Here, user onboarding service Appcues shows how it's done:



The four positioning tiers are segmented by the company's different buyer personas. Within each, the distinct parts of each profile are used to attract the ideal customer:

➡ **The demographics are condensed into a single word that best describes that persona:** a bootstrapper, a startup, a growing company, or a large unicorn.

➡ **The willingness to pay is shown in the actual pricing, which grows with the growing demographics and features.**

The smaller companies are only willing to pay \$90/month, whereas Appcues knows they can get 7x that for Growth buyer personas.

➡ **The packaging of the valued features show the relative preferences of each buyer persona.** The Bootstrap persona only wants quick and easy access to the product, while Growth wants custom analytics and support.

This final hurdle is where a number of companies fail as they suffer from decision paralysis at this final point.

➔ *Companies worry that once a price is in digital ink, it will scare customers away. If they get it wrong then customers won't sign up and they won't be able to recover.*

But this entire pricing process is designed to settle that argument in your company and in

your mind. If you have followed the process correctly, talked to your customers, and obtained all the right data, then the decision will be made for you.

Quantifying your buyer personas gives you concrete starting points for your pricing and packaging, showing you exactly what your customers value, and what they are willing to pay.

As long as you price within that range and tier out your packages correctly, you will have customers.

What should be obvious from this process is that this isn't just about that final pricing matrix. The questions and answers you get in this process go way beyond just that one page, into the entire design of your site:

➔ *If you know what feature your customers really value then that should be the first thing they see when they hit your landing page.*

➔ *Your sub-landing pages can be designed around each of the main features for each buyer persona.*

➔ *You can construct your sales funnel to pass through different features as potential customers travel to your pricing page.*



Quantified buyer personas are about one thing: Value.

They are about determining, via data and analysis what customers are most valuable to your company and how you are most valuable to your customers. By researching this data and defining each of these characteristics for your customers, you can gather a true understanding of your customers and what they really want from your product.

Instead of just funny names and general attributes, adding numbers to your customer profiles makes them actionable. It turns them into the foundation for the growth of your entire company, allowing you to find more and more of these great customers, getting optimum value from them, while offering exceptional value back.

4

CHAPTER FOUR

USING QUANTIFIED BUYER PERSONAS AS PART OF YOUR PRICING PROCESS

If you are already quantifying your buyer personas, or used the previous section as a jumping off point for learning more about your customers, then you are off to a great start with your SaaS business.

But a start is all it is.

Pricing is a process. Quantified buyer personas only show their true effectiveness when the data generated is used to drive this process and spur growth.

In this section of The Anatomy of SaaS Pricing Strategy, we're going to walk you through an example scenario of how a SaaS company can use quantified buyer personas continually to maximum effect, increasing revenue and growth.

Developing A Pricing Process

Most SaaS companies set their prices on instinct when they start the business and then either forget to update, or are too terrified of scaring away customers to then make the updates and changes needed to keep the business profitable and growing.

At Price Intelligently, our pricing process is ongoing, and revolves around the **Problem › Cause › Solution** framework:

This allows us to get ever closer to the optimal balance of what our customers want

and what is good for our company. This alignment of value is what drives growth.

The three steps of the Problem › Cause › Solution framework allow you to drill down into the actual issues your company is facing.





PROBLEM

Define individual problems that are stopping your company from offering good value and growing.



CAUSE

Use your quantified buyer persona data to find the source of these problems within each customer profile.



SOLUTION

Test possible hypotheses to determine the best solutions for the causes and in turn the original problem.

The fourth step in our pricing process is Implementation. This is where you take results from your experimentation and you embed them into your pricing.

This is the entire point of your pricing process, though also the part that companies rarely follow up on.

What follows is a hypothetical example of how simple buyer persona data can have a drastic effect on the profitability and growth of a SaaS company when used within an effective, data-driven pricing process.

Defining Your Growth Problems

*The #1 question any SaaS company asks is
“What is stopping us from growing?”*

This is a massive question. It could be product, people, customers or any one of a dozen other areas. The only way to find the answer is to chip away at this question and drill down into your biggest problem areas and your gaps in understanding.

From our extensive analyses of over 200 SaaS companies, we’ve identified the five major problem areas that SaaS companies face.

You need to explore these areas deeper, focusing on one at a time and collect the necessary data to define the problem. These are the things that are stopping you from succeeding and stopping your customers from succeeding with you.

Let's use the first problem on the below list as the main problem inhibiting the growth of an example company, Acme.io:

poor unit economics.

5 MAJOR PROBLEM AREAS

that SaaS companies face

 <p>THE PROBLEM</p> <p>No problem acquiring customers, but poor business unit economics</p> <p>MOST LIKELY CULPRIT</p> <p>Pricing</p>	 <p>DATA NEEDED</p> <p>Price Sensitivity by Buyer Persona</p>	 <p>BEST TOOL FOR GATHERING DATA</p> <p>Price Sensitivity Studies</p>
 <p>THE PROBLEM</p> <p>Poor User Retention</p> <p>MOST LIKELY CULPRIT</p> <p>Pricing, Packaging</p>	 <p>DATA NEEDED</p> <p>Price Sensitivity; Relative Preference to Core Features and Value Propositions</p>	 <p>BEST TOOL FOR GATHERING DATA</p> <p>Price Sensitivity Studies, Relative Preference Studies</p>
 <p>THE PROBLEM</p> <p>Poor MRR Retention</p> <p>MOST LIKELY CULPRIT</p> <p>Pricing and Value Metric</p>	 <p>DATA NEEDED</p> <p>Price Sensitivity; Relative Preferences for Value Metrics; Histogram Analysis of Current Usage on Key Metrics</p>	 <p>BEST TOOL FOR GATHERING DATA</p> <p>Price Sensitivity Studies, Relative Preference Studies; Excel (for Histogram Analysis)</p>
 <p>THE PROBLEM</p> <p>Poor Acquisition Volume</p> <p>MOST LIKELY CULPRIT</p> <p>Value Propositions or Misaligned Channels</p>	 <p>DATA NEEDED</p> <p>Relative Preference for Value Propositions and Brand Promise</p>	 <p>BEST TOOL FOR GATHERING DATA</p> <p>Relative Preference Studies; User/ Customer Interviews</p>
 <p>THE PROBLEM</p> <p>Poor Conversion</p> <p>MOST LIKELY CULPRIT</p> <p>Pricing</p>	 <p>DATA NEEDED</p> <p>Price Sensitivity by Buyer Persona</p>	 <p>BEST TOOL FOR GATHERING DATA</p> <p>Price Sensitivity Studies</p>

PROBLEM: POOR BUSINESS UNIT ECONOMICS

➔ *Unit economics are the foundation for the rest of your business. If your unit economics don't make sense, then not only do you not have growth, you don't really have a company. You just have an extravagant way of spending money.*

This is why it sits in the #1 spot of our problems that SaaS companies face. If you don't nail this, then there is little point worrying about everything else.

Establishing your unit economics means drilling down into your metrics. In particular, customer lifetime value (LTV) and customer acquisition cost (CAC). We've met both of these in previous sections, but to recap:

➔ **LTV:** revenue obtained from a customer over their time using your product

➔ **CAC:** amount it cost for you to acquire a customer through your acquisition channels

Though you should always be looking for ways to maximize efficiency within a SaaS, cutting back on CAC is generally the unfavored option to increase your LTV/CAC ratio. Customers, particularly the high-value ones, cost money to acquire. Cutting back here means cutting back on acquisition, leading to further problems.

The best course of action is to increase LTV for your customers. The equation for LTV is:

Equation for Lifetime Value (LTV)

$$\text{LTV} = \frac{\text{ARPA}}{\text{CUSTOMER CHURN RATE}}$$

Simplified Equation for
Lifetime Value (LTV)

$$\text{LTV} = \frac{\frac{\text{SUM OF ALL CUSTOMER MRR}}{\text{TOTAL \# OF CUSTOMERS}}}{\frac{\text{\# CUSTOMERS WHO CHURNED}}{\text{TOTAL \# OF CUSTOMERS}}}$$

So to increase LTV you need to either increase the numerator, average revenue per user (ARPU), or decrease the denominator, churn rate. Ideally both.

ARPA tells you the average revenue per month you will receive from an active customer. Your churn rate is the number of customers that leave your product in a given timeframe.

➔ Here is the hypothetical pricing page of Acme.io. We can see what their current pricing, packaging, and positioning is:

➔ Positioning


Defined tiers for each of their buyer personas, going from small to medium to large companies.

➔ Packaging

Each package currently contains the same features and is separated only by the size of the value metric.

➔ Pricing

Distinct pricing points for each of their buyer personas.



Acme.io

20 widgets	50 widgets	250 widgets
\$20 per month	\$50 per month	\$250 per month
All features ?	All features ?	All features
Best for Small Companies	Best for Medium Companies	Best for Large Companies

This all looks great until you look at the underlying unit economics of the company, and each buyer persona, which tell you what you really need to know about the company:

TIER	BUYER PERSONA	% OF CUSTOMER BASE	ORIGINAL PRICING	MRR	ARPU	CHURN	LTV	CAC	LTV:CAC RATIO
SMALL COMPANY	SMALL SALLY	30%	\$20	\$600	\$20	20%	\$100	\$35	2:9
MEDIUM COMPANY	MEDIUM MARY	60%	\$50	\$3,000	\$50	3%	\$1,666	\$600	2:8
LARGE COMPANY	LARGE LAURA	10%	\$250	\$2,500	\$250	15%	\$1,666	\$1,200	1:4

➔ *The CAC for Small Sally's is low, but because of their high churn, their LTV is also fairly low.*

LTV:CAC is almost hitting the requisite 3:1 ratio, but these customers still aren't a pathway to growth.

➔ *Medium Mary's seem the happiest buyer persona according to their churn rate which is lower than the others.*

Their ratio isn't great, just below 3:1, but changes specific to this buyer persona are likely to produce smaller gains.

➔ *Even though Large Laura's are the high-value buyer persona that Acme.io should be attracting, their low LTV:CAC ratio is killing the company's growth.*

The costs associated with the acquisition of these customers outweigh the benefit of having them long-term, because of their high churn, low price point.

The LTV:CAC ratio is below the 3:1 ratio needed for real growth for all buyer personas, but particularly the largest customers. Looking deeper at the metrics, you can see:

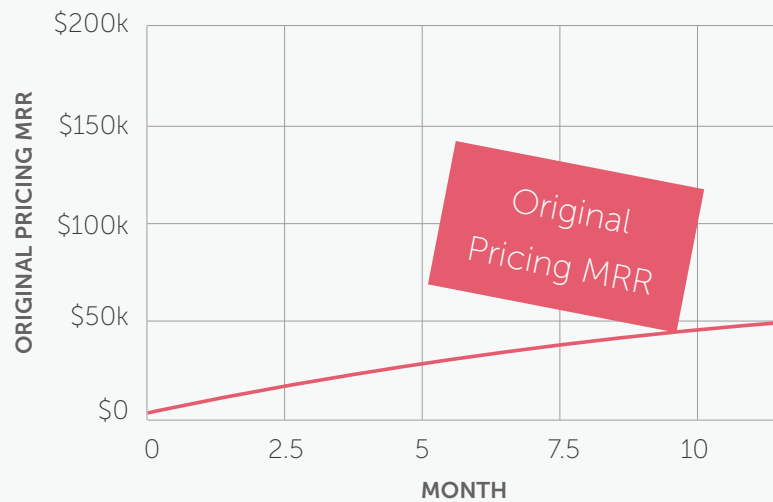
1. *Churn is high for both the smaller customers and the larger customers.*
2. *Not enough revenue is coming from the large, high-value customers.*

➔ *Both of these facts suggest the product isn't valuable to these essential buyer personas.*

Anyone seeing these static numbers would be worried, however, even they don't describe the whole problem. If these numbers stay the same, then any revenue growth the company is currently seeing will soon stagnate and plateau:

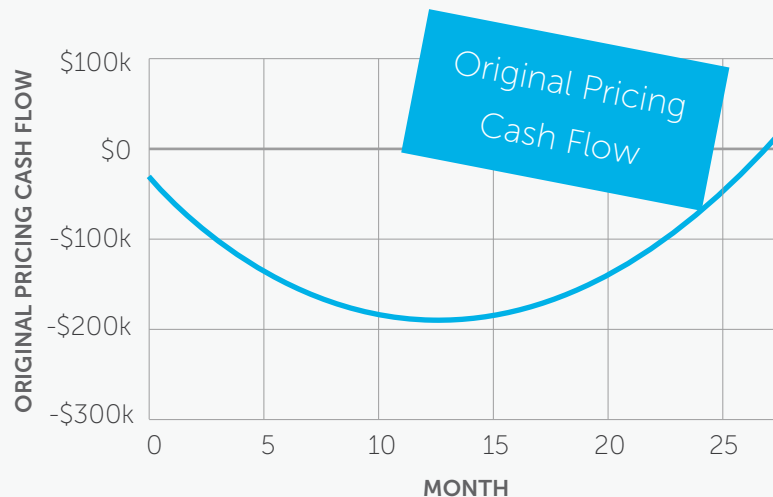
On the face of it, this looks OK. The graph is going up and to the right, right? But the problem with this low initial revenue is more evident when you take into consideration CAC.

Original Pricing MRR



Because customer acquisition costs are paid upfront, but SaaS revenues accrue over time, this leaves any company following the SaaS model with an initial cash shortfall while they pay back the CAC. Looking at the amount of cash the company has shown what a low LTV:CAC ratio can do:

Original Pricing Cash Flow



➡ *The company is in a cash trough for over two years with the nadir coming at almost \$250K in the red.*

This is unsustainable for any bootstrapping SaaS. Acme.io would need to have considerable funding to survive this profit drought, and no one would invest after seeing those metrics.

Acme.io has now defined its problem, low LTV:CAC. But this isn't the cause of their woes.

➡ *The next step is to discover the cause of this low ratio, why there aren't more high-value customers and why customers are churning out.*

Determining the Root Causes

You have to treat the cause, not the symptom. A low LTV:CAC ratio is just a symptom of an underlying disease in your company.

To find out what that underlying disease truly is you have to go to the source, your customers. Customers are the only people who can tell you why they don't value your product as it stands.

Companies don't do this for three main reasons:

➔ ***It is work***

Some customers might tell you where you're failing, but most will just churn out without a word.

➔ ***They're scared of what they will find out***

Disaffected customers will tell you things you don't want to hear. But these are exactly the things you have to hear.

➔ ***They think they already have the answers***

They think they know their product and know their customers. But it is that mindset that pushes companies entirely down the wrong path.

By asking the right questions of your customers, and adding the right data to your buyer personas, you can find out more about where your company is succeeding and where it is failing than you ever would looking

at an analytics dashboard. Yes, it is work. Yes, you will hear things you don't like. But all of this is data that makes your company better and moves you up and to the right.

CAUSE: INACCURATE WILLINGNESS TO PAY

➔ *Acme.io has buyer personas, but they aren't fully quantified. They have the metrics associated with them from their internal data, but by quantifying them fully they can dive into the root causes of their low LTV:CAC.*

In the previous section we introduced two fundamental market research techniques that companies can use (but don't) to better understand their customers and quantify their buyer personas:

1. *Feature value analysis*

Finding out from different customers what features they value the most and least within the product.

2. *Price sensitivity analysis*

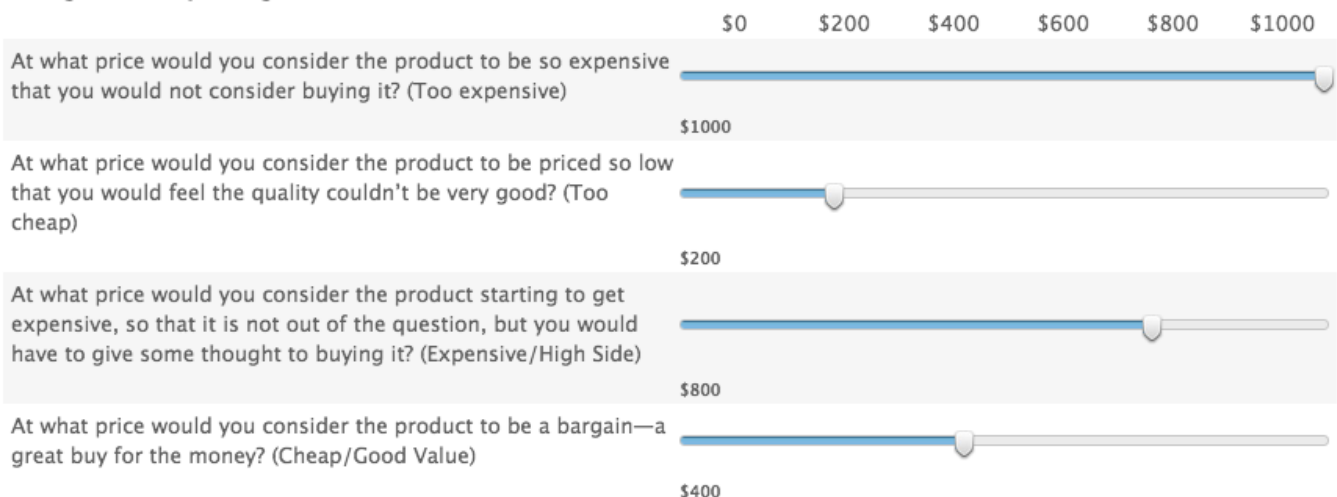
Asking customers what they are willing to pay for the product or a set of specific features.

Both of these can be used to determine the root cause of problem areas within a business. For Acme.io we are going to concentrate on using price sensitivity as willingness to pay has a fundamental effect on LTV. If the pricing isn't in line with each buyer persona's willingness to pay then those customers either won't sign up for the product or will leave the product when they don't realize its full value.

Price sensitivity questionnaires would then be sent to a representative sample from each of the buyer personas. This is why having well-defined buyer personas is so important. Without them, you would just get the average price across all your customers.

A sample of a reply from a Large Laura might look like this.

Willingness to Pay – Large Laura



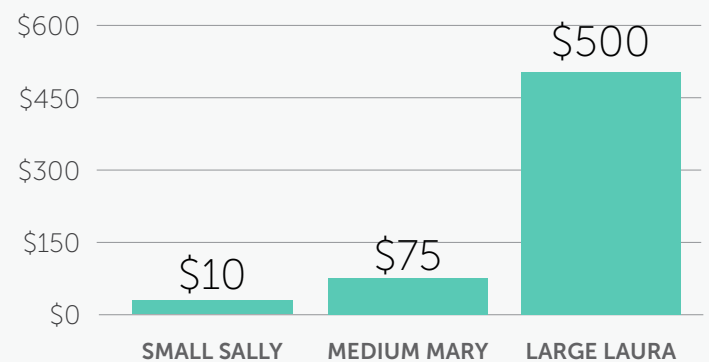
This hints at a partial cause of the problem. Large Laura customers are willing to pay far higher than the current price point for that buyer persona. In fact, the current price is very close to what these customers consider “low quality,” and under what they consider a bargain.

Large Laura’s aren’t signing up because they consider the product too cheap for them. Effectively, Acme.io has positioned themselves too low in the market to attract this buyer persona. This problem then cascades as the company then offers too few “widgets,” their value metric, at this price point, so those Large Laura’s that do sign up churn out as they can’t realize the full potential of the product for them.

Once you receive enough responses, you can collate the data and see what the willingness to pay is for each buyer persona.

This breakdown of average willingness to pay shows where the pricing for each buyer persona should be to line up with what the customers want. It gives us a jump-off point for the experimentation in the next part of our framework.

Average willingness to pay



➔ **Small Sally's are currently being asked to pay double what they are willing.**

Reducing their price point might make them less likely to churn.

➔ **Medium Mary's are close to ideal pricing, but could possibly be increased.**

A small increase here could increase their LTV.

➔ **Large Laura's are willing to pay much more than their current pricing.**

Their price point could be significantly increased.

None of this data is available without quantified buyer personas. This is one of the main reasons that people don't make these types of changes. They simply don't have the data available. Without it, you are stumbling in the dark when it comes to any pricing changes.

But with it, you can then move on to data-driven testing of these ideas to find the exact price point where value for your company and your customers align.

Testing Your Solutions

This is the fun/scary part. It's time to run tests to gather data to validate or invalidate your hypotheses. This is vital as you want to implement the best long-term pricing strategy that you can. By testing small changes often, you can constantly drill down into the best possible pricing solutions.

When companies don't do this they either:

➔ ***Don't make any changes, no matter how temporary,*** in case they upset the apple cart.

➔ ***Go straight to implementing all the changes they can think of immediately in one go,*** obfuscating any additional helpful data, and they are still in the dark about what really matters to their customers.

➔ *The benefits of these tests are that you can get reliable data quickly on each of your individual hypotheses. You can see what works, and what doesn't, and only take the time and effort to permanently implement the changes that maximize growth and revenue.*

SOLUTION: RUN MINIMUM VIABLE TESTS

➡ *A Minimum Viable Test uses the minimum amount of effort to validate or invalidate your hypotheses.*

In this case, that means changing your pricing in specific ways in 2-4 week sprints to see how that affects acquisition and retention, and how those affect your underlying metrics.

There are two big don'ts here:

1. *Don't try and test all these at the same time.*

Though you won't have the sample size for statistical power, trying to change too much at once will lead to confusion and less concrete data points.

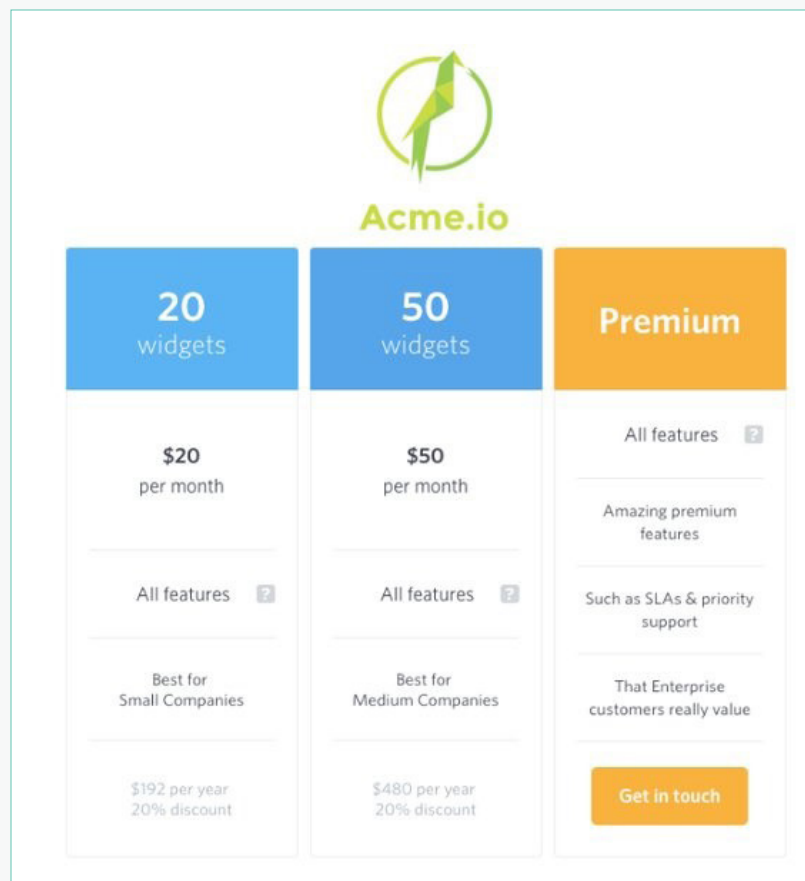
2. *Don't A/B test your pricing page.*

Again, unless you have thousands of customers signing up each day you won't have the statistical power for good results. Plus, if founder A finds out they're paying more for your product than founder B, they are going to get angry. Say goodbye to word of mouth referrals.

➡ *Hypothesis: Replacing our highest plan with "Contact Us" will allow us to pitch those folks higher priced plans.*

In the original pricing structure, \$250/month was the most obtainable from any given customer. Yet, the price sensitivity study of the largest customers found that they were willing to pay a substantial sum more for the product than this. They wanted and were able to pay more, but Acme.io couldn't release that value through their pricing structure.

The first test the company could run is to switch their highest-paid plan to a high-touch, “Contact us” plan for these large buyer personas:



This has two immediate benefits:

➡ ***Acme can now customize pricing for Large Laura’s and unlock value from these customers.***

➡ ***Medium Mary’s might also be interested in a slightly higher plan, and sales can now start a conversation with those customers as well about their needs.***

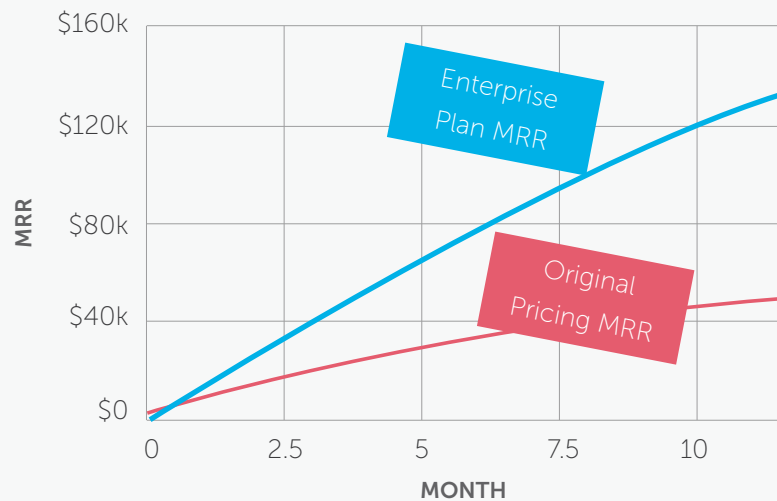
This will increase the MRR available from Large Laura’s, as well as their share of the customer base as Medium Mary’s are also likely to upgrade. As their needs now align better with the value of the product, they are also less likely to churn, leading to higher LTV.

With Large Laura’s willing to pay up to \$1,000/month before seeing the product as too expensive, this is a 4X increase on their original MRR. Even if we scale that down, as some customers will pay less, a 3X increase in ARPU is possibly from this type of pricing change.

Couple this with a significant increase in retention once these customers are happy with the product, and revenue can massively spike from this simple test:

➡ *This equates to a 2.8X increase in revenue within a year due to the increased month-on-month growth.*

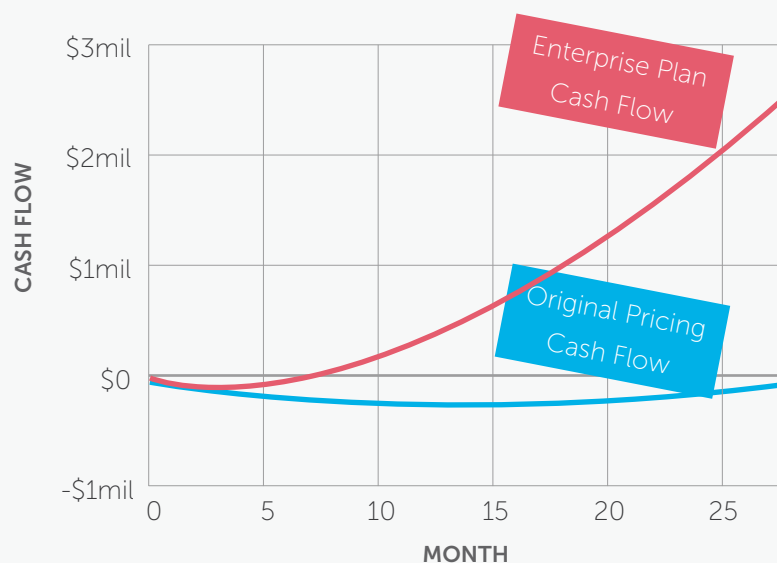
Original Pricing MRR vs Enterprise Plan MRR



More importantly for a bootstrapping SaaS is the impact on cash flow. Because this change has the potential to skyrocket your LTV:CAC ratio for these customers, the cash flow trough of the original pricing structure all but disappears:

➡ *The company is cash flow positive within six months, and the trough isn't as deep. Yes, there will need to be initial capital, but profitability occurs within half a year as the company continues to grow.*

Original Pricing Cash Flow vs Enterprise Plan Cash Flow




➡ *Hypothesis: Changing our prices up or down to align with willingness to pay will allow us to increase monetization.*

Not every company will be able to implement high-touch sales as quickly as they can change the HTML on their pricing page. A further possible test is to keep the self-service that makes SaaS great, but change the price points for each buyer persona. This coincides with the causes from the initial research. Small Sally's wanted to pay less, whereas Medium Mary's and Large Laura's wanted to pay more.

➡ In this test there is an upgrade of the medium/large plans and a downgrade of the smallest plan to better coincide with the willingness to pay of the separate buyer personas.

This again affects both MRR and churn to impact LTV. In the case of Small Sally, MRR will go down with the price cut. But as this price aligns with the value they see in the product better, churn will also be cut, leading to a higher LTV overall.

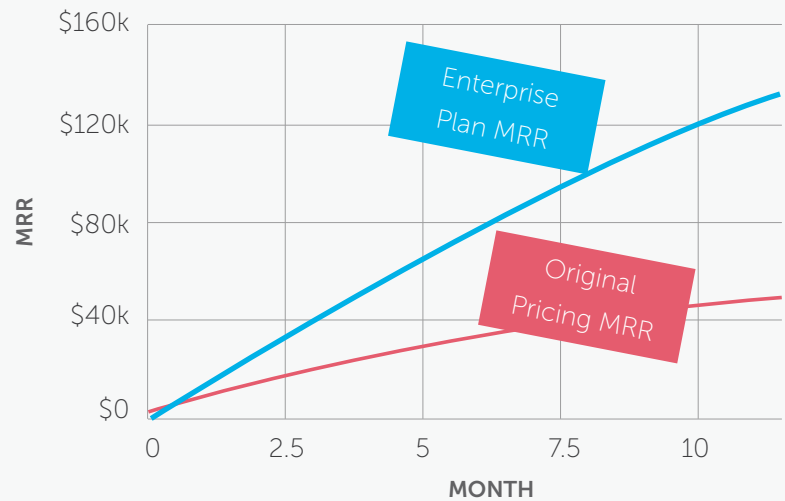


Acme.io

10 widgets	100 widgets	500 widgets
\$10 per month	\$100 per month	\$500 per month
All features ?	All features ?	All features ?
Best for Small Companies	Best for Medium Companies	Best for Large Companies
\$96 per year 20% discount	\$960 per year 20% discount	\$4800 per year 20% discount

Original Pricing MRR vs Enterprise Plan MRR

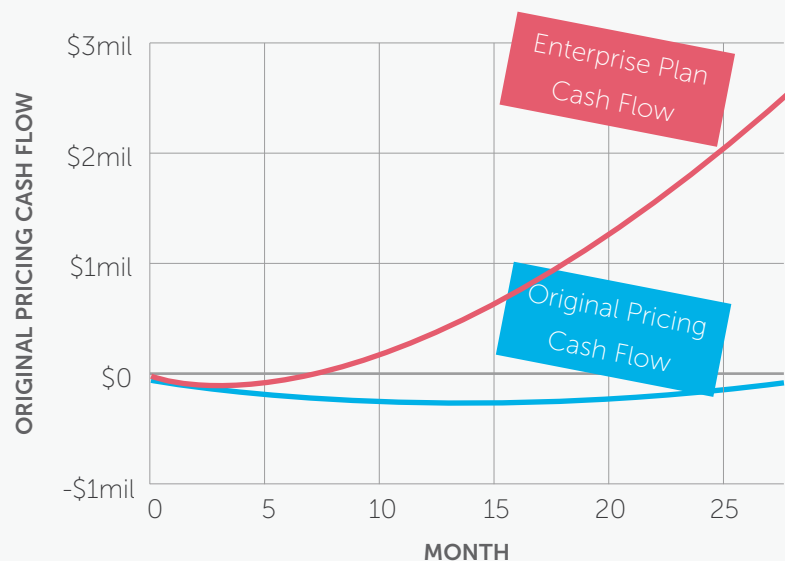
For both Medium Mary and Large Laura, the MRR increase from higher pricing and the lower churn from better alignment will lead to higher LTV and more overall revenue:



These pricing changes have a higher overall impact than just changing the highest priced plan to high-touch as it aligns all the buyer personas with the best value packaging for them. It's also better for cash flow as the CAC for each doesn't have to change because there is no additional sales team needed:

➡ *Again, the trough is shallower and quicker to turn net positive than with the original pricing, meaning that this is a step in the right direction for both Acme and its customers.*

Original Pricing Cash Flow vs Enterprise Plan Cash Flow




Implementation, Then Iteration, Iteration, Iteration

A company only makes money by offering value that aligns with what its customers want. This should be what you are always thinking about when deciding your pricing strategy.

Going live with major pricing changes is terrifying for any SaaS company. Will customer's blanch at the new prices? Will acquisition drop off a cliff? This is why people don't make these changes.

But with quantified buyer personas you can make these changes with fortitude, safe in the knowledge that the value aligns with what the customers want and what they are willing to pay. Having collected the data and run the tests, you can then make informed, secure decisions about your pricing.

For Acme.io, the next iteration of their pricing page might look like this:



Acme.io

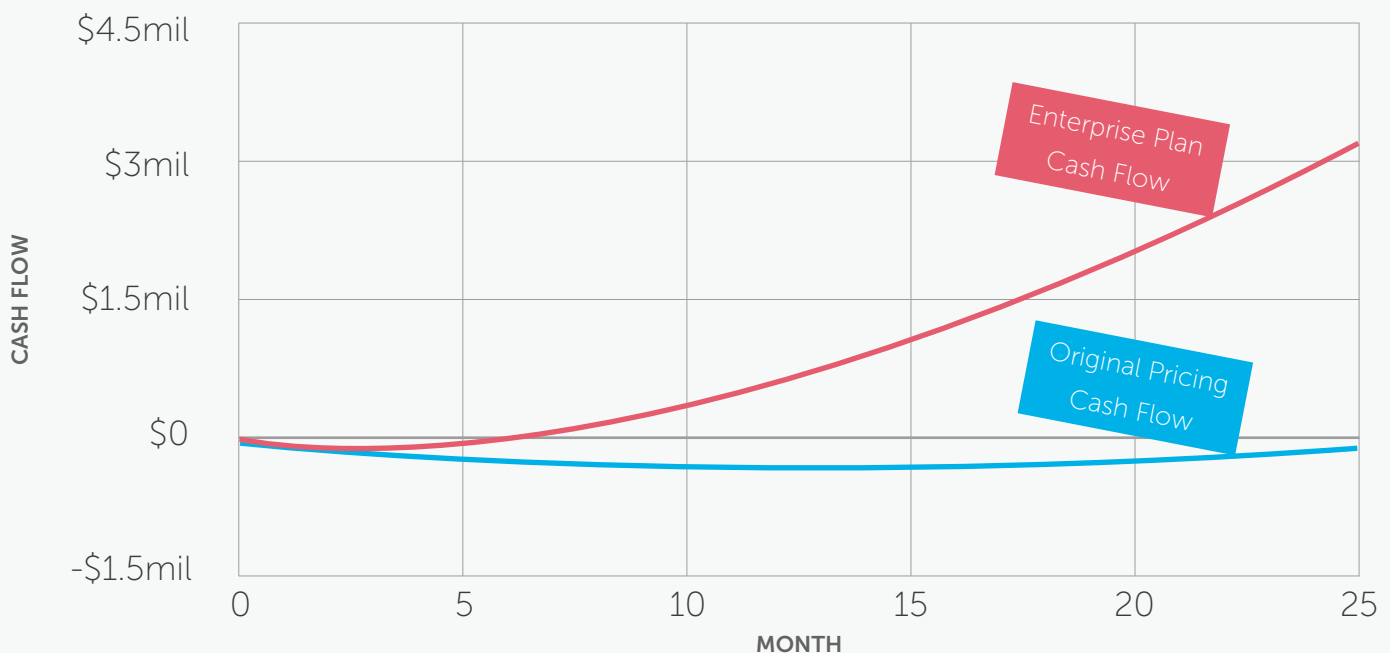
10 widgets	100 widgets	Premium
\$10 per month	\$100 per month	All features ?
All features ?	All features ?	Amazing premium features
Best for Small Companies	Best for Medium Companies	Such as SLAs & priority support
\$192 per year 20% discount	\$480 per year 20% discount	That Enterprise customers really value
		Get in touch

With this pricing, their two-year cash flow is drastically different from their original pricing structure.

➡ *This all through pricing changes that led to an increased LTV:CAC ratio, going from under 3:1 to over 9:1.*

Quantified buyer personas combine with an integrated pricing process to define the causes of problems in your business and solve them. This is the true power of quantified buyer personas. They allow you to know everything about your customers, then offer the right value to the right people.

Original Pricing Cash Flow vs Combined Changes Cash Flow





This isn't the end.

The next step for a company such as Acme.io is to go and tackle the next problem in the list and look for even more optimizations.

Continue to do this over and over again, finding problems, finding the cause, experimenting and fixing, working towards smaller and smaller goals, and a greater and greater understanding of your customers and company.

By developing quantified buyer personas you can get all this great data and work towards this goal of fantastic growth.

HOW TO FIND THE RIGHT VALUE METRIC FOR YOUR BUSINESS

In SaaS pricing, you've got to decide not only how much to charge, but what you're charging for.

This is your value metric.

Getting your value metric right is insanely important. A badly optimized value metric means that you aren't capturing all the value your product represents to your users. You also limit the value of your product for users, increasing churn.

A great value metric flips this around. Not only do you get more revenue and grow,

but you also unleash more value in your product for your users, decreasing churn and increasing upgrades.

In this section of The Anatomy of SaaS Pricing Strategy, we are going to take you through exactly how to build this great value metric and why it's critical to your success.


Why Value Metrics Are Vital in SaaS Pricing

In the previous section, we introduced Acme.io, our imaginary company that was crushing it with their buyer personas. If they hadn't been, their pricing could have been a lot worse:

This is a common type of pricing structure. You get full access to the service, then upgrades are based around other key features, such as analytics and dedicated support.

The problem with this is that a hobbyist using only one widget a month is charged the same as a megacorp using 100 widgets a month. If a large organization doesn't want analytics or support, they can continue to pay \$20 per month forever, even if they become the next Apple.

➔ *A value metric would allow Acme.io to capture this value as its prices according to usage. The more value a customer gets, the more they are charged.*



Basic plan	Plus plan	Premium plan
\$20 per month	\$50 per month	\$500 per month
All the Widgets ?	Basic features plus: ?	Plus features plus: ?
	Analytics & Integrations	Premium support & Compliance

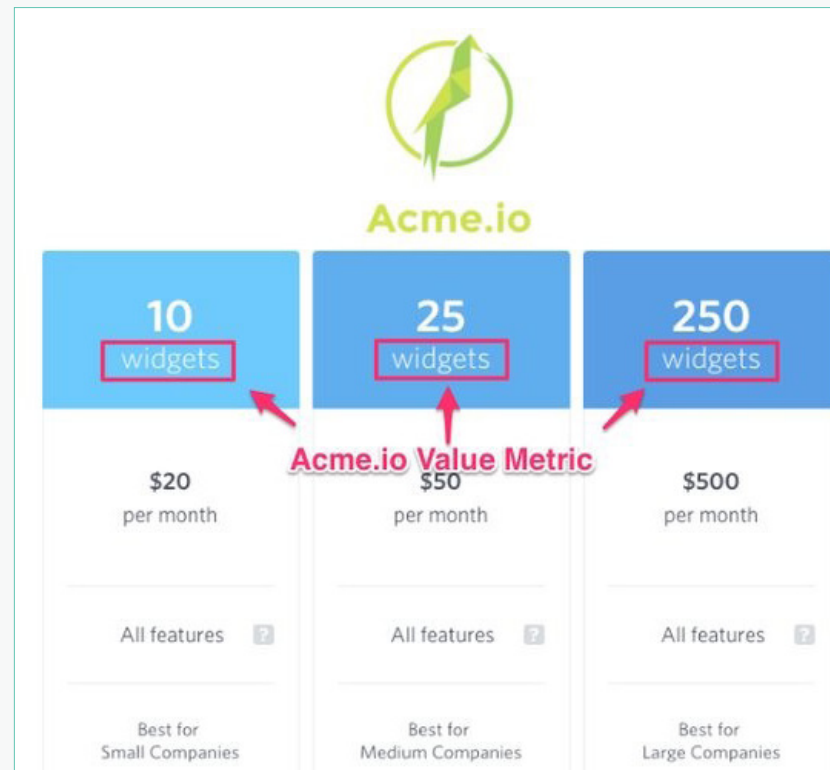
If the same pricing plan is redesigned around a value metric, the positives become evident:

Now customers are charged according to their use of the value metric, widgets. Each customer is paying for a certain number in their plan and will have to upgrade when they hit the threshold.

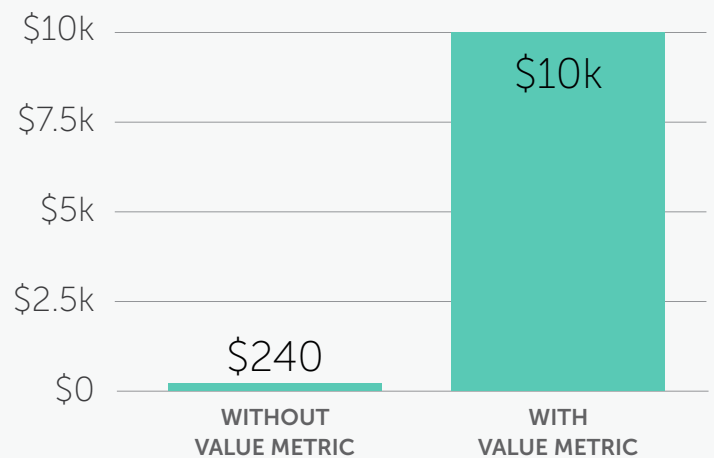
This means that the hobbyist can continue to pay \$20 per month, whereas the large company is now paying \$500. More in line with the value they receive. When extended over a year, this makes a massive difference.

➔ *This is 40X more revenue through changing pricing from a feature list to a value metric.*

This might be at the extreme end, but it is a beacon for what value metrics can achieve. A well optimized value metric allows you to grow as your customers grow. It puts you in lockstep. Their success is your success.



Annual revenue for one high-value customer with/without value metric



An optimized value metric needs three things:

1. *To be easy to understand*
2. *To align with your customer's needs*
3. *To grow with your customer*

We are going to take you through why each of this is critical for a value metric, and how you can design your value metric to hit these goals to increase growth for both you and your customers.

Making an Easy to Understand Value Metric

SaaS products can be complex. You could be offering seats on a CRM or help desk, analytics on financial or user data, or helping manage marketing campaigns, servers, or user authentication.

This is one of the great things about SaaS. For every complex problem one company has, another expert company is offering a valuable solution. But if they can't communicate that value and acquire customers, all that expertise is for naught.

When someone asks you to clarify your pricing, you know you have a problem. As we said in the first part of our SaaS DNA project:

“Your pricing page is where you guide customers through your marketing and sales funnels. If potential customers have no idea what your different plans offer, or a solid idea of what it's going to cost them, then they're never going to sign up for your service.

One of our takeaways from that section was that **simplicity is the key to pricing**. The more time it takes to understand, the less likely it is people will sign up. Value metrics are a way to encompass simplicity in your pricing.

Your value metric is the intersection between your pricing, packaging, and positioning.

These “3Ps” of pricing are what make your pricing page understandable to new customers:

➔ **Positioning**

The correct value metric allows you to align your product to different segments of the market and support them as they grow.

➔ **Packaging**

A value metric acts as the main component of your different packages and as the headline that differentiates them.

➔ **Pricing**

The pricing represents the ideal value of the value metric to the customer within each package.

➔ *It should be obvious within seconds to each buyer persona what your value metric is and which package fits their needs.*

The image shows a pricing table for Acme.io with three packages. A red arrow labeled 'Packaging' points to the widget counts (20, 50, 250). A red arrow labeled 'Pricing' points to the monthly prices (\$20, \$50, \$250). A red arrow labeled 'Positioning' points to the target audience descriptions (Best for Small, Medium, and Large Companies).

 Acme.io		
20 widgets	50 widgets	250 widgets
\$20 per month	\$50 per month	\$250 per month
All features ?	All features ?	All features
Best for Small Companies	Best for Medium Companies	Best for Large Companies

HOW TO MAKE YOUR VALUE METRIC UNDERSTANDABLE

- ➔ *To build an understandable value metric you have to decide which axes you are going to differentiate and charge along. This isn't about features, but specific, clear axes.*

This is a two-step process

1. **Define the high-level value of your product**

What are you actually offering your customers? Are you offering analytics, communication, storage?

2. **Consider the low-level components of this value**

If you break your product down, what are the smallest atomic elements that make up your value?

This makes your value metric specific for your company. One of the biggest mistakes we see SaaS companies making is defaulting to per user value metrics. But about 8 out of 10 companies using per user pricing should be using a different value metric, simply because their products probably don't provide more value with additional users, so charging for them doesn't make perfect sense.

This actually inhibits growth as customers are then reticent to add new "seats" to the app that they don't need to.

There are few use cases where it does make sense, those products where the phrase the more the merrier describes them well. CRMs, communication tools, and help desks all fit in this category.

Having more sales reps plugged into Salesforce, more team members on Slack, or more customer success agents on Zendesk will make your team more effective. The value is in having more people using these products. This is why Zendesk uses "per agent" pricing:

Once you have found a value metric that fits your product, you have to ask a fundamental question: does your customer know how many [your metric] he needs?

This is the single most important test of a value metric. If your value metric fails the final simplicity test, then it isn't going to be effective. That doesn't mean it has to be dumbed-down. Sometimes, your product is just complex and there is nothing much you can do about it.

→ A good example of this is data enrichment tool Clearbit.

Ultimately, the value metric for Clearbit is simple: API requests. But because it offers different types of APIs, and different buyer personas will have different use cases for these APIs, they have segmented them out to create a less linear pricing structure.

This means that instead of having convoluted triple or quadruple value metrics, each is separated and potential customers can quickly see where they fit. A customer can choose to only pay for the Enrichment API or the Discovery API if that best fits their needs.

Clearbit pricing

The image shows two screenshots. The top screenshot is the Zendesk pricing page, which displays four plans: ESSENTIAL (\$5/agent/month), TEAM (\$19/agent/month), PROFESSIONAL (\$49/agent/month), and ENTERPRISE (\$99/agent/month). The bottom screenshot is the Clearbit pricing configurator, which shows a 'Configure pricing' section with four API types: Enrichment (\$149/mo), Discovery (\$99/mo), Prospector (\$99/mo), and Watchlist. A slider for API requests is set at 2,500/month. Below this, 'ADD ONS' include Salesforce (\$100/month), Close.io (\$50/month), and Technology tags (\$50/month). The 'TOTAL PRICE' is \$149/month. At the bottom, a large green box shows the 'COMBINED TOTAL' of \$347/month.

Zendesk Pricing

Plans built for teams of all sizes. Start with 30 days for free.

ESSENTIAL	TEAM	PROFESSIONAL	ENTERPRISE
All the fundamentals with minimal setup	Work together better with your growing team	Customize and improve global performance	Ultimate cost flexibility
\$5 per agent per month*	\$19 per agent per month*	\$49 per agent per month*	\$99 per agent per month*
*Billed annually or \$9 month-to-month	*Billed annually or \$25 month-to-month	*Billed annually or \$59 month-to-month	*Billed annually or \$125 month-to-month
• Unlimited email addresses • Twitter and Facebook channels • Basic knowledge base • Web Widget & Mobile SDK • Agent Macros	Essential &... • Branded Help Center • Customer portal • Business rules • Performance Dashboards • Public Apps Marketplace	Team &... • Community forums • Multilingual content • Business hours & SLAs • CSAT surveys • Insights analytics • Custom private apps	Professional &... • Custom agent n... • Multibrand supp... • Ticket Forms • Multiple schedu... • Hourly insights • Launch Success... • Auditing & adm...
TRY BUY	TRY BUY	TRY BUY	CONTACT SALES

START YOUR FREE TRIAL

Configure pricing

Enrichment	Discovery	Prospector	Watchlist
\$149 /mo	\$99 /mo	\$99 /mo	

API REQUESTS

2,500 / month \$99 / month

100k

ADD ONS

S	C	T
Salesforce	Close.io	Technology tags
\$100 / month	\$50 / month	\$50 / month

TOTAL PRICE

\$149 / month you@email.com TRY FOR FREE

\$347 / month

COMBINED TOTAL

TAKEAWAYS:

- 1. Make your value metric easy to understand**
so that when new customers visit your pricing page, they can immediately understand what they would be paying for and where they fit in your packaging.
- 2. Start to define your value metric by considering the low-level components of your high-level value.** This will make your value metric specific to your business and help with customer alignment and growth.
- 3. Always perform a simplicity test on your value metric.** If a customer doesn't know how many of your metric they will need without asking, it won't be effective.

Aligning Value Between Customer and Company

Aligning your value metric with your customer's needs is crucial for growth. If your customers can't get what they need from your product, they will quickly churn out. However, if they can get what they need, then they will be successful and will, instead of churning, upgrade.

This has a drastic effect on customer lifetime value. Lifetime value (LTV) is calculated using the average revenue per user (ARPU) and churn:

If ARPU is \$100 and your churn rate is 10% per month, then your LTV is \$1000:

Equation for Lifetime Value (LTV)

$$\text{LTV} = \frac{\text{ARPA}}{\text{CUSTOMER CHURN RATE}}$$

LTV Equation: Example

$$\text{LTV} = \left(\frac{\$100 \text{ ARPA}}{0.1 \text{ CHURN RATE}} = \$1000 \text{ LTV} \right)$$

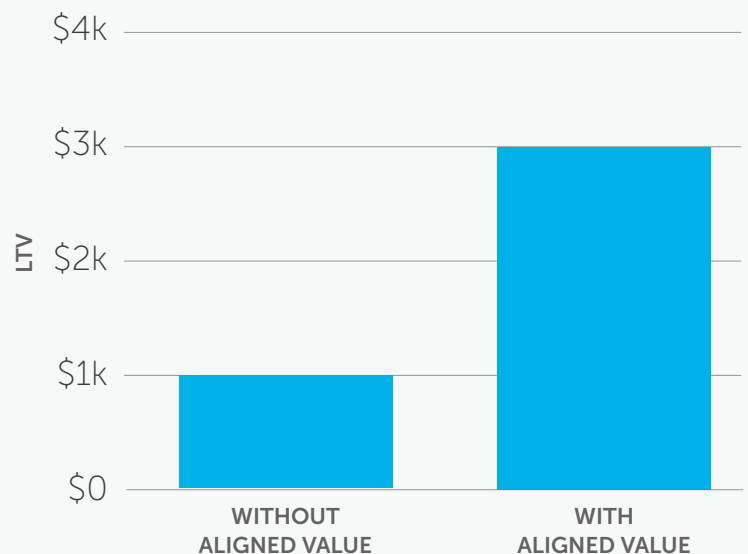
Alignment of value between customer and company can change both these numbers. Customers will upgrade, increasing ARPU. As they upgrade and become increasingly

successful with the product, churn decreases. Only minor changes in each are needed to significantly change LTV.

For instance, if ARPU increases to \$150, which would be an understandable jump with value metric pricing, and churn halved, again understandable if customers see greater success with the product, then that \$1000 LTV becomes \$3000:

This is a 3X increase through minor changes. Considering that you need at least a 3:1 LTV:CAC (customer acquisition cost) ratio to achieve sustainable growth in SaaS, being able to 3X your LTV is a major advance. Your CAC will either remain unchanged, or could decrease as upsell becomes more important than acquisition and happy upgrading customers spread word of mouth about your amazing product.

LTV with aligned value through value metric



HOW TO ALIGN VALUE THROUGH RELATIVE PREFERENCE ANALYSIS

➡ *Once you have considered what potential axes you could price across to make pricing easily understandable, the next step is to reach out to customers and find which best suits their needs.*

You align your value metric with your customer needs through relative preference

analysis. We touched on this in the sections covering buyer personas.

In this hypothetical, let's consider an email platform. There are a number of potential value metrics that you could consider. You could charge per email sent, or per received email, or for the number of contacts each account can keep. Or you could use per-user pricing, and charge by the number of team members who can access your account.

1. In terms of [COMPANY] pricing, which of the following when it comes to pricing is most preferred? Least preferred?

	Most Preferred	Least Preferred
# of emails sent	<input type="radio"/>	<input type="radio"/>
# emails received	<input type="radio"/>	<input type="radio"/>
# of users accessing account	<input type="radio"/>	<input type="radio"/>
# of contacts	<input type="radio"/>	<input type="radio"/>

Measuring user preferred value metrics

This allows you to measure exactly what the most appropriate value metric is for your product. You simply ask your customers which value metric is most and least suitable for them. It forces people to make a decision:

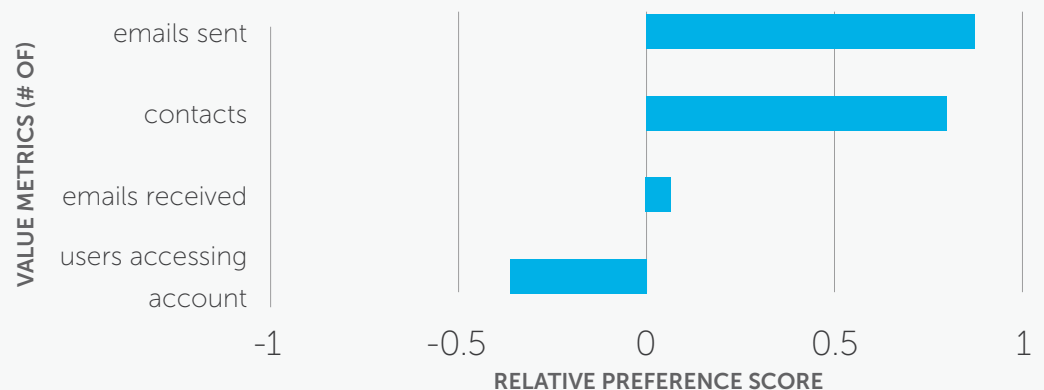
Once you've asked enough people, you can calculate a score for each value metric using:

$$\frac{\text{\# TIMES FEATURE IS MOST WANTED} - \text{\# TIMES FEATURES IS LEAST WANTED}}{n}$$

Plotting these scores shows you exactly what value metric your customers prefer.

➔ *Most of the customers see being able to send more emails as the most valuable component of your product, followed closely by maintaining more contacts in their accounts. They certainly don't care about having more team members accessing the account.*

Relative preference scores for different value metrics



From here, there are two potential avenues. The value metric can be set as the number of emails a customer can send in each tier. Alternatively, a dual value metric could be used, as customers see value in being able to send more emails, but also to keep more contacts in their accounts.

This is what behavioral email platform Customer.io use:

With a tool such as Customer.io, users get value not only from the number of emails they can send, but also from the size of their email list.

Emails that scale with you				
Join 900+ happy customers who have changed the way they email				
Start for Free				
You'll get 200 profiles and 400 monthly emails on our free plan. When you're ready, you can upgrade to one of the plans below.				
Growth	Recommended Small Business	Startup	Enterprise	Pricing calculator
\$100 /mo <small>\$91 /mo if paid annually</small>	\$250 /mo <small>\$229 /mo if paid annually</small>	\$750 /mo <small>\$687 /mo if paid annually</small>	\$1250 /mo <small>\$1145 /mo if paid annually</small>	\$250.00/mo <small>Total</small>
15,000 profiles <small>\$0.005 for each additional profile</small>	50,000 profiles <small>\$0.003 for each additional profile</small>	250,000 profiles <small>\$0.002 for each additional profile</small>	500,000 profiles <small>Get custom pricing</small>	Profiles <input type="text" value="50,000"/>
30,000 free emails <small>\$0.12 per 1,000 additional emails</small>	100,000 free emails <small>\$0.12 per 1,000 additional emails</small>	500,000 free emails <small>\$0.12 per 1,000 additional emails</small>	1,000,000 free emails <small>\$0.12 per 1,000 additional emails</small>	Monthly Emails <input type="text" value="100,000"/>
Add Team Members	Add Team Members	Add Team Members	Add Team Members	Sign Up for Free

TAKEAWAYS:

1. **Aligning your value with your customer's needs leads to increased LTV and the potential for reducing CAC.**
In turn, this leads to increased growth for both you and your customers.
2. **It is vital that you ask your customers what they consider the best value metric.** They know what they value the most in your product and what they are willing to pay for.
3. **If customers see different value metrics as important, consider constructing a dual value metric** to capture the highest potential value.

Why A Value Metric Means You Grow As Your Customers Grow

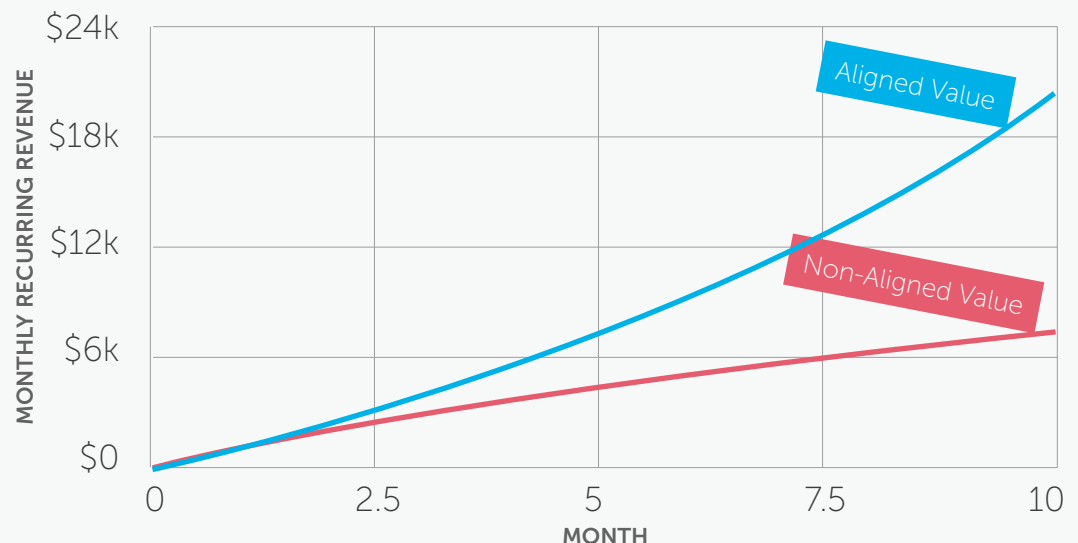
The ultimate aim of your product is to make your customers successful. Even if you are only a small part of that success, you are making their lives easier, making them more efficient, and allowing them to grow.

A well-defined value metric provides a path to growth for both you and your customer: when they grow, you grow.

This is why value metrics are such a fundamental component of pricing. They are the main driver of expansionary MRR, which

is more MRR you receive from your existing user base. This leads to the almighty, holy grail of SaaS known as net-negative churn, meaning when you put a dollar into your SaaS machine, you actually end up getting much more out.

Growth through aligned value




In this scenario, the blue line shows no alignment between the value metric and what the customer needs. It could be that the value metric is per user, whereas what the user really needs is more storage. Churn is high (10%), while expansion is low (1%). Growth is constrained and will plateau within two years.

The red line shows what happens if you switch these numbers through aligning value. If the company is offering different levels of storage, then as the customer grows they are going to need more and more. They will upgrade to the next step in the price ladder, passing on that growth to the SaaS company. Here churn is low (1%) and upgrade rates high (10%) because the customer can be successful with the product.

HOW TO GROW WITH YOUR CUSTOMERS THROUGH TESTING

➔ *Growing with your customers is all about getting the thresholds for your value metric correct. Though you should have an idea of the correct pricing and thresholds from your buyer persona willingness to pay data, the only way to drill down on exactly what works is to continually test and optimize.*

Let's go back to Acme.io. A previous version of their pricing page could have looked like this:

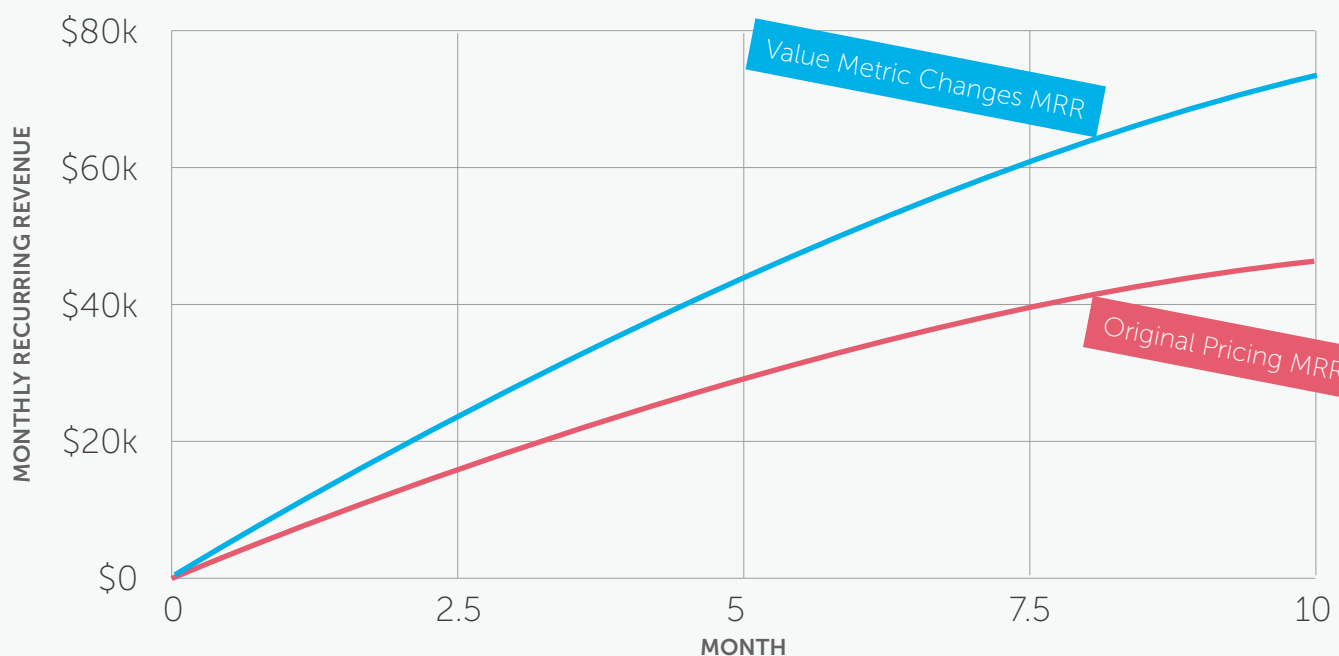


10 widgets	100 widgets	500 widgets
\$10 per month	\$100 per month	\$500 per month
All features ?	All features ?	All features ?
Best for Small Companies	Best for Medium Companies	Best for Large Companies
\$96 per year 20% discount	\$960 per year 20% discount	\$4800 per year 20% discount

Initially, this makes sense. The pricing lines up neatly with the value metrics. It looks like it should work. But on closer inspection, the thresholds are spread too far apart. Essentially, customers have no need to use up all of their widgets within their plan, so don't feel the need to upgrade.

By reducing the value metric by half, each buyer persona hits their quota earlier and are more likely to upgrade. Even this small change can change revenues significantly:

Original Pricing MRR vs Value Metric Changes MRR



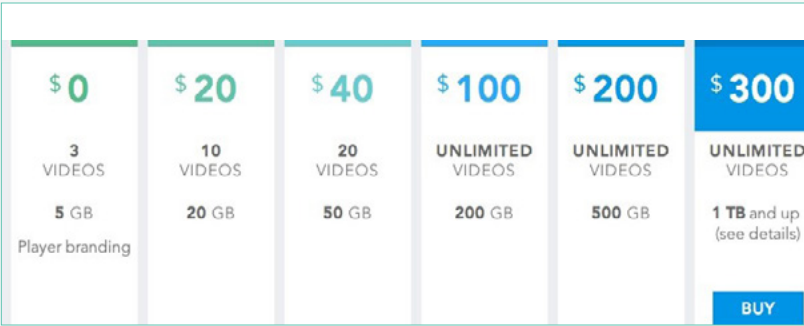
This is the kind of data that you can only get by putting your pricing in the wild. You have to get it in front of customers to understand how it is really understood and utilized. From there, you can start making the changes needed.

When we first wrote about value metrics we used Wistia as an example of a company that was doing it right. When we wrote that article, their pricing page looked like this:

They had a dual value metric, videos and bandwidth. We loved the idea of videos as a value metric, as this was something intuitive to the product. Bandwidth was a more difficult concept for some users to understand

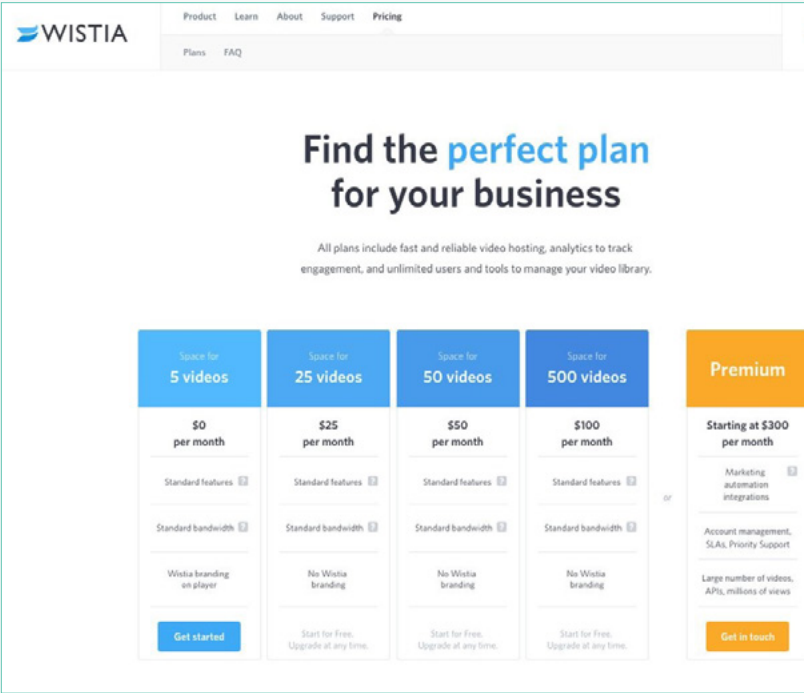
Today, their pricing page looks like this:

➡ *One single value metric: videos.*
As your business needs to host more and more videos as it grows, Wistia's value metric will grow with you.



This screenshot shows Wistia's old pricing page. It features six pricing tiers arranged horizontally. The first tier is free (\$0) for 3 videos and 5 GB of bandwidth, with 'Player branding'. The next three tiers are \$20, \$40, and \$100, each offering 10, 20, and 200 videos respectively, with increasing bandwidth (20 GB, 50 GB, 200 GB). The final tier is \$200 for unlimited videos and 500 GB of bandwidth. A sixth tier, partially visible, is \$300 for unlimited videos and 1 TB of bandwidth. A 'BUY' button is located at the bottom right.

Price	Videos	Bandwidth	Other
\$0	3	5 GB	Player branding
\$20	10	20 GB	
\$40	20	50 GB	
\$100	UNLIMITED	200 GB	
\$200	UNLIMITED	500 GB	
\$300	UNLIMITED	1 TB and up	(see details)



This screenshot shows Wistia's current pricing page. It features five pricing tiers arranged horizontally. The first four tiers are for 5, 25, 50, and 500 videos, with prices of \$0, \$25, \$50, and \$100 per month respectively. The fifth tier is 'Premium' starting at \$300 per month. Each tier lists 'Standard features' and 'Standard bandwidth'. The \$0 tier includes 'Wistia branding on player', while the others do not. The \$0 tier has a 'Get started' button, while the others have 'Start for Free, Upgrade at any time.' buttons. The Premium tier has a 'Get in touch' button.

Plan	Price	Videos	Branding	Action
5 videos	\$0 per month	5	Wistia branding on player	Get started
25 videos	\$25 per month	25	No Wistia branding	Start for Free, Upgrade at any time.
50 videos	\$50 per month	50	No Wistia branding	Start for Free, Upgrade at any time.
500 videos	\$100 per month	500	No Wistia branding	Start for Free, Upgrade at any time.
Premium	Starting at \$300 per month	Large number of videos, APIs, millions of views		Get in touch

➡ *This is what pricing should look like.*

Constant iteration. Wistia has continually updated their pricing and value metrics throughout their existence.

TAKEAWAYS:

1. **The best thing about value metrics is that they allow you to capture more value as your customers grow.** The better they do through your product, the better you do as well.
2. **The only way to drill down to this ideal alignment between company and customer is through testing.** Put your value metric out there and see how it performs with real customers.
3. **Constantly implement and test different ideas. This iteration should never end.**



Value metrics are the best way to optimize your pricing for growth.

They work through aligning your product with what your customers really want and need.

Building an effective value metric isn't difficult, but it does require adhering to a pricing process. That means thinking about pricing constantly, reaching out to your customers about your pricing, and being brave enough to constant update and iterate to find that sweet spot that works for both you and your customers.

Without a value metric you can't grow efficiently.

With a value metric, you will grow alongside every single one of your customers.

HOW YOUR COMPANY CAN BUILD A PRICING MACHINE

Throughout this guide we've shown you the importance of an effective pricing strategy. Every company already has access to a ton of data to build the best pricing for their company.

But implementing a great strategy is another challenge altogether.

Without buy-in from your entire company, and a practical pricing process in place, all your hard work to find value for your customers will be for naught.

In the section of The Anatomy of SaaS Pricing Strategy, we are going to show you how you can build a pricing machine

that will align your people and processes around value and pricing. Instead of the set-it-and-forget-it approach that most companies take with pricing, building a machine that builds pricing will mean you are constantly optimizing your pricing strategy every single day.

Building the Machine That Builds Your Company

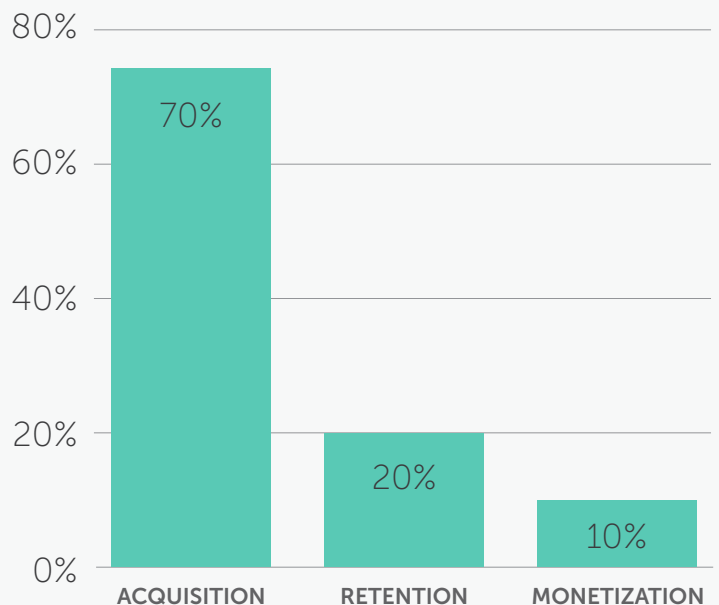
Attaching value to the products or services you deliver is one of the most important business decisions you're going to make. It is a fundamental component to success.

Yet, our studies of SaaS companies have shown that most businesses only think about pricing for 6 hours. That isn't per month or even per year. That is in the entire lifetime of the company. To illustrate this, let's look at one of our most harrowing findings from researching SaaS pricing:

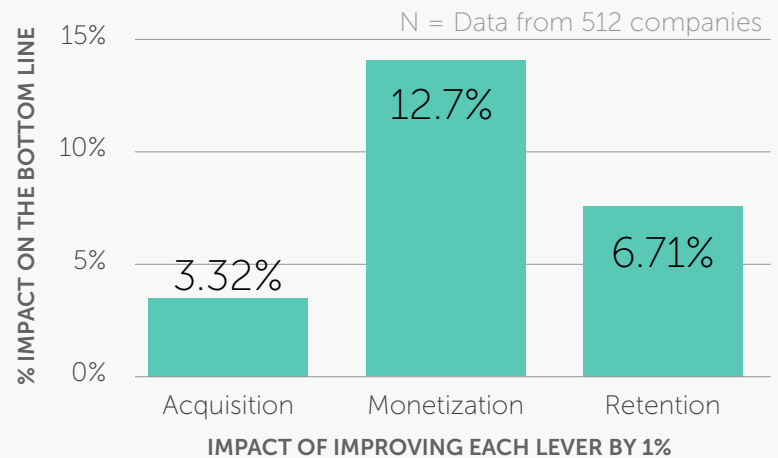
➔ ***When we studied 10,342 blog posts about growth in SaaS, only one in ten was about monetization.***

70% instead were talking about growth purely in terms of user acquisition.

References in blog posts to 3 growth levers



Impact of improving each growth lever



Though monetization is the least referenced growth lever across SaaS, it is actually by far the most effective:

This data, taken from our study of 512 SaaS companies, shows that just a 1% improvement in monetization allows you to increase revenue by 12.7%. This makes it by far the best growth lever in your business. Monetization is almost 4X more effective than acquisition at raising your bottom line.

The fact that all the talk is about acquisition while all the growth is made through monetization shows that companies aren't taking their best growth lever seriously. When it comes to pricing, companies lack:

➔ **Commitment**

Companies spend an average of 6 hours total on pricing but spend hundreds of hours on acquisition (2015 survey of 312 companies).

➔ **Expertise**

No one is hired to manage the pricing process, instead getting handed off to "whoever wants to take the project on."

➔ **Process**

Pricing is treated as "argue, guess, and check" rather than a validation process ingrained in customer development.

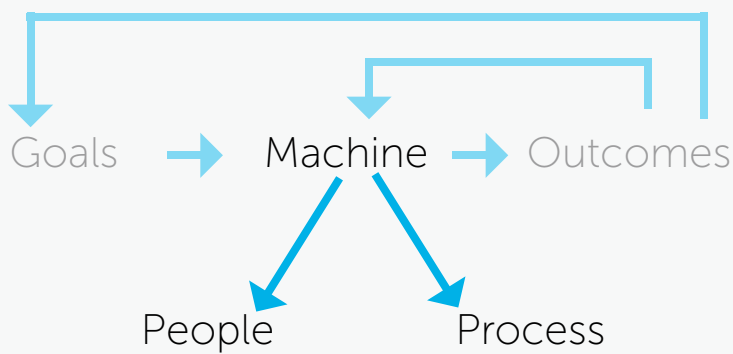
But these problems aren't solved by accident. When you look at acquisition and retention in companies, it is obvious that they have processes set up to maximize these growth levers. The same cannot be said for monetization.

MACHINE = PEOPLE + PROCESS

Dennis Crowley, co-founder and CEO of Foursquare says:

“The hard part is building the machine that builds the product.”

It's not just product. The hard part about building a company is building all of the individual machines that make it sustainable and successful. Ray Dalio, founder of Bridgewater Associates, sees this machine as “consisting of the right people doing the right things to get what they want.”



Each company has serious discussions every week around acquisition. Which channels are working, which aren't, and what strategies they are trying to get more users. They have an acquisition machine, made up of specific people and processes.

What most companies lack is a pricing machine. The input of this machine is pricing goals—increased growth, better LTV/CAC ratio—as its inputs, and the pricing outcomes work as feedback to allow you to optimize your goals and run the machine itself more effectively.

The machine itself has two parts:

➔ Pricing People

The team members who are going to decide exactly what your pricing structure should look like.

➔ Pricing Process

How they are going to implement your pricing and make changes over time.

Over the next two sections, we'll show you why your team and your processes are the essential components to the machine that will be the engine of your growth.

Aligning Your Team Around Pricing

The first part of your pricing machine is the people. Each and every person in your company is impacted by the pricing strategy, so it is crucial that your team is aligned around your pricing goals. This is the only way to maximize revenue.

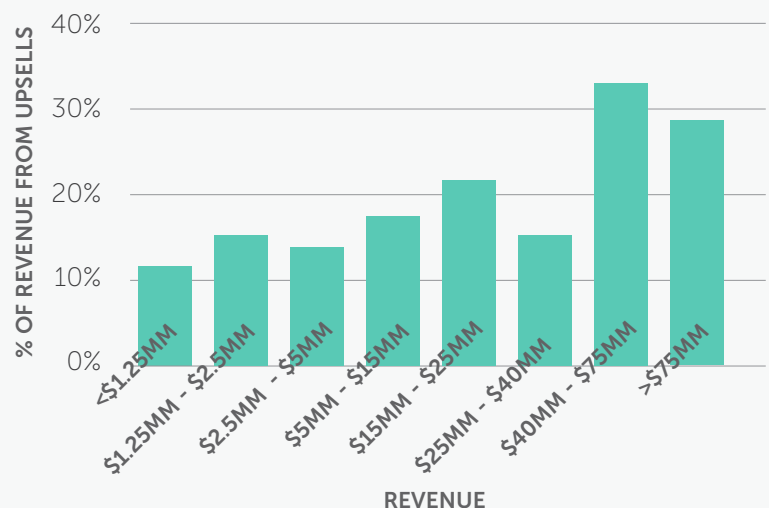
➡ *When we studied over 270 SaaS businesses, only 17% saw pricing as a team endeavor.*

This is damaging to your growth because alignment of your team around customer value is critical to upselling. And upselling is critical for SaaS growth.

Upsell is when your customers find so much value and success with your product that they themselves grow and move up within your price tiers. You get more revenue from these customers with almost no extra customer acquisition costs. Therefore it is a major revenue generator for SaaS companies:

Here is data from the 2015 Pacific Crest SaaS Survey. What it demonstrates clearly is that SaaS companies with higher revenues get more of that higher revenue from the upsell than smaller companies. By doing this, they are also spending less money, as they have already acquired the customers.

Percentage revenue from upsells



The same survey showed that whereas it took companies on average over 14 months to recoup CAC for new customers, it only took 3 months to reclaim the costs of an upgrade.

So to have success in SaaS, you need to make a significant proportion of your revenue from these upsells. But upsell only happens if your customer has found the core value in your product that they initially wanted.

Consider if a company has no alignment around the value a customer is getting, and therefore no alignment around pricing.

This means each department has different incentives, and none align with what the customer values.

➔ **Marketing**

Has no strategic messaging to appeal to different buyer personas.

➔ **Product**

Have no idea of the features that customers are actually after. Their roadmap is either empty, or filled with internal ideas that the engineers deem necessary.

➔ **Sales**

Offer prospects everything under the sun to close the deal. Make a promise of features that aren't on the roadmap and value that doesn't really exist in the product. Push discounts to close deals within the quarter.

➔ **Customer Success**

Are constantly dealing with customer complaints and trying to resolve issues. Fighting an uphill battle against customers that can't find the nonexistent value they were promised.

Customers churn out of a company and product built like this at a high rate. They certainly don't upgrade.

GETTING THE RIGHT PRICING TEAM IN PLACE

- ➔ *When everyone on your team is on the same page with pricing, it makes upselling to customers far easier. Optimizing the funnel for upsell is all about aligning the team around customer value.*

➔ *Marketing can acquire the right leads*

➔ *Sales will maximize their deal value*

➔ *Product will use feedback to build the product*

➔ *Customer Success can increase user engagement.*

Everyone has the customer's value at the heart of their thinking. Sales want customers to find continual value in the service, Product delivers that value, and Success guides them through their journey. These customers upgrade.

To get this alignment you need to commit to pricing, designate a point person, and put together a pricing committee. Depending on your size, the point person can be:

➔ *In a small company*, an individual in product, business development, or marketing that takes on pricing strategy as a 20% project.

➔ *In a large company*, a full-time pricing strategist with a background in one of these disciplines.

Once you have that point person in place, you can motivate them to set up a pricing committee. The idea of a committee is to be a strong hand on your pricing

lever, guiding the strategy, and identifying strengths and weaknesses in your machine as you optimize.

This committee should have equal representation from within your organization:

➔ *Sales will provide valuable insights into the sales tactics that are working in pricing conversations.*

➔ *Marketing will provide necessary customer persona data.*

➔ *Product will know the roadmap.*

➔ *Finance will know the current revenue goals.*

At the very end, you need one key decision maker who has final decision making authority for implementation. This should be someone at the very top of the organization, such as the CEO, that can get everyone involved.

Your Pricing Committee

Product Leadership

**Corporate Dev/
Finance**

Sales Leadership

Marketing Leadership

Main Coordinator

Typically in Product or Marketing



Main Decision Maker

Could be a member of the committee, as well

Establishing Your Pricing Process

As we said right at the top, pricing is not a priority for most SaaS companies. They are not even thinking about it, let alone implementing the processes necessary to optimize.

Some SaaS companies will be shipping updates to their product every single day. Yet, they might not have made any changes to their pricing in years. You need a defined cadence to your pricing updates so that you can constantly capture the value of any product improvements you are making.

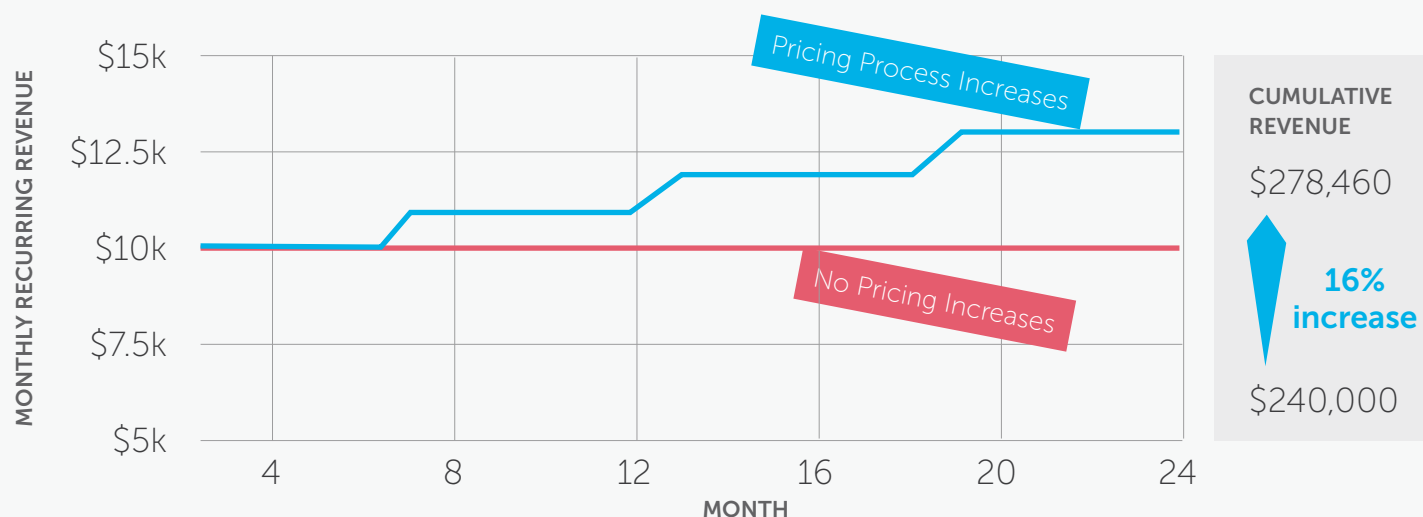
Whenever you make a product change, you should be recalculating your value and translating that value into pricing. Movement is growth. Pricing changes don't always mean higher prices. It could be changing value metrics, shifting features within tiers,

or even just changing the language on your pricing page.

➔ *If you're not constantly testing and iterating your pricing like this then your company will be stagnant.*

Imagine that every 6 months; you made improvements to your product that increased its value to your customers by 10%. If you are not changing your pricing somehow in lock-step with those product improvements then you are leaving money on the table.

Pricing improvements with staggered price increases



Here, a product with 100 customers starts out charging \$100 per month for the service. But every 6 months product improvements are made. In one scenario (blue), the company isn't taking pricing seriously and leaves the price of the product the same. In the second scenario (red), pricing changes are

made concurrently with product changes to capture extra value.

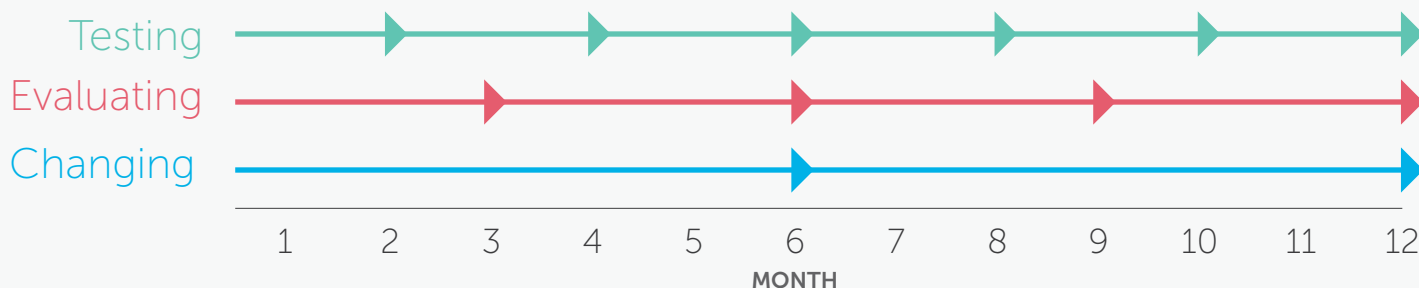
After two years the cumulative revenue has increased by 16%, and MRR is 33% higher, all through constant recalculating of pricing to match value through a stringent pricing process.

TEST, EVALUATE, CHANGE

*Building a pricing process isn't hard.
You just need a defined cadence.
Here is what we suggest:*

Every 8-9 weeks you run market research and implement your testing. Every three months you evaluate your current pricing structure. Every six months you make pricing changes.

That's it. Like we said—not difficult.



Testing Pricing

Typically, this is an eight-to-nine week sprint that involves collecting data on your customers and current pricing, making decisions on changes via your pricing committee, running an impact analysis, and

deciding on a communication plan for your customers.

If it coincides with your larger evaluating or changing cycles, it might also include implementing any changes:

Changing Your Pricing




Price Intelligently

The middle section of this cycle is something that often gets missed. Companies might collect the data and move to implementation, but they miss the point where they tell customers how awesome the change is.

It is essential that your pricing committee develops a communication plan and then starts talking to your customers. As Jeanne Hopkins, CMO at Continuum told us at SaaSfest, you have developed

a superior product, with more value and a better experience, so you have to tell your customers all of that.

 *This part of the process lets you get feedback on the changes, identify pain points, and also tests your internal strength. If your pricing changes can't withstand this level of critique, they are not going to survive in the real world.*

Evaluating Pricing

At the end of every quarter you should be evaluating your pricing strategy. This allows you to always have a perspective on how your pricing machine is performing compared to your pricing goals. Ideally, you should have just one performance-

based goal per quarter, whether that is increasing growth over that quarter, or improving your LTV/CAC ratio. By having just one compass metric to change with your pricing machine, everyone knows what this ultimate goal is.

Every three months is probably a too small cadence to make major pricing changes. It is possible to make changes at this resolution for small, new companies that are trying to work out their initial pricing structures. But for most customers, pricing changes at this speed would put them into too volatile of a pricing environment.

However, you can make smaller changes that just impact your upgrade and downgrade rates, such as:

➔ **Reduction in value metric**

Setting your value metric correctly is critical to optimizing for the upsell. Evaluating different thresholds allows you to find the best way for customers to get the greatest value at each tier, while pushing them to upgrade when they need to.

➔ **Reducing discounting thresholds**

We are not a fan of discounts overall, but sometimes they are necessary. Pushing these lower while still incentivizing customers to choose annual pricing is a good way of increasing revenue through pricing changes.

➔ **Moving features or adding features**

Your tiers shouldn't be set in stone. As you get to understand more about what your customers value through testing and feedback, you can move features between tiers to maximize both value and revenue.

➔ *Most of these impact only small subsets or prospects only, so are a great way of testing out new ideas.*

Changing Pricing

These are the big changes that you can make when you have significantly improved your product. Anytime you think you have added value for your customer, you can think about making substantial changes.

Major changes you can implement every six months are:

➔ **Raising/lowering prices**

This is the big change that will have an effect on most people and will see the most pushback. But as Jeanne Hopkins says, you have to “stay steadfast in your mission.” If you think you are offering more value, then it is reasonable to change the pricing to reflect that.

➔ **Expanding/contracting tiers**

As you get a better idea of your buyer personas you can consider adding or removing tiers to better orient value to these people. This is one of the big changes you should be considering on a regular basis so that you are always positioned effectively in the market.

➔ *If you communicate these changes effectively, then you also have an extra benefit. If you tell current prospects that a price increase is coming next quarter, this helps clean out your funnel as people want to get in now under the old pricing structure.*



If you haven't thought about your pricing in the last few weeks, that is too long.

If it has been months or years since you updated your pricing, whether that is changing value metrics, tiers, or actual prices, then you are almost definitely inhibiting the growth of your company.

But by making some simple changes you can reverse this trend. By aligning your team around customer value you increase the chance of upsell. By developing a process with a defined cadence you can continually optimize your pricing.

These are the components of your pricing machine that allow you to put pricing at the heart of your business and turn it into the constant stream of growth it can be.

DESIGNING YOUR PRICING PAGE

*In the first chapter of SaaS DNA, we looked at The Anatomy of a SaaS Marketing Site to help you build the most important page on your SaaS site: **the pricing page.***

This is the page that your entire marketing, advertising, and sales strategy is pushing people toward. You can do everything right in those spheres, but if your pricing page doesn't compel people to sign up, then it is wasted money.

In this section of The Anatomy of SaaS Pricing Strategy, we are going to look at

the main elements of your pricing page and how you design it so your potential customers understand the value you provide.

Here are three design principles you must keep in mind when creating your pricing page, along with three examples of SaaS companies that we think are doing it right.

One Plan per Persona

We dedicated two sections of SaaS DNA: The Anatomy of Pricing to quantifying buyer personas. Your pricing page is where all that work gets put to the test. Each of your buyer personas should have three elements:

➔ **Demographic data**

The size and type of target company, along with specific title and role definitions from individuals at those companies. This is common buyer persona information, but yours should be based on current customer data rather than just brainstorming.

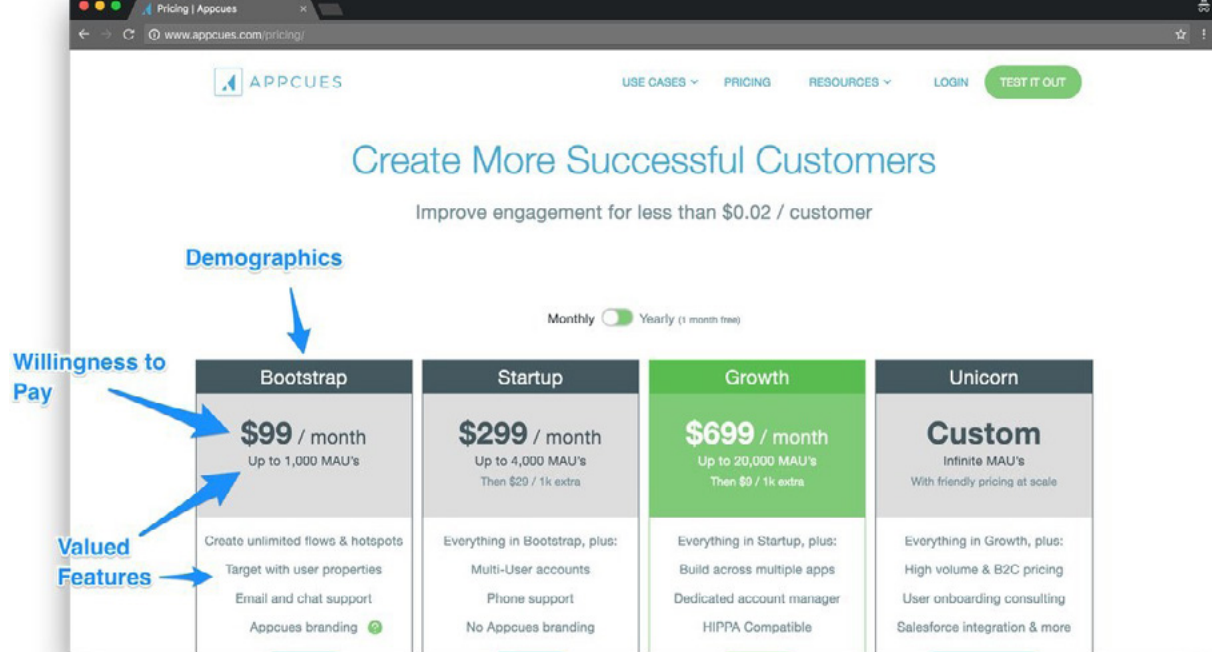
➔ **Valued features**

The results from your market research and feature value analysis. Each buyer persona should have different features that they value over others.

➔ **Willingness to pay**

Price sensitivity data from your market research showing pricing ranges that each buyer persona will pay for their most valued features or positioning on your value metric scale.

If you have run your market research effectively, this information can then be translated directly onto your pricing page. Each buyer persona equates to one of your plans on your pricing page.



EXAMPLE: APPCUES

Appcues, a user onboarding tool, has segmented their pricing page by buyer persona. Let's break down their lowest tier to see how it is packaged.

The information is different for each tier. Whereas the CEO of the company is the buyer persona for the Bootstrap tier, it is probably a product manager or marketing director for the Growth and Unicorn tiers. These companies and people will want different features, and are evidently willing to pay more for them.

DEMOGRAPHIC DATA

Bootstrap. Though it is just one word, it will encompass a number of different demographic traits that are unique to that buyer persona. This will be an unfunded company just starting out. They are looking to use onboarding and tooltips within their product to test the ROI. The individual signing up and implementing Appcues is probably the CEO.

VALUED FEATURES

1,000 MAU's, targeting, Appcues branding. At the lower end, they probably don't have significant traffic, so they don't need a higher value metric. However, they still do want to be able to use Appcues effectively so they need unlimited flows and targeting. They are willing to sacrifice branding for good value.

WILLINGNESS TO PAY

\$99/month. This is low enough that bootstrapping companies just wanting to test out Appcues aren't deterred. It acts as an entry point for companies to find value and grow into the other tiers.

Value Metric as the Center Point

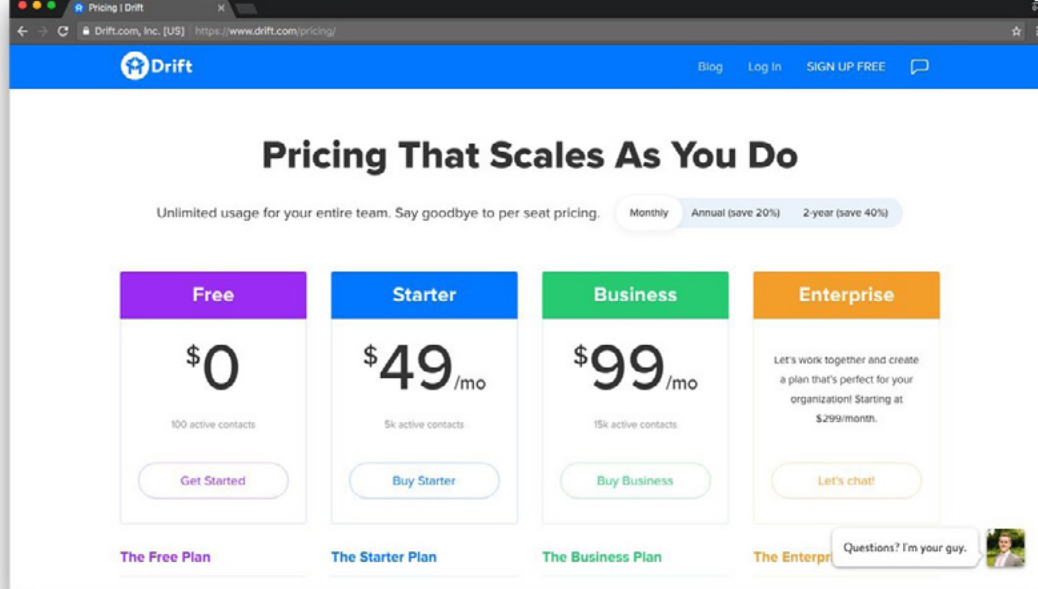
Value metrics are how you point people in the right direction for their, and your, growth. They should be a fundamental component of your pricing page.

➡ *This is the main value that customers are going to get from your product. It is how many X they are getting for \$Y. They should be defined by what your customers care about, and not what you care about.*

You find out what value metric is best for your pricing the same way you find out everything else about your pricing: by asking customers and collecting data.

Though you can have multiple feature differentiators per tier, it is the value metric that is critical for price differentiation across tiers. It is also critical for expansion revenue.

As customers get more from your product, they can move up the tiers (for example, from "Bootstrap" » "Startup" » "Growth" » "Unicorn"). As they do, you can capture more value and revenue from them. This means that a unicorn using your product millions of times a month, thus finding more value, is charged a higher rate than a bootstrapper using it a few hundred.



EXAMPLE: DRIFT

A number of companies are now starting to understand the benefits of pricing revolving around value metrics. Drift, a real-time live-chat messaging tool, is a good example as their main pricing plans highlight only the value metric. All the other information about each plan is hidden below the fold. Even the headline of the page "Pricing That Scales As You Do" is basically the advantages of a value metric in one sentence.

Their value metric is "active contacts," a customer-focused metric that revolves around allowing Drift's customers to communicate with their customers.

Every potential customer that lands on Drift's pricing page can see their own journey from initial use to significant success:

FREE

The customer is just trying Drift out on their site to get a feel with the first few customers. This is no-cost to allow Drift customers to understand the value proposition.

STARTER

They are starting to see some early success with feedback from live chats. The site is growing and they want to continue offering live-chat, so they upgrade to this tier. Drift starts charging a small monthly fee and capturing some of the value of this customer's success.

BUSINESS

Now the customer is growing healthily, partly due to their use of Drift. As the number of active contacts grows, so does the amount Drift charges to manage these communications.

ENTERPRISE

Now the customer is at the very top of their industry, potentially talking to tens of thousands of customers each month. They will pay the very most for the chance to have good communication with their customers

Clarity over Simplicity

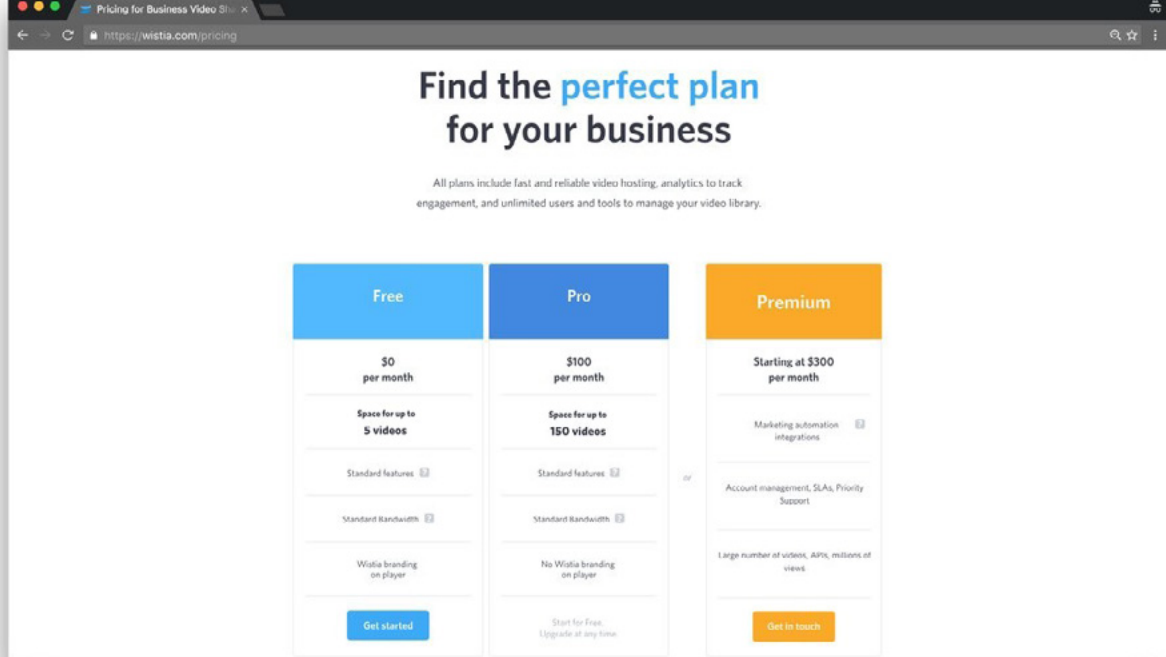
In many areas of design, simplicity is key.

While simpler pricing pages are almost always better than complicated ones, it isn't that, er, simple.

To get people to make an informed decision and sign up for your product with confidence, you have to make sure you are giving them all the information they need to make that informed decision.

➡ *One of the key findings from SaaS DNA: The Anatomy of a Marketing Site was that, even for tech-savvy customers, SaaS sites could be confusing. If people weren't able to find the information they needed quickly and clearly, they would leave.*

This is even more crucial on the pricing page. This is the point where the potential customer is going to part with their money. Any ambiguity here about what they are going to be getting for that money each month will drastically increase their chances of not signing up.



EXAMPLE: WISTIA

When you first land on the pricing page of Wistia, a video marketing platform, it looks very clean and simple. In fact, they have simplified the pricing page multiple times in the past few months and years.

But they haven't sacrificed information. Here is the pricing page:

From this page you know:

The prices for each tier
(\$0, \$100, and \$300 per month)

The main value metric (videos hosted)

The standard features (video hosting, analytics, unlimited users, video management tools)

Whether or not you get branding on the player

The added features available to Premium

How upgrades work

All of that information is collected on a page that is ~60% whitespace.

Don't Forget Pricing Design

For too many SaaS startups, pricing page design is an afterthought. They put tons of effort into their product design, but no effort into the most important page potential customers are going to see before getting to the product.

This is the most important page of your marketing site. It is the one that is going to convince prospects to sign up or not. To part with their hard-earned revenue or not. So the design has to be right.

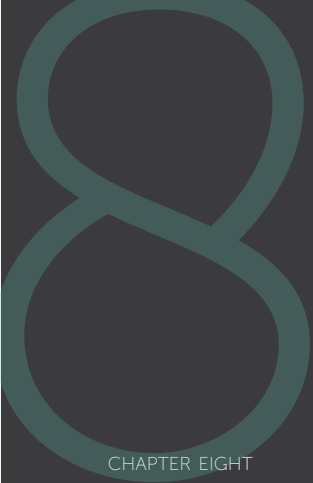
These are only the three main considerations when designing your pricing page. You also might consider whether to use design to push people towards annual payments (yes), to include FAQs for any last minute questions (yes), feature matrices (no), or constant information (sometimes).



These are the three main elements of a pricing page.

If you have clear information so that potential customers can make an informed decision, orient the tiers around your buyer personas, and highlight your value metric to show exactly what matters most to customers, then you have a solid foundation for a great pricing page.

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CHAPTER EIGHT

WHY YOU SHOULDN'T A/B TEST YOUR PRICES

A/B testing your pricing page to figure out the optimum amount to charge for your product sounds great in theory.

Make two versions of the page. Show half your users the second version. Pick the prices that perform the best. Rather than guessing and checking, you're systematically figuring out what people will pay for your product through a low-cost, low-thought experimental process.

Sounds great in theory.
But it's terrible in reality.

Why A/B Testing Your Prices Sucks

Statistically, the odds of you having enough traffic to draw conclusive results from an A/B test are low.

Even if you do, the results you get from A/B testing are going to be relative—derived from whatever prices you tested before—rather than objective. You're not going to find the best price for your product, just a slightly better one than you had before.

Lastly, A/B testing is fundamentally improvement through guesswork. When a page as sensitive as your pricing page changes based on guesses, you're going to annoy the hell out of your customers.

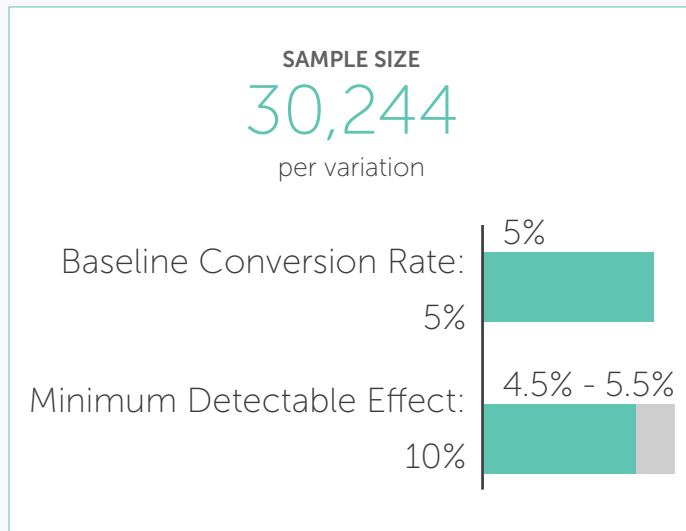
STATISTICAL INSIGNIFICANCE

The concept behind A/B testing is simple, but the math behind it is not. To achieve actual statistical significance—to get results you can conclude affect conversions—you need a huge sample size. The required sample size is modeled by the following equation:

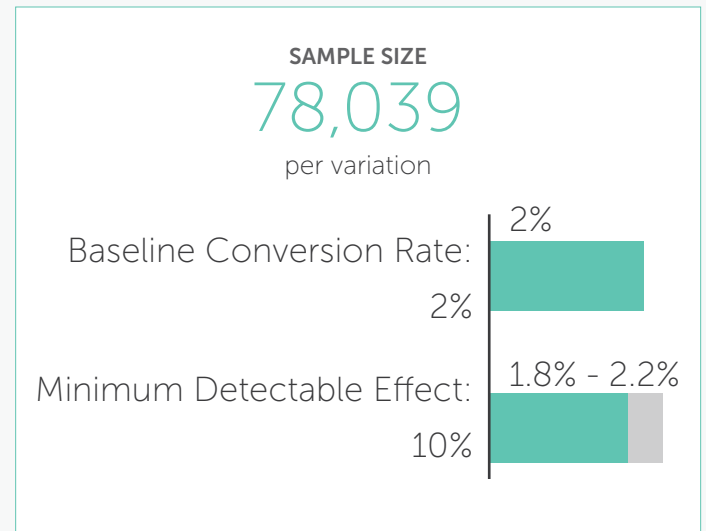
Where δ is the minimum change in conversion rate you want to detect and δ_2 is the conversion rate you have. Let's say your pricing page is doing decently well already—you're getting 10,000 hits per month and converting 5% of that traffic.

$$n = 16 \frac{\sigma^2}{\delta^2}$$

If you wanted to test for a 10% lift in your conversion rate—from 5% to 5.5%—you would need a sample size of 30,244.



The math is even worse if you're converting at closer to 2%. If you wanted to test for a 10% lift on your 2% conversion rate, you'd need a sample size of 78,039.



You could run an eight-month A/B test to get those 78,000 hits, but you'd only be aiming for an increase from 2% to 2.2% on your conversion rate. You could spend those eight months much better.

The math behind A/B testing your pricing page gets even more dire when you start to think about your different buyer personas. Separate tests will be needed for different kinds of customers, so you'll need to be able to segment your traffic by persona—a serious task.

➔ *For the vast majority of companies, A/B testing is simply not a viable tactic for drawing statistically significant conclusions about your pricing page.*

For companies where hundreds of thousands of people do visit their pricing page, it's still not the best way to get better.

RELATIVE VS. OBJECTIVE

Even if your company's pricing page gets thousands of visitors a day, you're still going to sell yourself short with A/B testing. You don't arrive at the perfect price for your product by making small, incremental improvements to your current one. The hill climbing algorithm, also known as the local maximum problem, provides an elegant illustration.

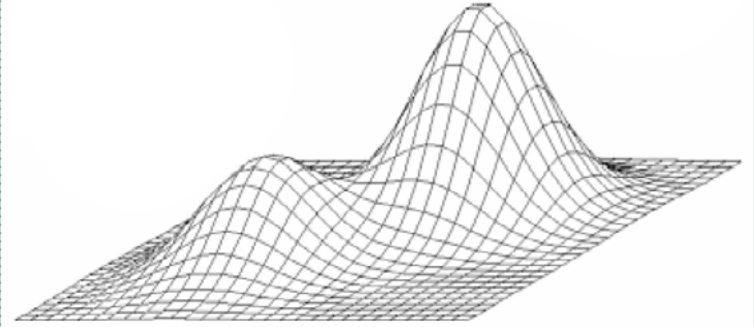
The hill climbing algorithm is an iterative approach to problem solving used when you're not sure what to do. It works like this:

➡ ***Make an arbitrary change***

➡ ***Check whether the result is an improvement***

- a. If it isn't, undo it and go back to 1.
- b. If it is, use it as your new starting point for 1.

Imagine you're a blind hiker trying to climb the hill below, starting from the bottom-left corner:



You'd start walking arbitrarily, constantly assessing the result of each step you take—am I higher now than I was before? Keep going. Am I going back down? Turn back and try again.

This method would be very effective for climbing one hill here—the local maximum on the left—but it would be highly unlikely to lead you to the global maximum on the right.

A/B testing can similarly help you find local maxima. But you find global maximums in your pricing strategy by surveying customers, talking to them, and putting in the effort you need to understand willingness to pay. You have to learn about customer valuations, and you can't do that by running a rote algorithm.

TWO-TIMING YOUR CUSTOMERS

➔ *Even if we set aside the ethical issues involved in selling to different customers at different price points at the same time, the prevalence of social media means that significantly A/B testing your prices is a huge risk.*

If you're testing whether visitors will be more receptive to a price of \$49.99 or \$49.98, then it's likely that no one will notice, but your gains won't have been worth it. If you're testing between \$5 and \$50, then the potential reward is big—but the odds of detection (over the course of a statistically significant A/B test with average traffic levels) jump to a virtual 100%.

Even if you're testing a more modest difference in pricing, you're at risk of running into the price anchoring problem. Price anchoring is the psychological tendency people have for valuing your product according to the first price they experience. If you anchor people at a low price and raise it later, then no one will see it as getting new value. They'll see it as gouging.

➔ *You're going to lose sales by turning your pricing page into a chaotic palimpsest of all your various A/B tests.*

➔ *You will lose the customers you win when you try to raise prices because they will have been acquired on faulty premises.*

➔ *Even if you manage to A/B test your prices “under the radar,” you'll still feel the pain eventually. That's because it simply won't produce results.*

Improvement By Learning

To implement value-based pricing, test your customers for their willingness to pay using surveys.

Make sure your questions are framed to create as little cognitive load as possible.

For instance, ask what features are most important to your users and which are least important rather than asking for a list ranked in descending order of usefulness.

When it comes to understanding the actual price points that your customers are willing to go to, ask the question you want to ask and ask it directly—when is our product too expensive? When is it getting too expensive?

In order to up your response rate, you might be tempted to offer people incentives for answering your survey. But these will be

more often than not ineffective on the kinds of people whose input you want. Instead, summon a collective spirit and include the recipient of the survey in it. Make them feel like they're part of a larger mission to make things better and give them a call-to-action that makes them feel good.

➔ *Once you get your responses, start looking through your data for patterns. Take the features regarded as “most useful,” “least useful,” and people's willingness to pay—and start implementing your value-based pricing strategy.*

Of the following options, which is MOST and LEAST important to you

Least Important

Most Important

☐

Email support

Send an email with your issue or create a support ticket and file a request, and New Relic will respond with a solution ASAP.

☒☐

Online Support

Context-sensitive help immediately appears when you click Help in the New Relic toolbar, giving you insight into every feature of the platform.

☐☒

Technical Expert

Access to a New Relic Tech Expert who will help you get the most out of the platform so you can focus on monitoring and

☐

At what price would you begin to think one pair of YourReebok customized shoes is too expensive to consider purchasing?

\$

At what price would you begin to think one pair of YourReebok customized shoes is getting expensive, but you still might consider purchasing it?

\$

A/B Testing, What Is It Good For?

"Absolutely nothing!" Just kidding.

➡ *A/B testing is a highly effective way to optimize landing pages, design choices, and other site elements when you know the problem you're solving for.*

For instance, you can try to optimize the checkout button on your e-commerce store if you find that people are abandoning their carts in the middle of the flow.

But pricing is a complex beast. When someone arrives on your pricing page, they're thinking about your product's value, its features, their goals, Q4—there are tons of factors on their mind when they're making that purchasing decision.



True pricing leverage is found when you learn about those factors, create and distribute surveys, and make hypotheses about the value that customers are getting from your product.

You're looking to understand your customer's willingness to pay, not manipulate them into wanting to pay you more with some "insane" penny-and-decimal-point "growth hack."

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WHY LOCALIZING YOUR PRICING INCREASES YOUR GROWTH

In earlier sections of The Anatomy of SaaS Pricing Strategy we talked about the importance of pricing page design and how price sensitivity studies can help determine pricing ranges based on your customer's willingness to pay.

Choosing the right price point is key to appealing to your target customers, but if you are just reaching out to your local audience you are missing out on one of the greatest parts of SaaS—that's its global.

You need to make sure you're getting pricing right in more than just your home country and appealing to all of your target audience. This is what email optimization company Litmus did. They saw a 5X increase in conversion just by changing their pricing from euros to dollars when they realized most of their customers were in the US.

A simple cosmetic change like this can cause such a large impact due to the fact that people feel more comfortable with their own currency. The psychology of pricing revolves around trust, and people trust those they can identify with.

In this section of The Anatomy of SaaS Pricing Strategy we are going to show you why price localization is key, and how you can go much deeper than just changing currencies.

Why Should You Care?

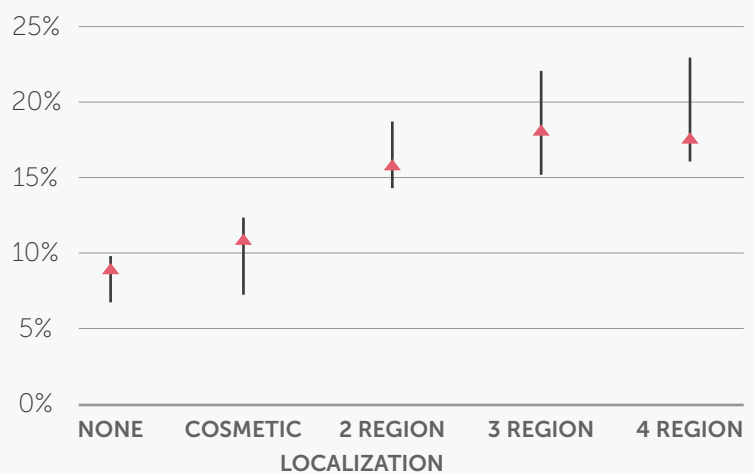
Conducting pricing studies consumes time and resources, so why can't you just set prices the same across the board? While that is an option, you'll quickly start falling behind your competition. More and more SaaS companies are localizing prices and expediting their growth.

In an analysis of 50 SaaS companies, we found that those with a greater focus on localization were growing faster. As the number of localized regions increased, the average growth rate also increased. By using price localization, your company can quickly see a much faster growth.

Companies with no localization saw a Month-over-Month (MoM) growth rate of about 9%. Those with cosmetic localization saw a MoM of about 11%, and those with multi-regional localization saw almost double those with none.

To further bolster growth, it's important to make sure you combine this with being aligned with the unique buyer personas in different regions.

Average MoM growth rate past two quarters



When looking closer at one of the companies in the study, we saw that even for areas where the price point was set lower than the US, using differential pricing actually allowed the company to see growth in all areas. Most surprisingly, areas with lower prices saw the largest average MoM growth.

➔ *By optimizing your pricing page using price localization, you can see revenue increase in every area of the world.*

Two Ways to Localize Your Prices

Price Localization helps determine how you should display your pricing pages in different countries. There may be more interest than you know in other countries and you're missing out on that market if you don't appeal to those customers. There are two types of price localization.

① COSMETIC LOCALIZATION

Cosmetic Localization includes any type of change merely to do with appearance. This includes:

➔ **Price**

Using the latest exchange rates, you should be converting your price to the local currency.

➔ **Currency**

As Litmus did, you should be displaying your prices in the local currency.

➔ **Language**

Translating your website to the local language will appeal to more potential local customers.

These types of changes are the bare minimum of what you should be doing to appeal to your international audience. It's best to at least start with the areas that have the largest target audience and expand from there.

② TRUE LOCALIZATION

With true localization, you're taking advantage of the different market saturation based on the area to maximize your revenues. In areas where you have a lot of competition, lowering your price point can appeal to customers there. But in markets where your product is scarce, raising your prices will bring in more revenue.

➔ *By changing your price based on markets and packaging your product based on persona, you are maximizing the power of true localization.*

To determine how to set your prices, you'll need to localize based on:

➔ **Market Saturation**

This can be determined by price sensitivity studies in every market to determine your customer's ability and willingness to pay.

➔ **Buyer Persona**

Not every customer will be interested in the same features or design. By making sure your design and packaging of features highlight the ones each persona finds valuable, you'll be appealing to the right audience.

How Should You Determine Your Pricing?

There are many different tools to help determine pricing, but one of the best ways to measure the buying power of currencies around the world is by using the “Big Mac Index”.

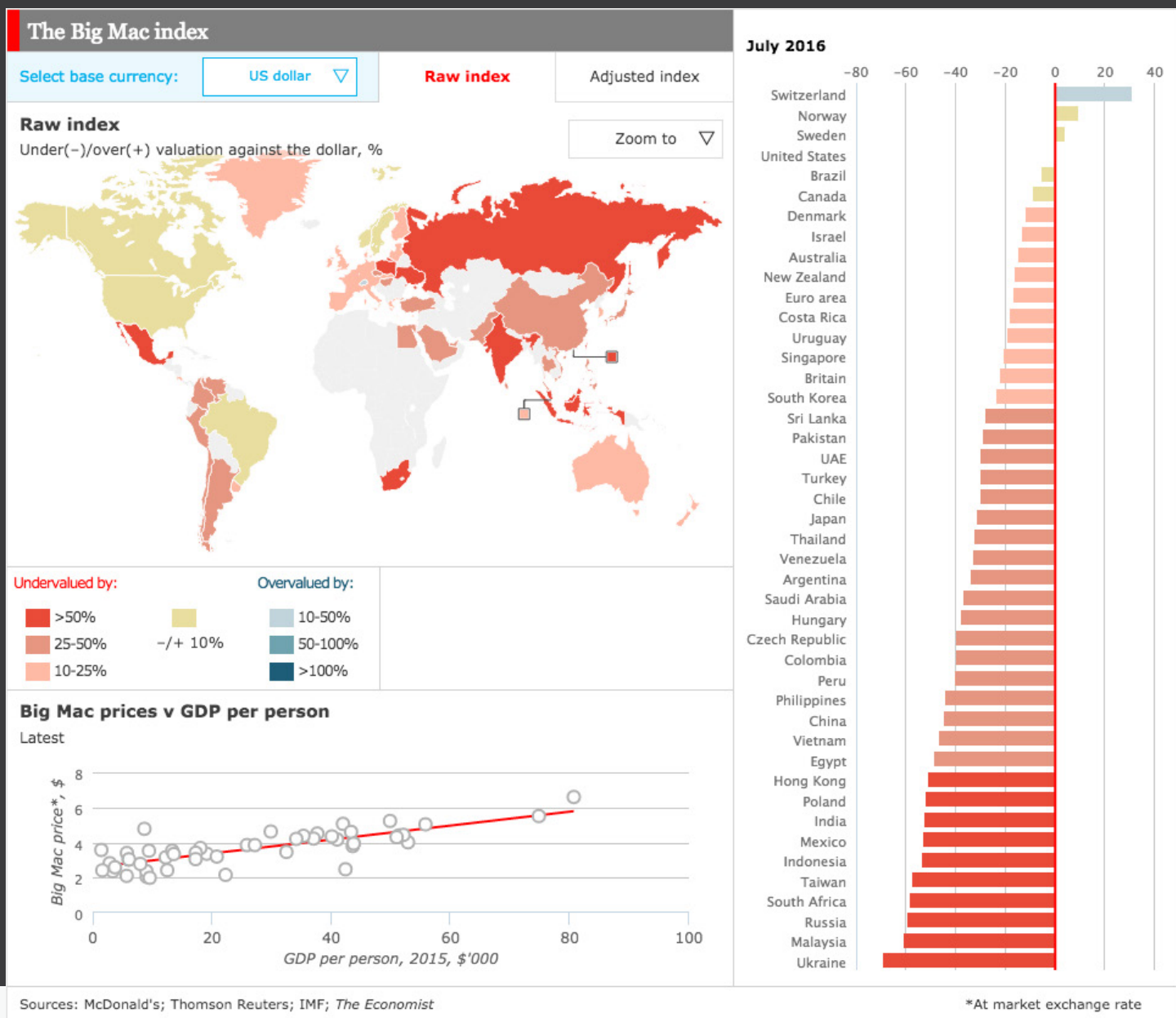
➡ *This index is published yearly by The Economist and measures the purchasing power-parity (PPP) of currencies around the world and is so-named because it's calculated based on the price of a Big Mac in a certain country compared to that in the US.*

The PPP determines the relative value of different currencies around the world and what adjustment should be made to the exchange rate to achieve equilibrium.

For example, if the price of a Big Mac in

Australia is higher than that in the US and people are aware of that, then the law of one price would come into play. It states that a bundle of goods should cost the same in any two countries when evaluated with the same legal tender. This means that the higher demand for cheaper big macs in the US would drive the price up while the lower demand in Australia would drive the prices down, moving towards equilibrium.

For 2016, The Economist released their study on the current “Big Mac Index” as of July, shown below.



The "Big Mac Index" provides an interesting perspective into value across demographics. Why would something as simple as a Big Mac be priced so differently across the world? It has to do with what we've been referring to as market saturation and how much people value a product.

In the US, we tend to view the Big Mac as a late night, cheat-day, indulgent kind of food but it's not something we value highly. But in another country, McDonalds and the Big

Mac might be seen and marketed as a luxury item and so people are more willing to pay more for it.

When determining how you price your product, you should be following the same mentality. When conducting true localization, it's important to know a baseline based on the country's currency but in the end your price should be determined by how people value the product.

What Should You Do When

While eventually you should be incorporating all of these tactics, pricing is a process and should be determined by your company's stage in growth.

➔ **Early Stage**

At this point you're still searching for your ideal product-market fit, so don't waste time on full optimizing just yet. Focus on cosmetic localization and design changes to build up trust and connect with customers in every market.

➔ **Growth Stage**

This is when you should be focusing heavily on monetization and pricing. By setting price points based on market saturation and willingness to pay, you can optimize your Lifetime Value (LTV) to Customer Acquisition Cost (CAC) Ratio to make sure you're spending just the right amount to gain customers but

also getting the maximum amount of returns. Make sure you reevaluate every six months to make sure you aren't losing money!

➔ **Late Stage**

At this point if you haven't localized your prices yet then you're way behind. You're likely losing out on business and losing money and need to internationalize now. When possible, you should also be expanding your markets to new products and users.

You should be thinking about pricing from the beginning, but make sure you're timing each change to maximize results.

Don't Leave Money On The Table

Price localization captures cash. By understanding your customer's interests and the market saturation, you can optimize your price point to make sure you're not losing out on any opportunities.

➔ **Test before you price**

Arbitrarily setting price points can drive away potential customers if too high and if too low can mean you're missing out on profits. Make sure you understand your customers' willingness-to-pay.

➔ **Understand your value**

Market saturation can determine how much people value your product. Know where you need to stand out and where you already do.

➔ **Build trust**

The smallest changes, such as using the local currency or language, will appeal to your customers and make them feel valued. This trust is what will close more deals and bring in more customers.



**Localizing your prices can do more than
just gain trust.**

By using price sensitivity studies in conjunction with market saturation, you can charge more in regions with less competition in your field.

10

CHAPTER TEN

WHY YOU SHOULD BE SMART ABOUT DISCOUNTING

To get people into their product, many SaaS companies turn to discounts to increase acquisition. They think that they can raise prices later, once these customers see the value in the product.

But by discounting, you have already hurt that value.

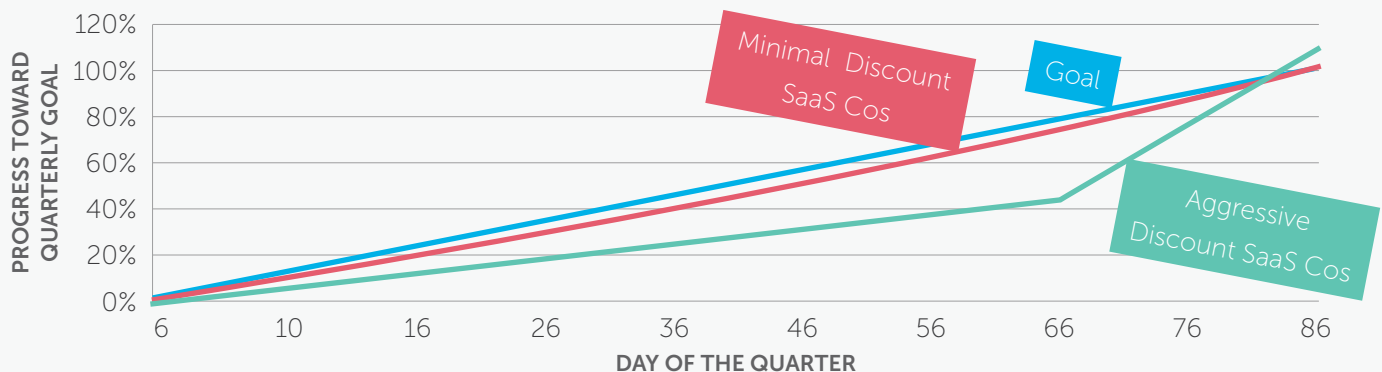
Throughout this series, we've discussed how pricing is a dedicated and patient process. After spending so much time perfecting your pricing, you shouldn't use discounting as a "quick fix" to bring in more customers by underselling the value of your product.

In this part of The Anatomy of SaaS Pricing Strategy, we address how much discounting, when used spontaneously, can really hurt your company.

Discounted Customers Are Less Willing To Pay, So They Won't Stay

In retail, providing discounts works to bring in more business because brands can limit supply. In SaaS however, customers are constantly presented with so many promotions and discounts that if you offer a discount “for two days only,” they know there will be more coming down the pipeline.

Comparing Cos with Minimal and Aggressive Discounting Strategies



To look into the effect of different discounting strategies, we compared data from 88 SaaS companies (55 for minimal and 33 for aggressive) and tracked progress towards meeting their goal over the course of a quarter.

Throughout the quarter, the minimal group remained close to the anticipated goal while the aggressive group lagged further and further behind until the last couple of weeks. At this point to make sure they hit their quarterly goal, the sales team would start to use discounting aggressively.

When just looking at the goal, it seems that the aggressive strategy may be the better choice as they exceeded the goal in the end. However, limiting our view to only this small window of time means we miss the significant repercussions of such an aggressive discount strategy further down the line.

➔ *We looked deeper into the metrics to see how each strategy affected the companies over time.*

GROUP	WILLINGNESS TO PAY RELATIVE TO PRICE	AVG 3 MONTH CHURN RATE	AVG RELATIVE LTV
MINIMAL DISCOUNTS	+5.73%	3.44%	--
AGGRESSIVE DISCOUNTS	-19.78%	10.82%	-32.41%

We see that by using aggressive discounts, customers had:

➔ **Lower willingness to pay**

Their price threshold is already set so low so when the price is brought back up, they have a higher price sensitivity and are less likely to renew.

➔ **High churn rate**

Following the rise in price, rather than renewing, customers are more likely to churn out and look for a cheaper alternative.

➔ **Lower lifetime value**

With so many customers that don't renew, you're losing out on that investment you've made to acquire them without even experiencing any revenue.

➔ *By offering an aggressive discount without having the proper retention strategies in place, businesses are seeing high turnover rates and loss in revenue.*

Discounting Undervalues Your Product Both Externally and Internally

Companies often offer discounts, thinking that it will help with cash flow by increasing acquisition of customers. However in the long term, it ends up hurting you instead as you have to spend longer recovering CAC which is even higher with the increase in customers.

To compare how detrimental discounts can be on CAC, we looked at the impact a 20% discount, one of the most common discounts, could have on a \$500/m customer that costs \$6000 to acquire.

GROUP	CAC	MRR	TIME TO RECOVER CAC
MINIMAL DISCOUNTS	\$6,000	\$500	12 MONTHS
AGGRESSIVE DISCOUNTS	\$6,000	\$400 (WITH DISCOUNT)	15 MONTHS

The 20% discount takes your customer's MRR down to \$400 and raises the time to recover CAC by 3 months. That's pretty significant, especially considering that we already know that churn rates are even higher for discount customers. Even if the discount brings in more business initially, you may never end up recovering CAC for these discount customers and end up losing even more money in the end.

While discounting directly affects your actual revenue, it also kills your momentum as a company by training both your customers and your team to devalue your product.

➔ ***Your customers don't think it's worth it***

By offering the same product at a discount, your potential customers may not think your product is worth your original price.

➔ ***Your sales teams just want to close***

They may be using discounts as the path of least resistance to close a sale, diminishing the culture of profit you want to center your company on.

➔ *Not properly valuing your product can cause profits to leak out of the discount faucet at a flood-like rate before you even have a chance to notice they're gone.*

When Should You Discount?

We're not saying that you should never offer discounts. In fact, they can be useful especially for promotions and deals during certain times and events.

But before you decide to offer a discount, you should make sure you're following these rules:

➔ **Be discrete**

Don't broadcast to everyone that you're offering the same product at a lower price. Those paying the full price may feel undervalued.

product should convince them that the full price is worth it. By only offering the discount for a certain time, you'll add in that sense of urgency to make customers feel the need to buy now.

➔ **Segment discounts**

Only target those who need the extra push to close the deal. Don't offer to those who are willing to pay the full price or you'll miss out on those opportunities.

➔ **Vary your offers**

Making your offers predictable will cause customers to expect it and wait for the discount to go live rather than pay the full price now.

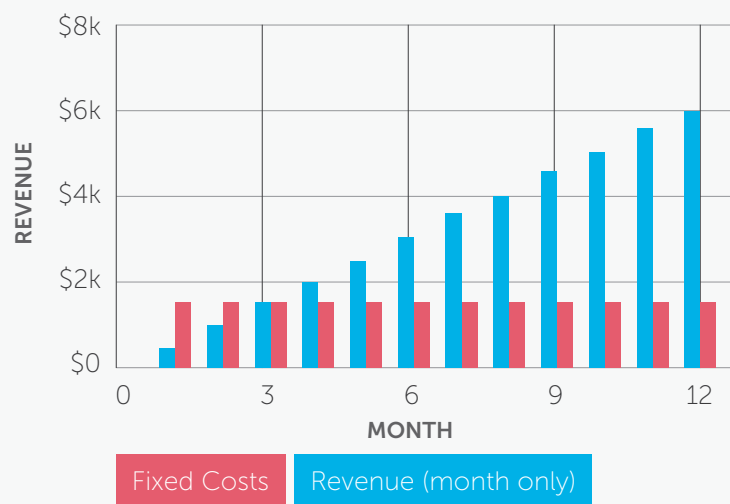
➔ **Limit in scope and time**

The point of a discount is to lower the initial activation energy needed for someone to close, but then your

If you do decide to offer a discount, you can maximize your initial returns by offering the discount on your annual plan. Annual plans are a great way to get cash up front, especially important for new bootstrapping SaaS companies.

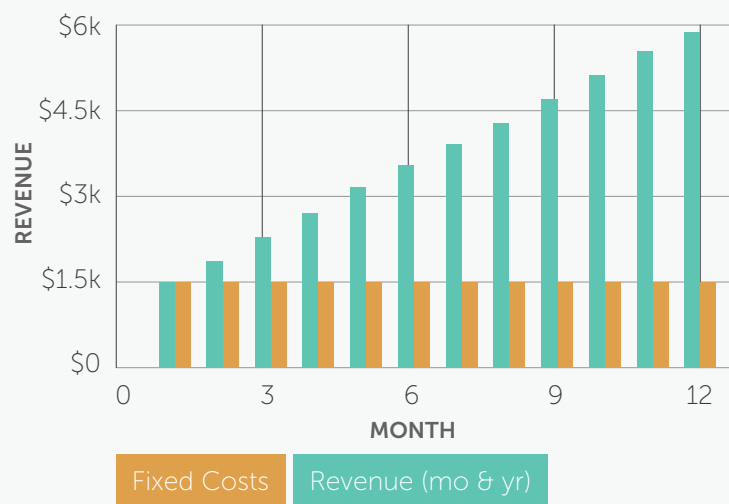
Assuming a company has \$1500 of fixed costs a month, we see that it takes the company at least 4 months to start making a profit.

Revenue per month vs costs



Compare this to the company offering annual subscriptions. We see that the company would break even within the first month and start making profits much faster than if only the monthly plan was available.

Revenue per month (mo & yr) vs costs



Compared to a monthly subscription, having an annual plan gives you more money to invest in your business and grow it through the year rather than waiting for each month to pass for more cash.

By offering a discount on your yearly plan, but not your monthly, you can convert more customers to potentially stick around for longer, and it gives you an increased cash flow at the beginning of the year. Even just 10% of customers signing up for a discounted yearly plan can make a massive difference in your revenue.



When used correctly, discounting can give customers that extra push needed to convert, but it should be used as more of a secret weapon, rather than the first resort, whenever a deal needs closing.

