Price Intelligently
by Paddle

The anatomy of SaaS pricing strategy

An in-depth guide to understanding and optimising your recurring revenue pricing strategy

Price Intelligently brings unrivalled expertise in subscription companies. With 10+ years of industry experience and working with 400+ subscription companies, we'll deliver impactful pricing and packaging strategies based on data and insights you can trust.

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How your company can build 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, what we've seen for over ten years is that most SaaS companies don't know their value to their customers or how to best communicate it.

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, or missing the chance to exponentially grow your revenue with higher but more accurate prices. You're leaving huge amounts of revenue on the table, which makes you vulnerable to sudden disruptions.

In this guide, 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.

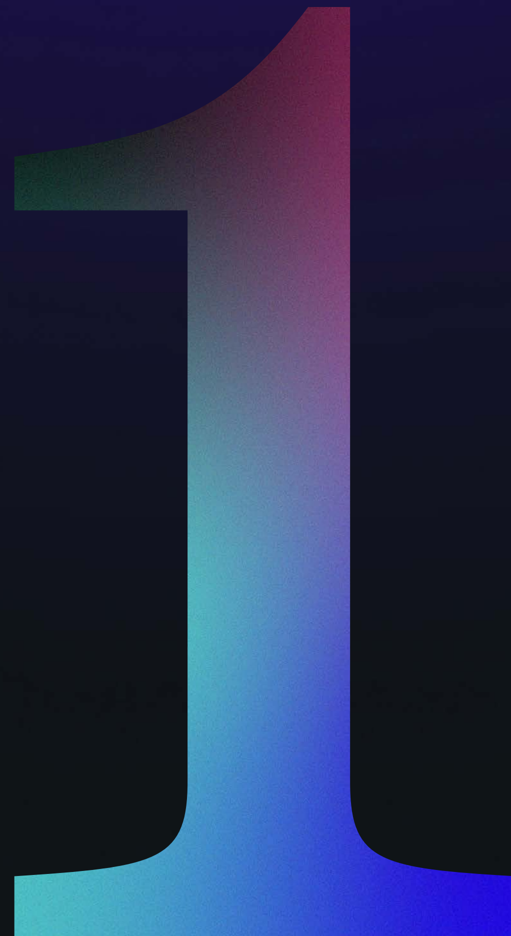
A pricing strategy is a plan or approach for setting prices for a product or service

A successful pricing strategy for a SaaS product typically involves determining:

1. **Your value to customers**
2. **The most effective pricing model**
3. **The pricing levels**
4. **Other factors that may impact pricing** (discounts, promotions, and add-ons).

CHAPTER ONE

Why you need a pricing strategy



Pricing is the untapped growth lever

Pricing is crucial for a SaaS company's revenue, profitability, customer acquisition, and retention.

We've seen inside more subscription companies than anyone else on the planet. One common problem that we see time and again is that SaaS companies don't consider pricing as a growth lever.

When companies think of growth, they think customer acquisition. Yet, pricing is the crucial part of your business, which has the highest impact on growth. It is in most cases, an untapped growth level.

Growth is more revenue, not more customers. How you monetize those customers is vital. And yet we see businesses consider customer acquisition more than pricing and packaging.

From our experience, ironically, the frequency with which people think about each growth lever is inversely related to its effectiveness in driving growth. People write about acquisition, retention, and pricing in that order, but pricing and packaging have the biggest impact on the bottom line, followed by retention and then acquisition.

A well-oiled pricing strategy is 7.5x more effective at generating growth than acquisition strategies alone. By concentrating on pricing, and looking for all possible improvements, you have the chance to use this most effective lever to maximize your profits.

People write about acquisition, retention, and pricing in that order, but pricing and packaging have the biggest impact on the bottom line, followed by retention and then acquisition."

7.5x

more effectiveness at generating growth than acquisition strategies alone when using a well-oiled pricing strategy

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 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.

Equation for LTV:CAC

$$\frac{LTV}{CAC}$$

In our experience, companies that don't think about their unit economics tend to hover in the danger zone, just above break-even.

Companies who at least had a yearly review had a solid foundation for growth.

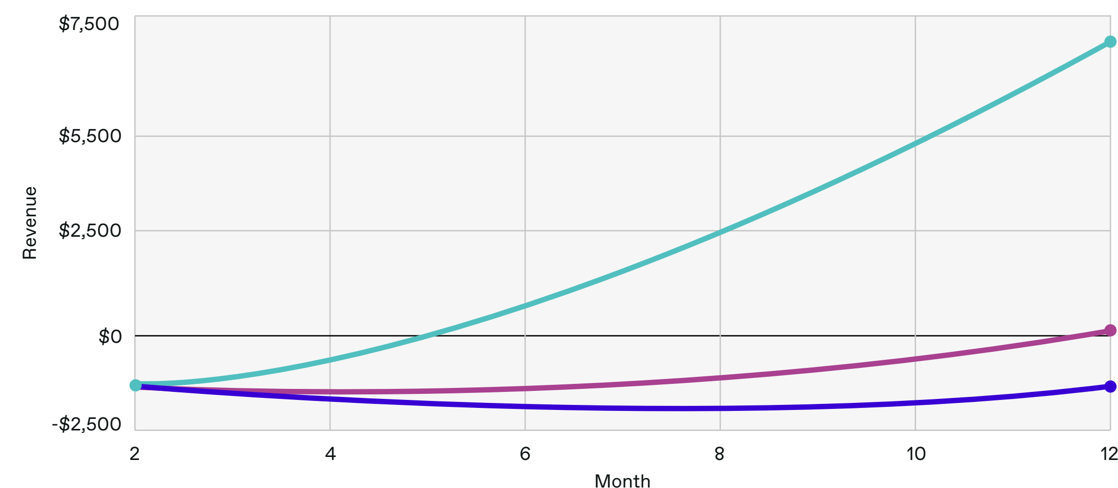
But those that made price optimization a continual focus realized far more lifetime value from their customers than it cost to acquire them.

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.

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.

Payback periods for different pricing commitments



Pricing is at the heart of your entire business

Pricing is 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.

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

1. **Positioning**
   Aligning your product to attract the right customers.
2. **Packaging**
   Having the right feature mix in your plans.
3. **Pricing**
   Finding the right price points that represent value and customers are willing to pay.

There also needs to be 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.

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.

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.

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.

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. They 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.

Pricing is the foundation of your unit economics

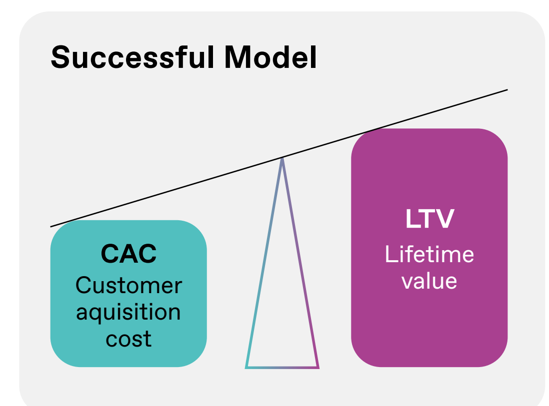
Pricing optimizes for growth and is so intrinsic to your business because of its ability to drastically improve the foundational numbers of your business: your unit economics.

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.

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

Successful Model



Equation for CAC

$$\text{CAC} = \frac{\text{Total cost of sales \& marketing}}{\text{Number of customers acquired}}$$

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 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 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.

Equation for LTV

$$\text{LTV} = \frac{\text{ARPU}}{\text{Churn rate}}$$

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.

In our experience, the average SaaS company will spend less than one work day on 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 are 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.

CHAPTER TWO

How do you decide the price of your product

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 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.

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. 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
2. You will cover your costs

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. Also, costs fluctuate over time.

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.

> "The big problem with cost-plus pricing: Customers don't care about cost, they care about value."

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.

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
2. It might be close

> "The big problem with competitor-based pricing: Customers don't care about your competitors, they care about you."

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. 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.

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.

Value-based pricing

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

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**

   You need to know what customers will actually pay for your product based on the value they see in your product. Competitor-based pricing does this in a roundabout way. But this misses the fundamental point that your product should be different to your competitors. It should offer more value, and therefore be 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.

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.

That said, 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.

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.

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.

CHAPTER THREE

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, 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, and most companies are unable to describe their buyer personas beyond a few generalities.

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

In our experience, buyer personas are really about numbers not words. Qualitative buyer personas such don't have any actionable data associated with them. It's not clear what features of a product each persona 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.

With all this key information missing, you're most likely guessing when it comes to marketing and development.

What is a quantified buyer persona?

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 anecdotes and gut impressions. 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.

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.

Quantified buyer persona

Person-pricing fit

Table Stakes Tony	Advanced Arnie
Valued features: • SFDC integration • Chrome extension	**Valued features:** • Analytics • API access
Least valued features: • Analytics • API access	**Least valued features:** • Chrome extension • Premium support
WTP: $10/month **CAC:** $22 **LTV:** $160	**WTP:** $25/month **CAC:** $56 **LTV:** $325

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.

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.

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 barriers to adoption are there?
- What are their pain points?
- What are your value propositions?
- 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?

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

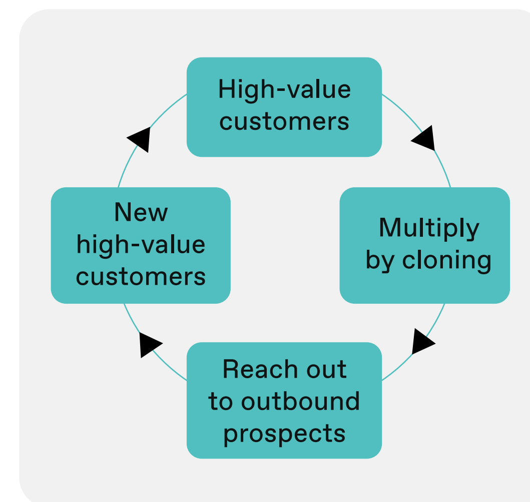
Break down your customers into three-to-five identifiable people

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 bestcustomers 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 three to five identifiable people. You need to find out who these people are in real life:

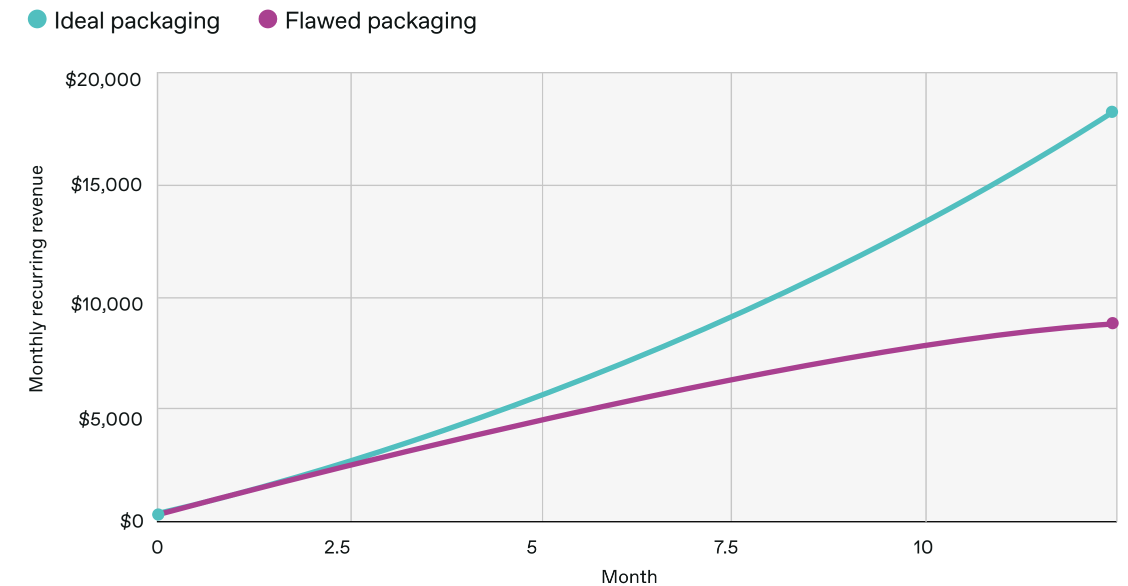
- What industries are they in?
- What is the size of their company?
- What is their role within their company?

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 Metrics, you can pull up the payment information for each of your customers and sort by monthly recurring revenue (MRR).

Understand what your customers value

MRR 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.

Relative preference analysis

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.

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	○	○	○	○	○	○	○	○	○	✓
Premium support	○	○	○	○	○	○	○	○	✓	○
Integrations	○	○	○	○	○	○	○	✓	○	○
SLA	○	○	○	○	○	○	○	✓	○	○
Customizations	○	○	○	○	○	○	○	○	✓	○
Single sign-on	○	○	○	○	○	○	○	○	✓	○

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.

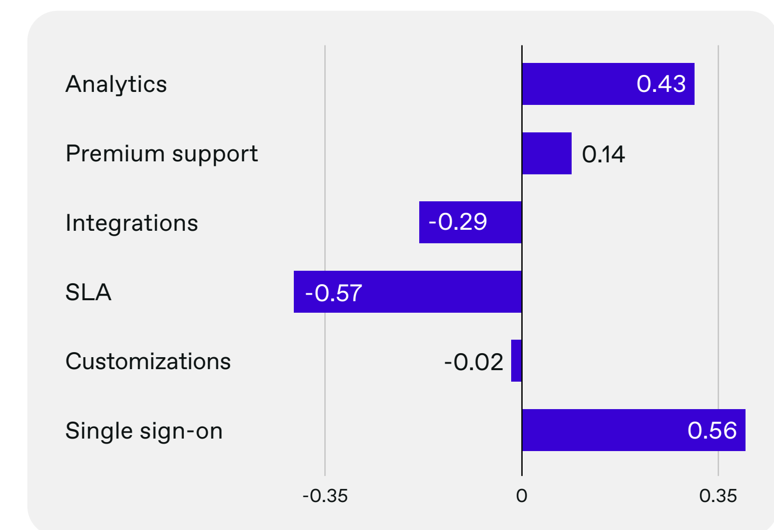
In terms of [Company] pricing, which of the following when it comes to pricing is most preferred? Least preferred?

	Most preferred	Least preferred
Analytics	✓	○
Premium support	○	○
Integrations	○	○
SLA	○	○
Customizations	○	✓
Single sign-on	○	○

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

Number of times feature is most wanted — **Number of times feature is least wanted**

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



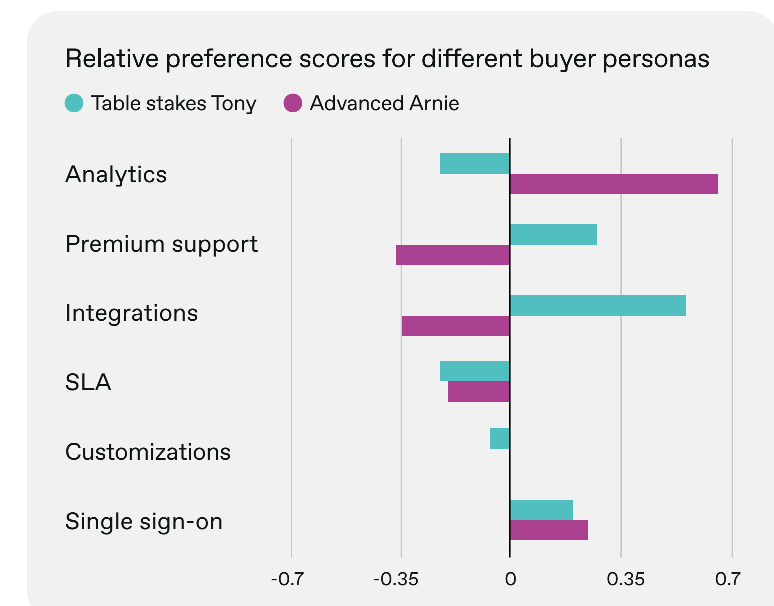
It's at this point that a picture starts to emerge from your packaging. If one buyer persona cares more about analytics and another about integrations, then you have a natural delineation for your packages.

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.

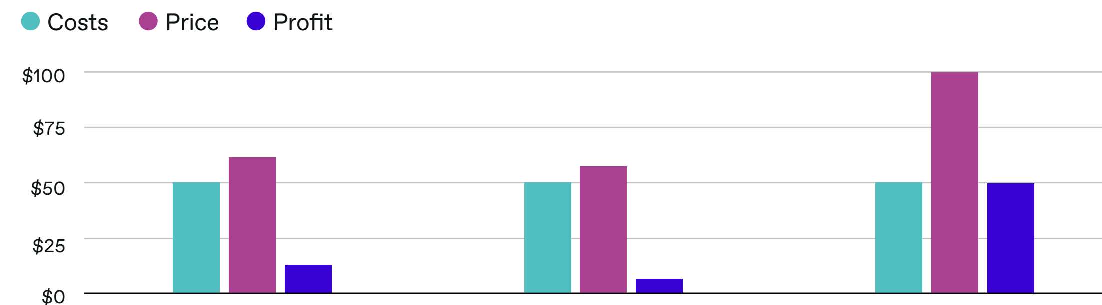


Your customers' willingness to pay

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



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.

Here, a 20% profit margin is added on top of costs, leading to a $10 profit per customer.

Competitor-based

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

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

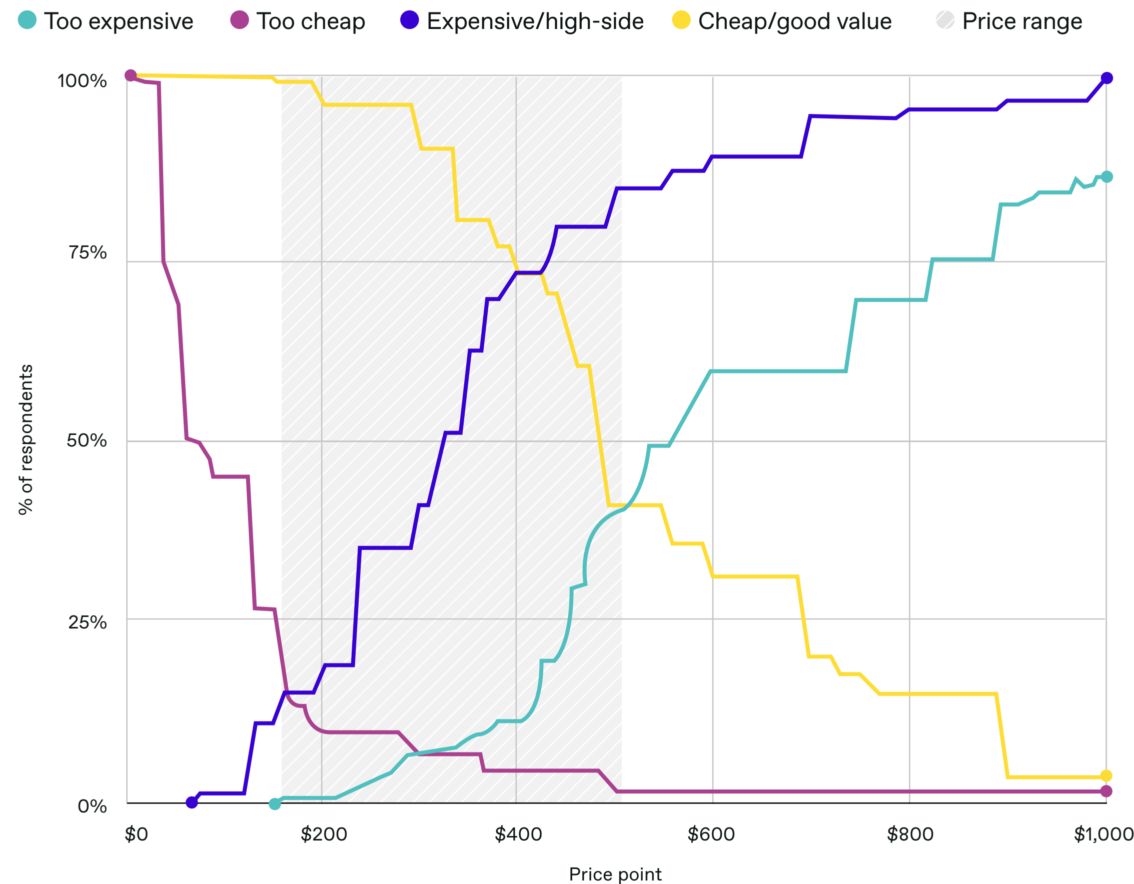
People aren't very good at thinking about specific price points. They won't be able to tell you if your product is worth $99/ month or $79/month.

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

1. At what price would you consider the product to be so expensive that you would not consider buying it? *(Too expensive)*
2. 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)*
3. 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)*
4. At what price would you consider the product to be a bargain—a great buy for the money? *(Cheap/Good Value)*

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

Price sensitivity analysis



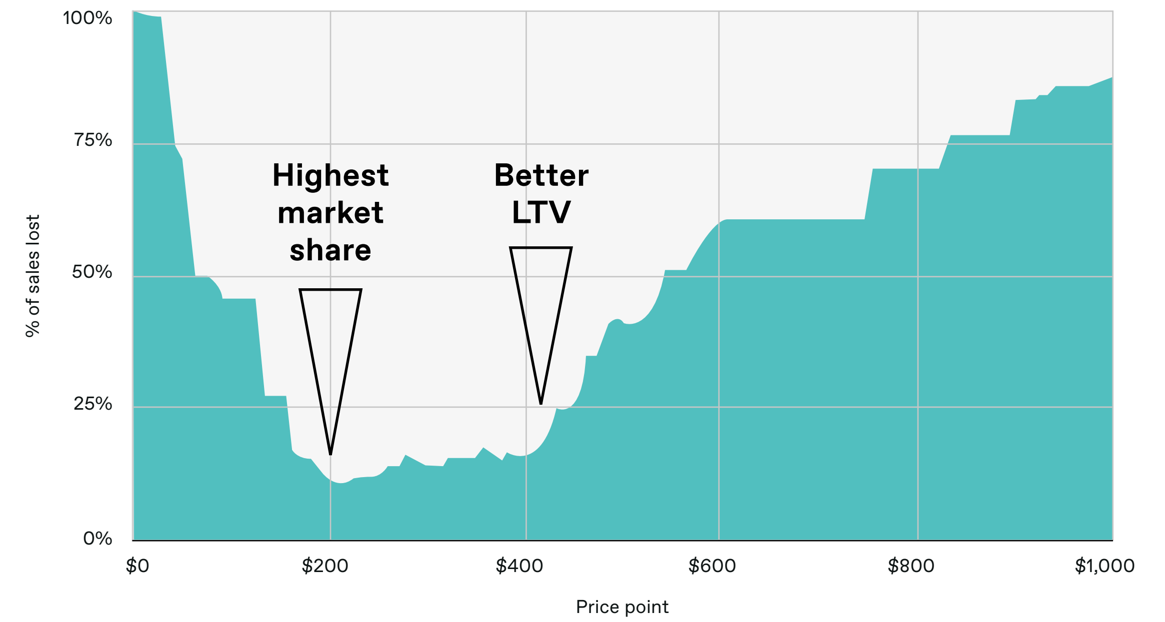
The optimal price here lies in that middle price range. You want your pricing to be within that center mass where customers find value from your product, don't consider it too cheap, but still consider it a good deal.

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

> "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."

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

Percentage of sales lost at different price points



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.

However, using this data, you can also see other pricing points that may return higher profits.

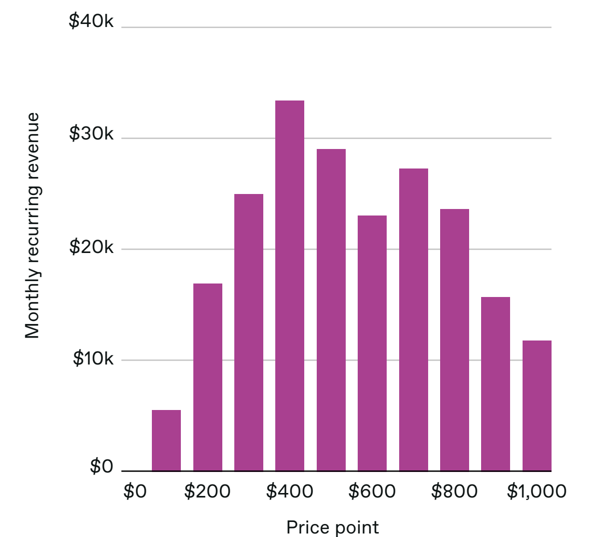
In this scenario, shifting the price point higher, from $200 to around $400 sacrifices barely any market, but for potentially far better LTV per customer.

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.

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

Potential MRR at different price points



How much your customers cost

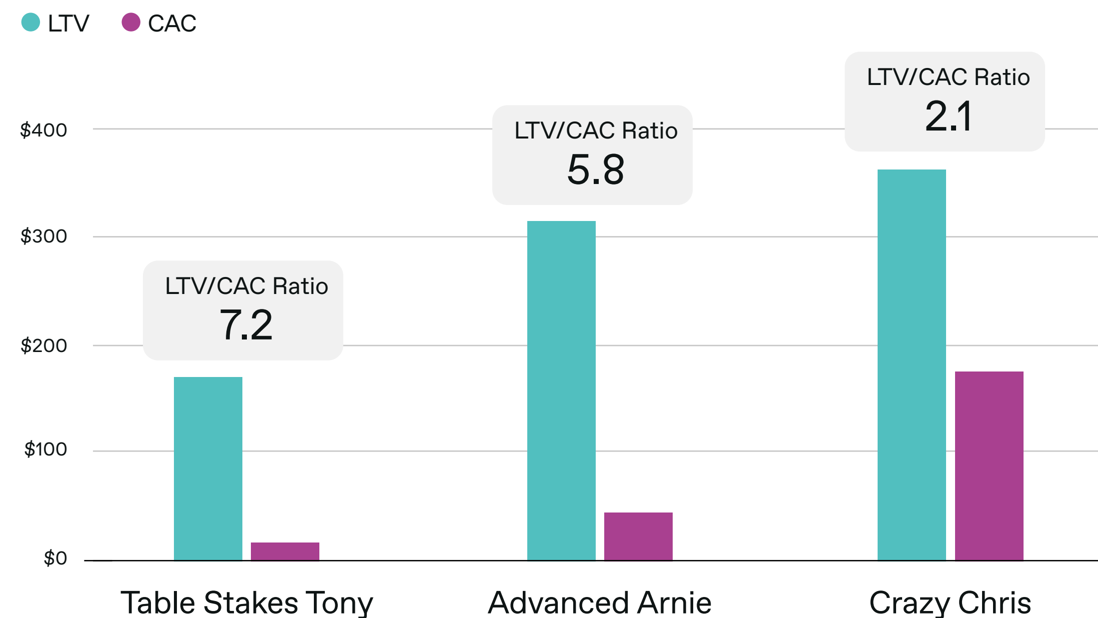
It's obviously great to have high-value customers, but without knowing how much it's going to cost to acquire them, you can't know if the underlying unit economics of your pricing strategy are sound.

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 of 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:

Equation for CAC

$$\text{CAC} = \frac{\text{Total cost of sales \& marketing}}{\text{Number of customers acquired}}$$

When you are initially developing your buyer personas, this is difficult to do. You probably won't have reliable data of sales and marketing costs, and the number of customers acquired might be too low to produce a stable CAC.

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-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.

Let's say you're using paid social ads to acquire new customers. In this channel, the cost per click (CPC) for different ads along with the conversion rate will give you an approximation of the CAC.

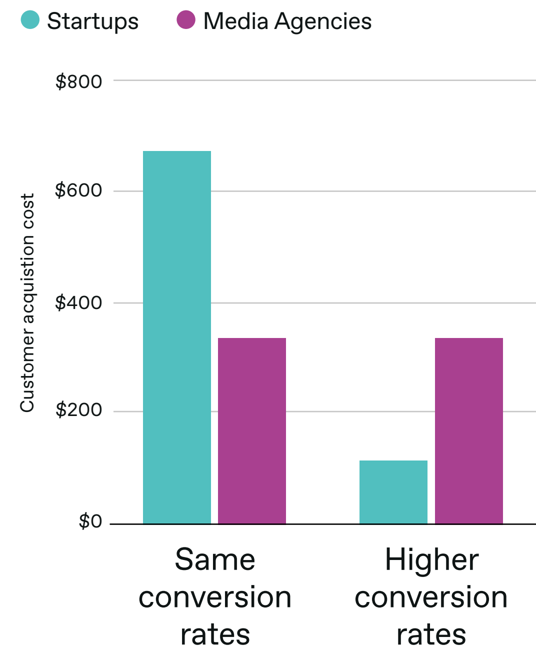
Equation for CAC

$$\text{CAC} = \frac{\text{CPC}}{\text{\% trial} \times \text{\% paid}}$$

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.

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 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.

Your tiers should be segmented by buyer personas. Consider what the smaller customers are going to be able to pay vs what customers in the higher tiers will consider as reasonable.

Consider what the distinct parts of each profile are used to attract the ideal customer:

1. The demographics are condensed into a single word that best describes that persona.
2. The packaging of the valued features show the relative preferences of each buyer persona.
3. The willingness to pay is shown in the actual pricing, which grows with the growing demographics and features.

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 features 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.

CHAPTER FOUR

Applying quantified buyer personas to your pricing process

4

If you are already quantifying your buyer personas, or used the chapter 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 your pricing process and spur growth.

Let's run through an example scenario of how a SaaS company can use quantified buyer personas continuously to maximum effect, increasing both revenue and growth.

Developing a pricing process

Most SaaS companies set their prices on instinct when they start the business and then don't make changes to their pricing to keep the business profitable and growing. They either forget to update pricing, or are terrified of scaring away customers with a price increase.

At Price Intelligently, we believe pricing is an ongoing process which revolves around the Problem › Cause › Solution framework.

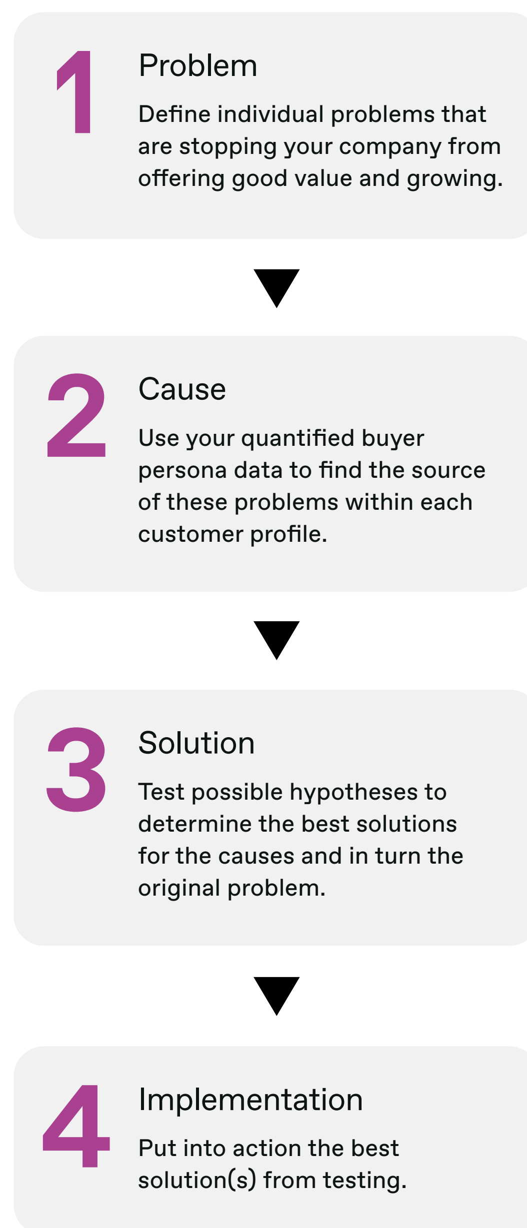
This allows us to get ever closer to the optimal balance of what our customers want and what is good for our company. This alignment of value is what drives growth.

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

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 number one 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.

In our experience of working with SaaS businesses for over a decade, we've identified the five major problem areas that SaaS companies face. These are the things that are stopping you from succeeding and stopping your customers from succeeding with you.

The number one 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."

5 major problem areas that SaaS companies face

	The problem	Most likely culprit	Data needed	Best tool for gathering data
1	No problem acquiring customers, but poor business unit economics	Pricing	Price sensitivity by buyer persona	Price sensitivity studies
2	Poor user retention	Pricing, packaging	Price sensitivity; relative preference to core features and value propositions	Price sensitivity studies, relative preference studies.
3	Poor MRR retention	Pricing and value metric	Price sensitivity; relative preference for value metrics; histogram analysis of current usage on key metrics	Price sensitivity studies, relative preference studies; Excel (for histogram analysis)
4	Poor user acquisition numbers	Value propositions or misaligned channels	Relative preference for value propositions and brand promise	Relative preference studies; user/ customer interviews
5	Poor conversion	Pricing	Price sensitivity by buyer persona	Price sensitivity studies

Problem: Poor business unit economics

Unit economics are the foundation for the rest of your business. If your unit economics don't make sense, you don't really have a growing company. You just have an extravagant way of spending money.

Establishing your unit economics means drilling down into your metrics. In particular, your 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 costs 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.

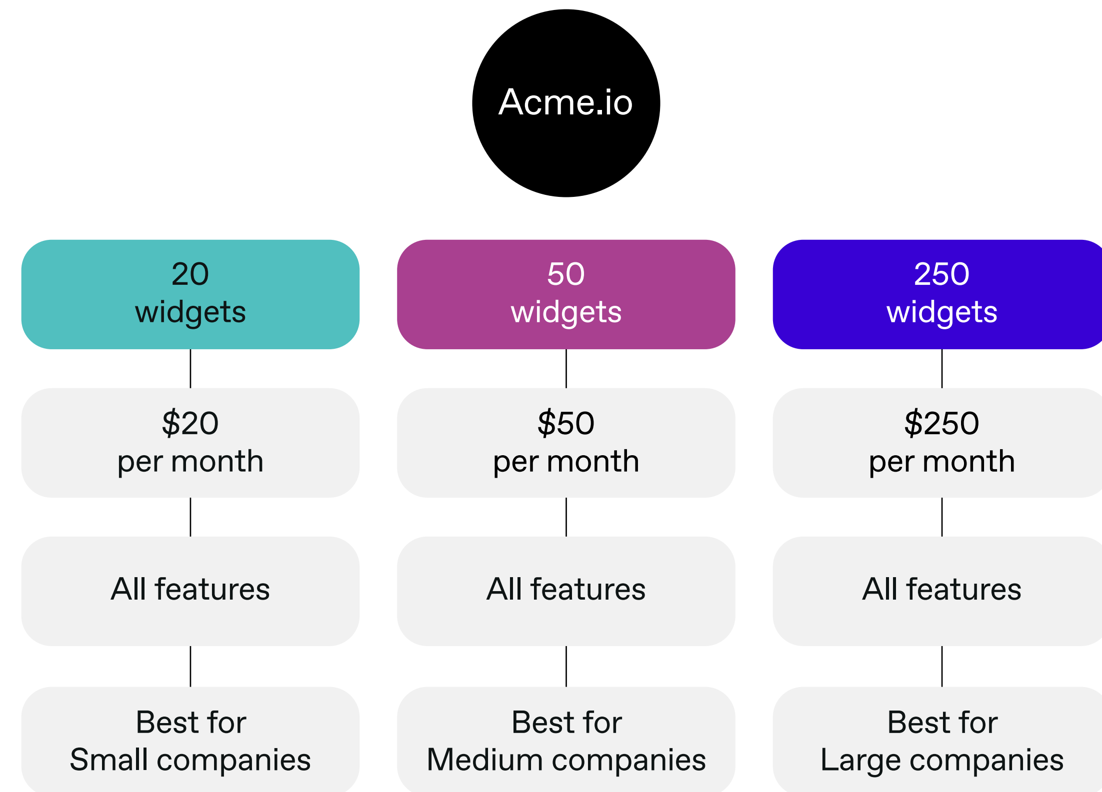
The equation for LTV is:

$$LTV = \frac{\textbf{ARPA}}{\textbf{Customer churn rate}}$$

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

ARPU 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.

Our hypothetical pricing page



Here is the hypothetical pricing page. 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 price points for each of their buyer personas.

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	Sally	30%	$20	$600	$20	20%	$100	$35	2:9
Medium company	Mary	60%	$50	$3,000	$50	3%	$1,666	$600	2:8
Large company	Laura	10%	$250	$2,500	$250	15%	$1,666	$1,200	1:4

The CAC for Sally is low, but because of their high churn rate, their LTV is also fairly low. LTV:CAC is almost hitting the requisite 3:1 ratio, but these customers aren't a pathway to growth.

Mary seems the happiest buyer persona based on 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 Laura is 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 and 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:

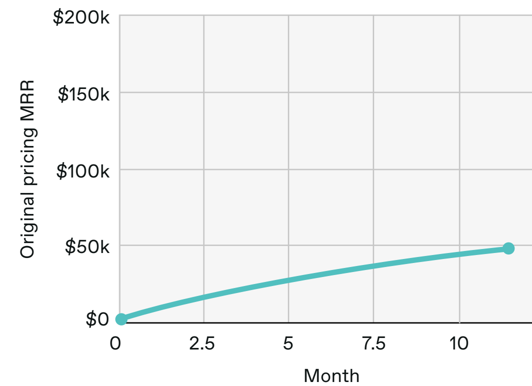
1. Churn is high for both the smaller customers and the larger customers.
2. Not enough revenue is coming from the large, high-value customers.

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

Original pricing MRR

Anyone seeing these static numbers would be worried, even if 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.

Let's take a look at the "Original Pricing MRR" graph. 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 cash flow

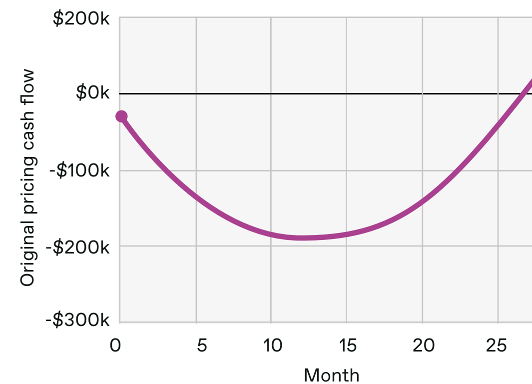
Because customer acquisition costs are paid upfront while SaaS revenues accrue over time, this leaves companies with an initial cash shortfall while they pay back the CAC. Looking at the amount of cash the company has, we can see what a low LTV:CAC ratio can do to a business.

The company is in a cash trough for over two years with the lowest point coming at almost $200K in the red.

This is unsustainable. 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 don't they have 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 problem in your company.

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

Price sensitivity test

Acme.io has buyer personas, but they aren't fully quantified. They have metrics from their internal data, but should quantify them fully so 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:

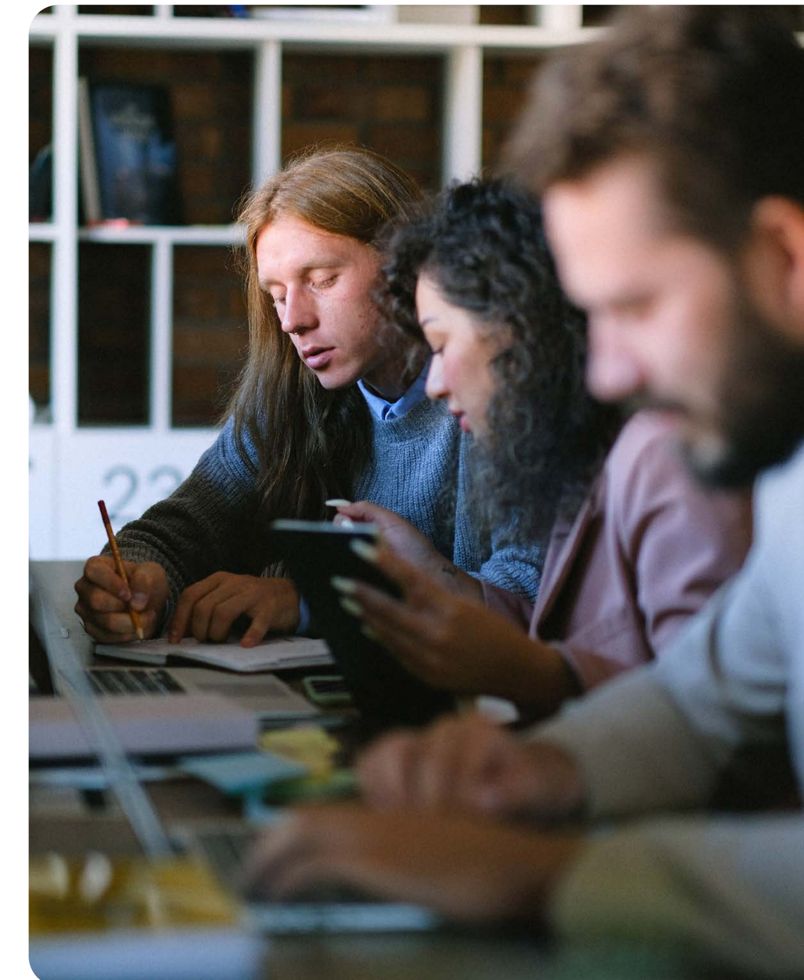
1. **Feature value analysis**
   Finding out from different customers what features they value the most and least within the product.

2. **Price sensitivity analysis**
   Asking customers what they are willing to pay for the product or a set of specific features.

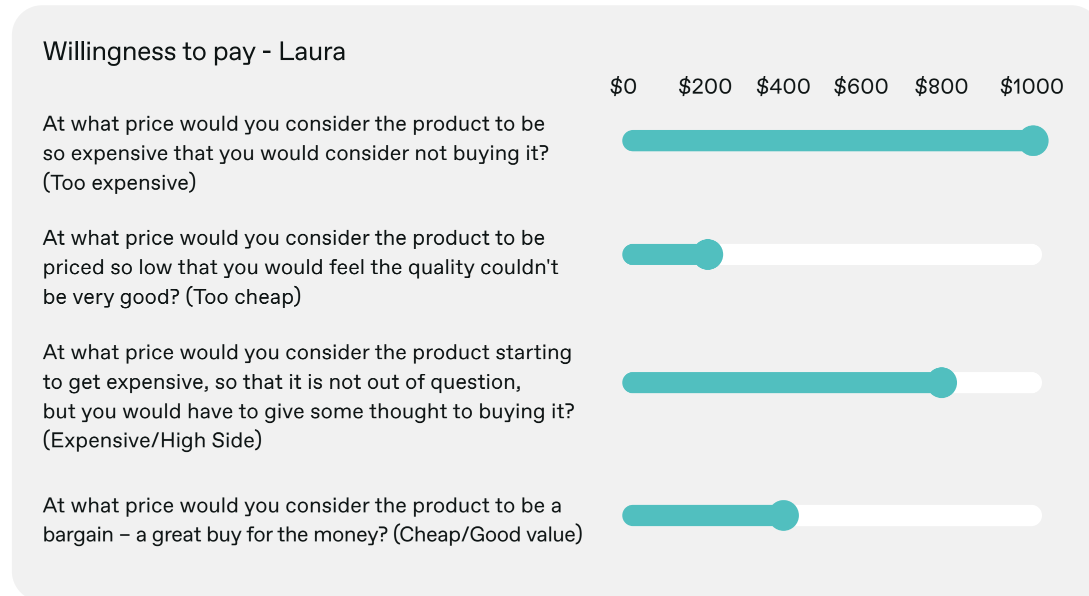
Both of these can be used to determine the root cause of problem areas within a business. For Acme.io we are going to use the price sensitivity analysis as willingness to pay has a fundamental effect on LTV. If the pricing isn't in line with each buyer persona's willingness to pay, then those customers 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.

> "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."



A sample of a reply from a larger persona like Laura's company might look like this:

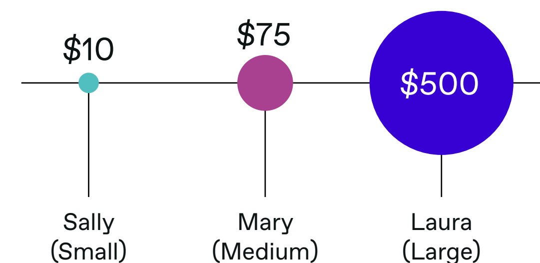


This hints at a partial cause of the problem. Larger companies like Laura's are willing to pay far more than the current price point for that buyer persona. In fact, the current price is very close to what these customers consider "low quality," and under what they consider a bargain.

Lauras 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 cascades as the company then offers too few "widgets," their value metric, at this price point, so Lauras that do sign up churn 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.

Average willingness to pay



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

Here are some hypotheses we can test:

- Small businesses might be paying double what they are willing to pay. Reducing their price point might make them less likely to churn.
- Medium businesses might be close to the ideal price point, but could possibly be increased. A small increase here could increase their LTV.
- Larger businesses are willing to pay much more than their current price. Their price point could be significantly increased.

Companies can only understand their customers this deeply when they can quantify their buyer personas. In fact, one of the main reasons why companies don't make pricing changes is because they do not have enough meaningful insights about their customers.

However, when companies are armed with these insights, they can move on to data-driven testing to find the exact price point where value for your company and value for 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 some customers.
- 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 focus on implementing the changes that will maximize growth and revenue.

Run minimum viable tests

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.

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

Test 1

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 found that the largest customers were willing to pay a lot more for this product. Even though this customer segment could pay more, Acme.io couldn't access this potential revenue with their existing 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.

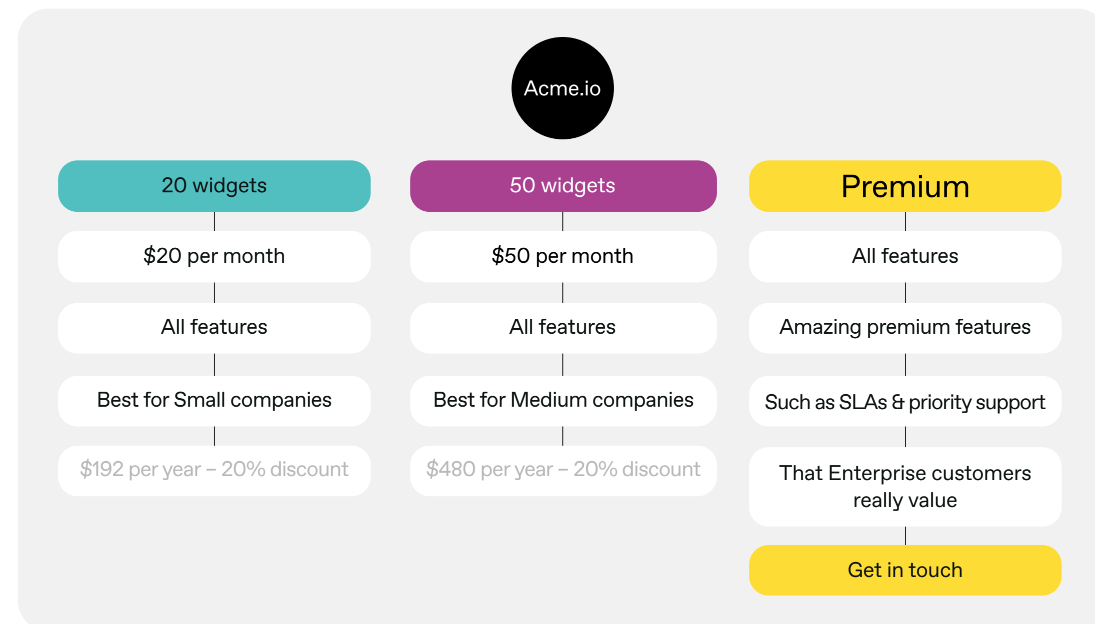
This has two immediate benefits:

1. Acme can now customize pricing for larger customers and unlock value from them.
2. Medium sized businesses might also be interested in a slightly higher plan, and sales can now start a conversation with those customers as well.

> **The number one 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."**

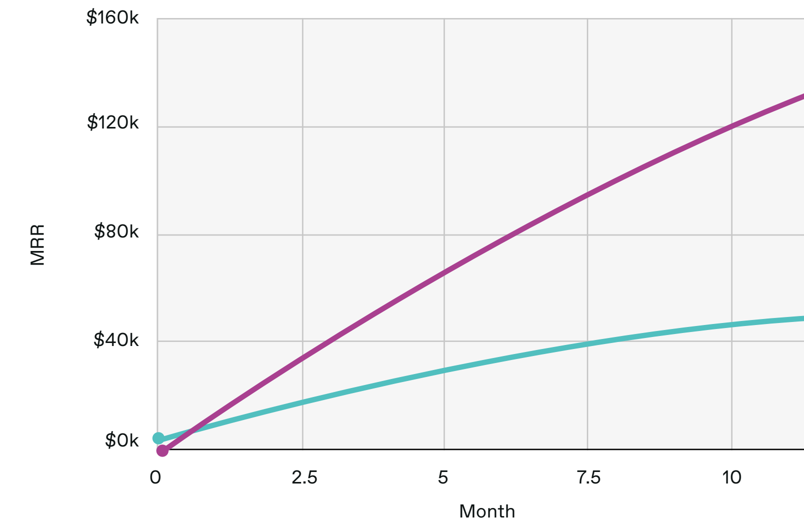
This will increase the MRR from larger customers, as well as their share of the customer base as medium businesses are also likely to upgrade. As their needs now align better with the value of the product, they are also less likely to churn, leading to higher LTV.

With larger customers willing to pay up to $1,000/month before deciding that the product is "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 possible from this type of pricing change.



Couple this with a significant increase in retention as these customers are more likely to be happy with the product, revenue can grow exponentially from this simple test.

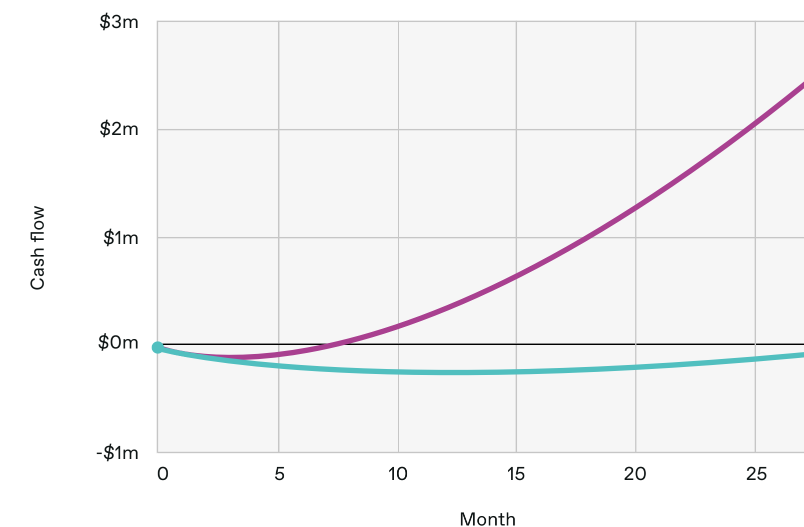
Original pricing MRR vs Enterprise plan MRR



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

For bootstrapped companies, these small tests can have a significant impact on cash flow. A change like this has the potential to drastically improve LTV:CAC for these customers, the cash flow trough of the original pricing structure all but disappears.

Original pricing cash flow vs Enterprise plan cash flow



Within **6** months, the company is cash flow positive and the trough isn't as deep, due to the new pricing structure

Test 2

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. Another test is to keep the self-serve flow, but change the price points for each buyer persona. This reflects our initial findings too: smaller businesses wanted to pay less, whereas medium and larger customers wanted to pay more.

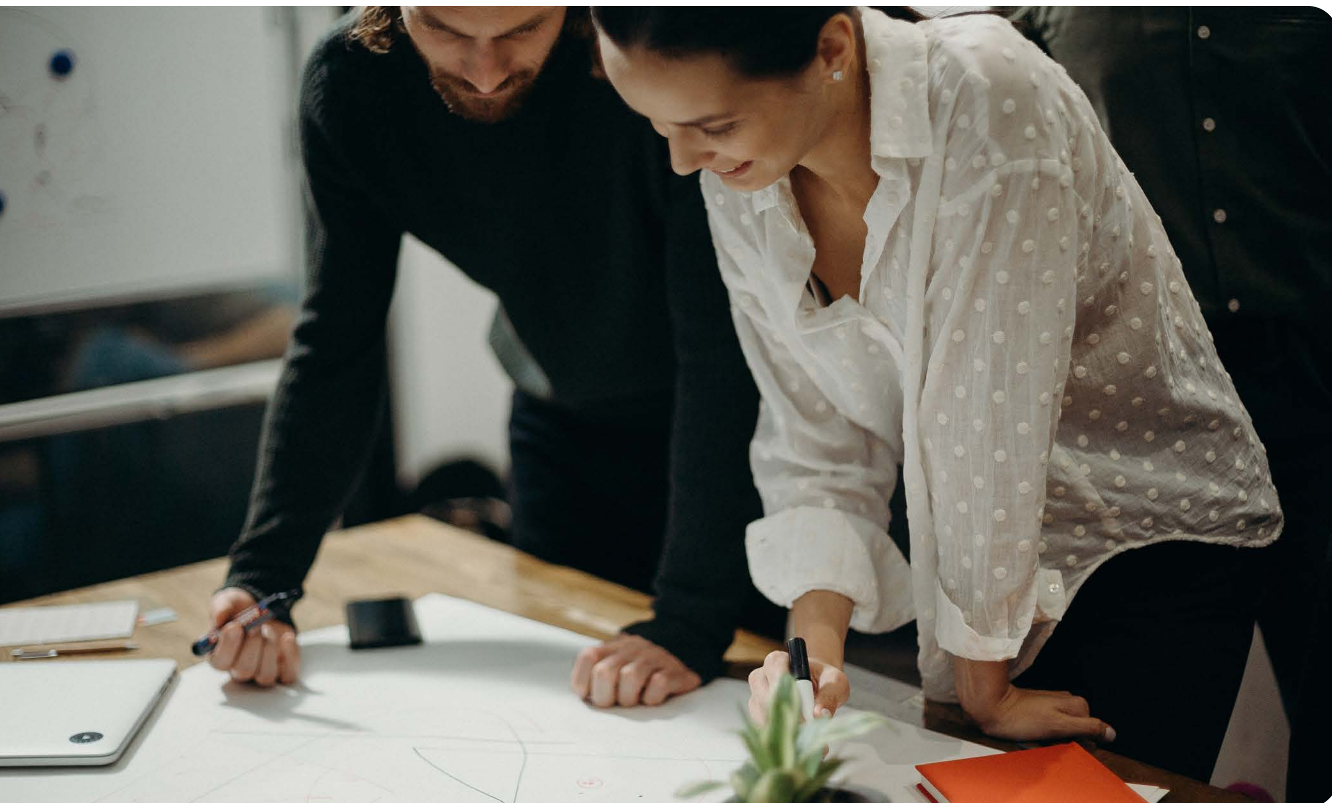
> "In this test there is an increase of the medium/large plans and a decrease of the smallest plan to reflect the willingness to pay for each buyer persona."

This again affects both MRR and churn, which in turn impacts LTV. In the case of smaller customers, MRR will go down with the price cut. However, a lower price point aligns closer with the value they perceive from the product, leading to lower churn and improved LTV.

For both medium and large customers, MRR increases from higher pricing while churn is lowered as there is better alignment between perceived value and willingness to pay for the product. This would also lead to higher LTV and an overall increase in revenue.

This pricing exercise is more than just introducing higher price points and high-touch sales for larger customers, it is also about aligning your buyer personas to the plans that are most valuable to them. It also positively impacts cash flow as CAC remains the same.

Again, the trough is shallower and turns profitable faster than with the original pricing structure, meaning that this is a step in the right direction for both Acme and its customers.



Pricing changes can lead to big rewards

A company only makes money by offering value that aligns with what customers want. This should be your focus when building out your pricing strategy.

Going live with major pricing changes is terrifying for any SaaS company. Will customer's blanche at the new prices? Will acquisition drop off a cliff? This is why people don't make pricing changes. With quantified buyer personas, you can make these changes safe in the knowledge that your value aligns with what customers want and what they are willing to pay. Having collected the data and running the tests, you can make informed and confident decisions about your pricing.

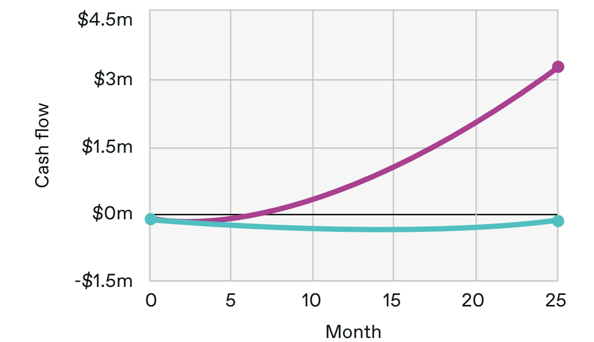
For Acme.io, the next iteration of their pricing page might look like the diagram below.

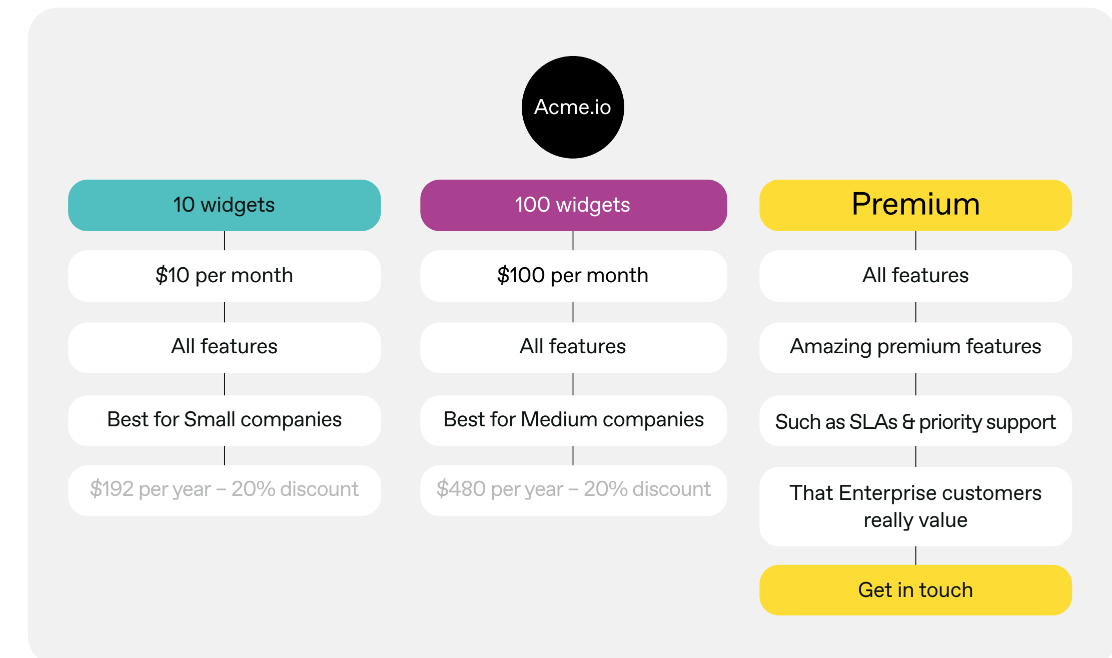
With this pricing structure, their two-year cash flow is now drastically different from their original pricing structure.

These pricing changes led to an increased LTV:CAC ratio, from below 3:1 to over 9:1.

Original pricing cash flow vs Combined changes cash flow

- Original pricing cash flow
- Enterprise plan cash flow





Implement, then iterate, iterate, and iterate again

This isn't the end.
Remember, pricing is a process.

The next step for a company like Acme.io is to go and tackle the next problem on the list and look for other ways to optimize their pricing strategy.

Continue to define your revenue growth challenges, determine the root cause, and run minimum viable tests on your solutions. Each iteration will get you closer to that sweet spot, where you achieve alignment between the value you deliver and the value your customers want.

Get as close to that alignment of value to continue driving growth.

CHAPTER FIVE

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.

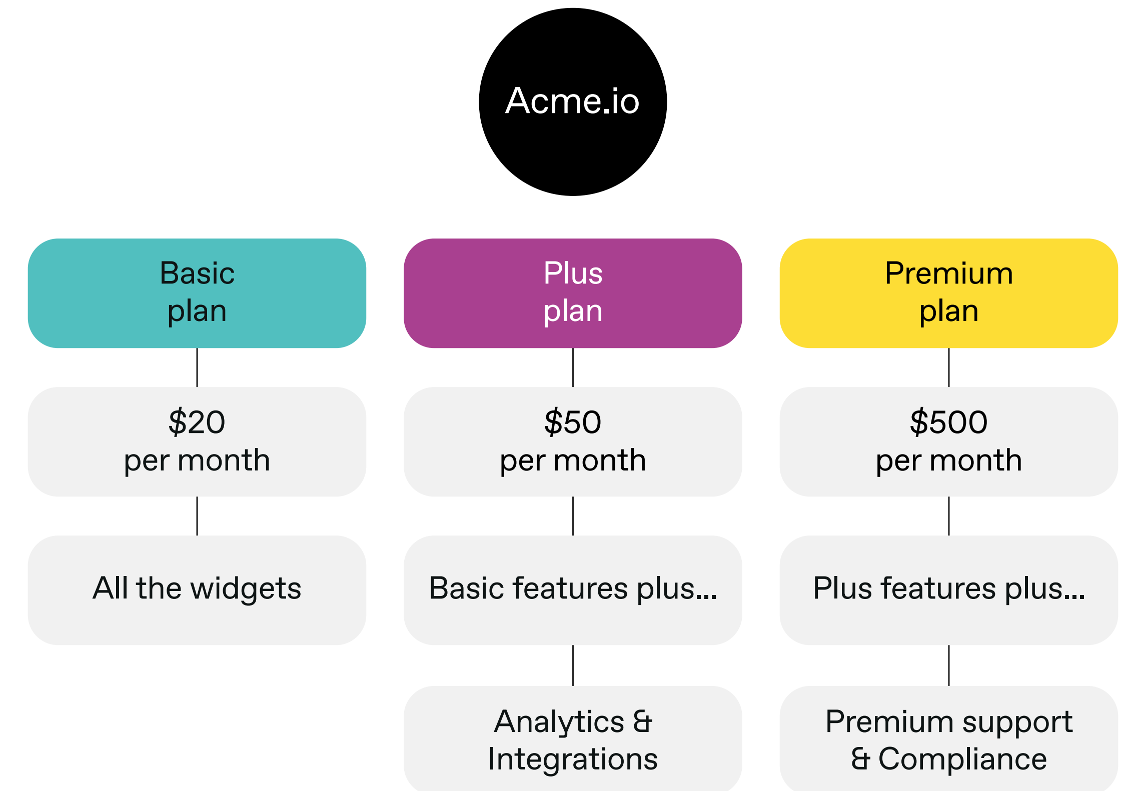
Getting your value metric right is incredibly important. A poorly optimized value metric means that you aren't capturing all the value your product represents to your users. You also limit the value of your product for users, increasing churn.

A great value metric flips this around. Not only do you get more revenue and grow, you also unleash more value in your product for your users, decreasing churn and increasing upgrades.

Next, we are going to show you 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 had gone above and beyond 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.

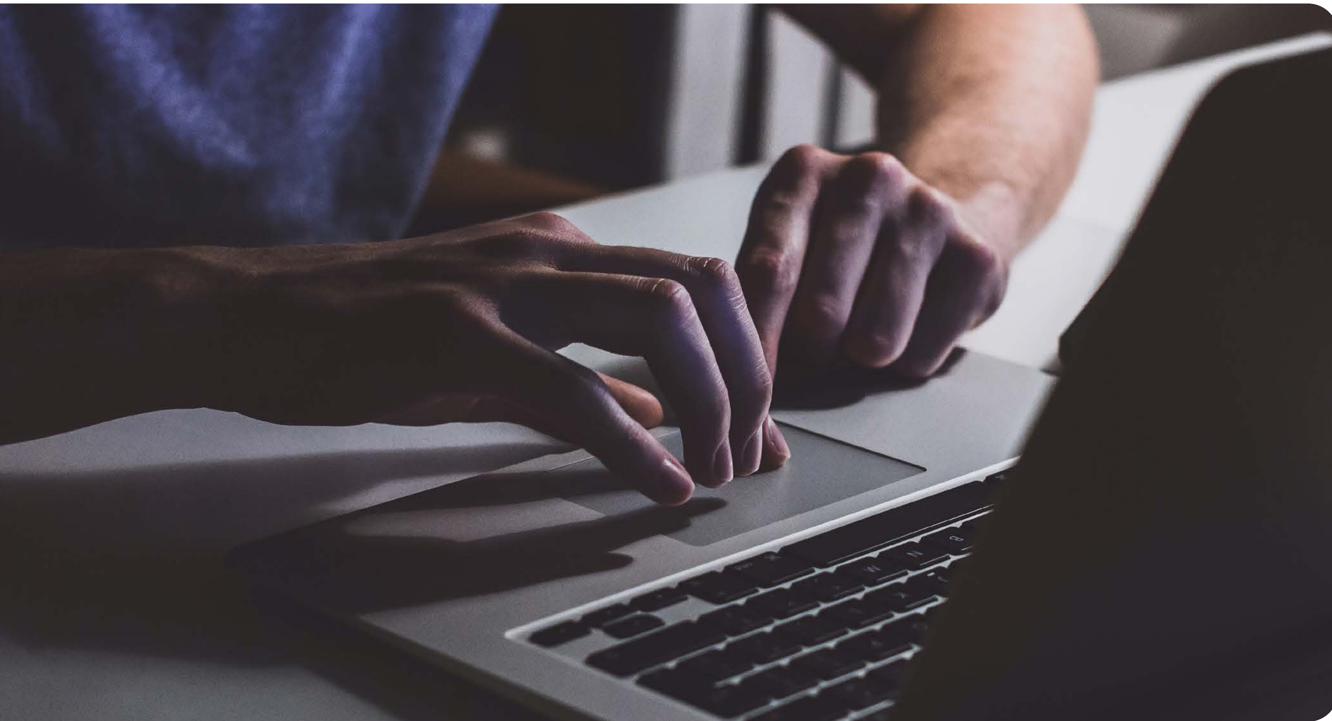
The problem with this is that a hobbyist using only one widget a month is charged the same as an enterprise client using 100 widgets a month. On the other hand, if a large organization doesn't want analytics or support, they can continue to pay $20 per month forever, even if they become the next Apple.

If the same pricing plan is redesigned around a value metric, the positive effects 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 a large customer is now paying $500. This pricing structure is better aligned with the value customers receive. When extended over a year, this makes a massive difference.

> **"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."**



40x more revenue through changing pricing from a feature list to a value metric

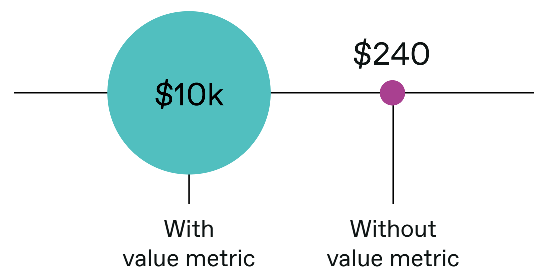
This might be at the extreme end, but it is a beacon for what value metrics can achieve. A well optimized value metric allows you to grow as your customers grow. It puts you in lockstep with them. Their success is your success.

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.

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

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



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:

1. **Positioning**
   The correct value metric allows you to align your product to different segments of the market and support them as they grow.
2. **Packaging**
   A value metric acts as the main component of your different packages and is the headline that differentiates them.
3. **Pricing**
   The pricing represents the ideal value metric to the customer.

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

How to simplify your value metric

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 to your company. One of the biggest mistakes we see SaaS companies make is defaulting to per user value metrics. 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 sense.

This also inhibits growth as customers are then reluctant 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.

Once you have found a value metric that fits your product, you have to ask a fundamental question: Does your customer know how many of [your metric] they need?

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.

Takeaways

Make your value metric easy to understand

So that new customers who visit your pricing page can immediately understand what they would be paying for and where they fit in your packaging.

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.

Always perform a simplicity test on your value metric

If a customer doesn't know how much 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. 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:

Equation for LTV

$$\text{LTV} = \frac{\text{ARPU}}{\text{Customer churn rate}}$$

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

Equation for LTV

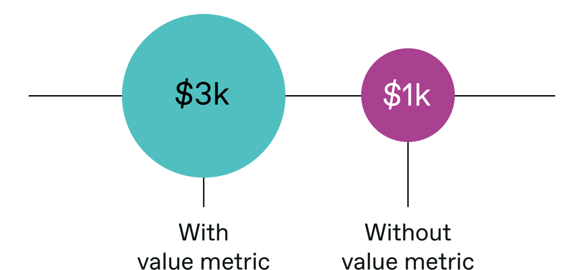
$$\text{LTV} = \frac{\$100 \text{ ARPA}}{0.1 \text{ Churn rate}} = £1000 \text{ LTV}$$

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 example, 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 an account.

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

Number of...	Most preferred	Least preferred
Emails sent	○	○
Emails received	○	○
Users accessing account	○	○
Contacts	○	○

This allows you to identify 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:

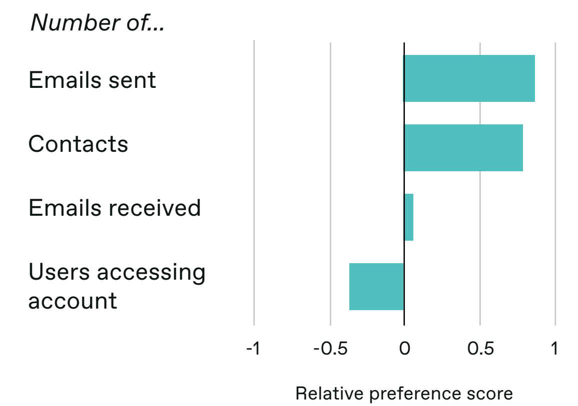
Plotting these scores shows you exactly what value metric your customers prefer.

Most 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.

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.

Relative preference scores for different value metrics

Number of...



Takeaways

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.

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 it.

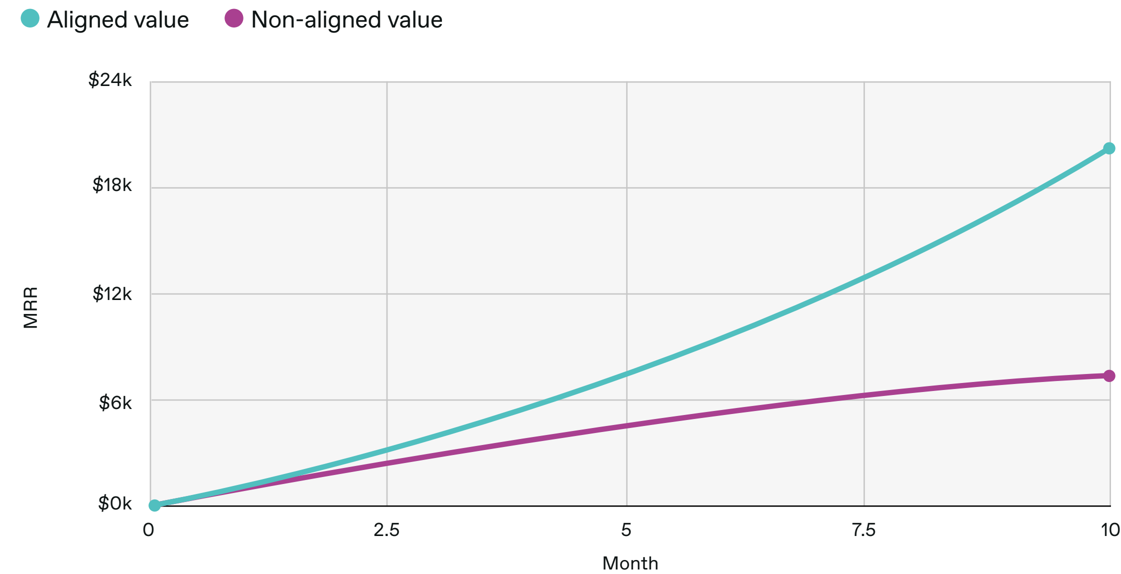
If customers see different value metrics as important, consider constructing a dual value metric

To capture the highest potential value.

Growing with your customers

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.

Growth through aligned value



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. This leads to net-negative churn, meaning when you put a dollar into your SaaS machine, you actually end up getting much more out.

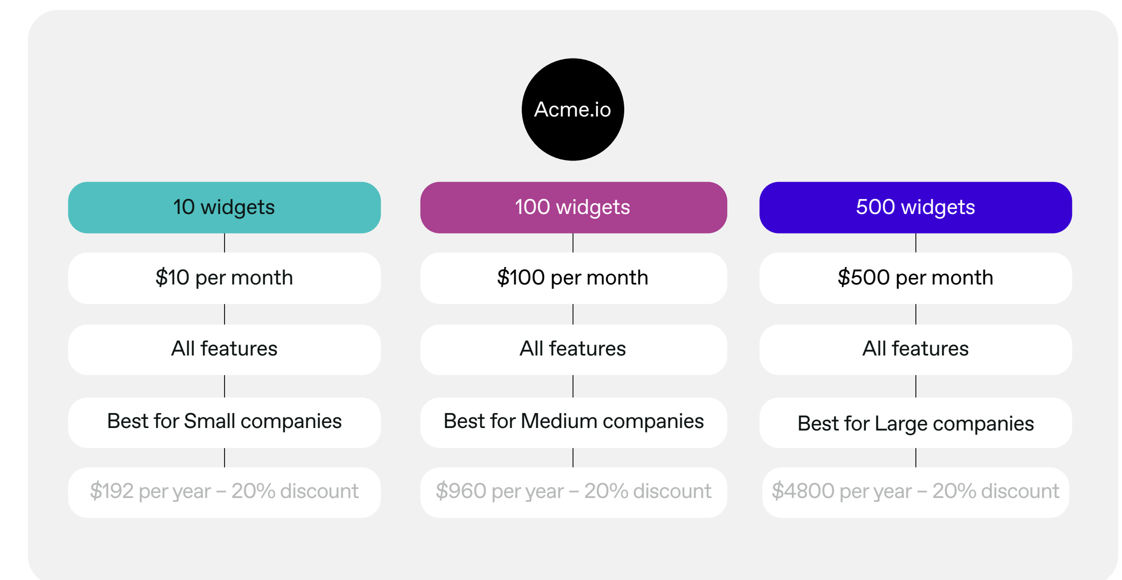
In this scenario, the blue line shows no alignment between the value metric and what the customer needs. It could be that the value metric is per user, whereas what the user really needs is more storage. Churn is high (10%), while account expansion is low (1%). Growth is constrained and will plateau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

The blue line shows what happens if you improve these numbers by aligning value. If the company is offering different levels of storage, then as their 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 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's willingness to pay data, the only way to drill down to exactly what works is to continually test and optimize.

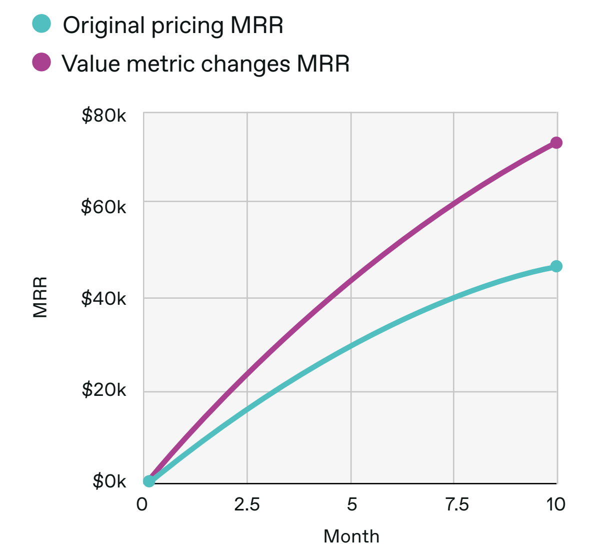
Let's go back to Acme.io. A previous version of their pricing page could have looked like this:



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. Customers are unlikely to use up all their widgets in their plan so they 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. Allowing customers to purchase additional "buckets" of value metrics or add-ons without needing to move onto the next tier (up to a certain limit, of course) can also expand monetization opportunities that would otherwise be lost. Even this small change can change revenues significantly:

Original pricing MRR vs Value metric changes MRR



This is the kind of data 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.

Your pricing page should have constant iteration throughout your existence.

Takeaways

The best thing about value metrics is that they allow you to capture more value as your customers grow
The better they do with your product, the better you do as well.

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.

Constantly implement and test different ideas
This iteration should never end.

Value metrics is the best way to optimize your pricing for growth. It works by 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 constantly 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.

Without a value metric you can't grow efficiently. With a value metric, you will grow alongside every single one of your customers."

CHAPTER SIX

How your company can build a pricing strategy

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.

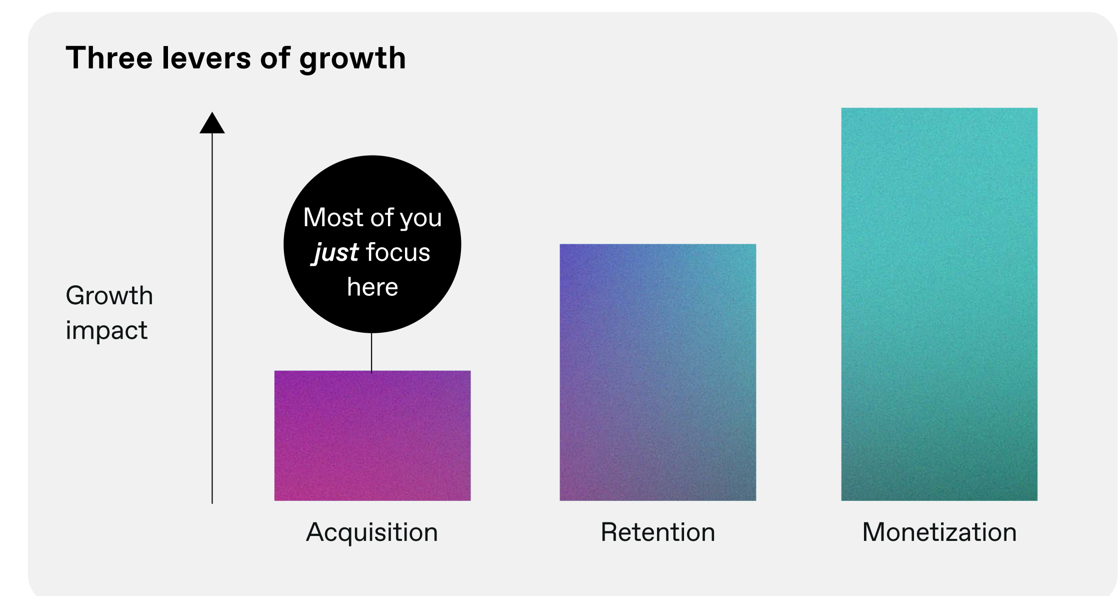
Without buy-in from your entire company, and a practical pricing process in place, all your hard work to find value for your customers will be for naught.

In this chapter, we are going to show you how you can build a pricing strategy 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 strategy that builds pricing will mean you are constantly optimizing your pricing strategy every single day.

Building blocks that build 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, in our 10 year's experience of working with SaaS companies, they hardly think about pricing. Though monetization is often an afterthought when it comes to growth levers, it has the biggest impact.



The fact that most companies focus is on 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:

1. **Commitment**
   We have seen companies spend very little time on their pricing but spend a ton of hours on acquisition.

2. **Expertise**
   When we meet a SaaS business, usually no one is hired to manage the pricing process.

3. **Process**
   Pricing is often treated as gut feeling rather than a validation process rooted 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.

Pricing = people + process

It's not just the product. The hard part about building a company is building all of the individual components that make it sustainable and successful.

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 culture, made up of specific people and processes.

What most companies lack is a pricing strategy. The goal could be increased growth or better LTV/CAC ratio, and pricing outcomes can serve as feedback to gauge how effective your pricing strategies are.

The pricing strategy itself has two parts:

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

2. **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 pricing practice that will be the engine of your growth.

Aligning your team around pricing

The first part of your pricing practice 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.

Team alignment around customer value is critical to upselling, and upselling is critical for SaaS growth.

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.

In this scenario, customers are more likely to churn at a high rate. They certainly don't upgrade.

> **"To have success in SaaS, you need to make a significant proportion of your revenue from these upsells."**

Marketing

Has no strategic messaging to appeal to different buyer personas.

Sales

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

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.

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.

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
- Product will use feedback to build the product
- Sales will maximize their deal value
- 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 pricing team as you continue to 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 buyer 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 say about implementation. This should be someone at the very top of the organization, such as the CEO, that can get everyone involved.

Establishing your pricing process

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.

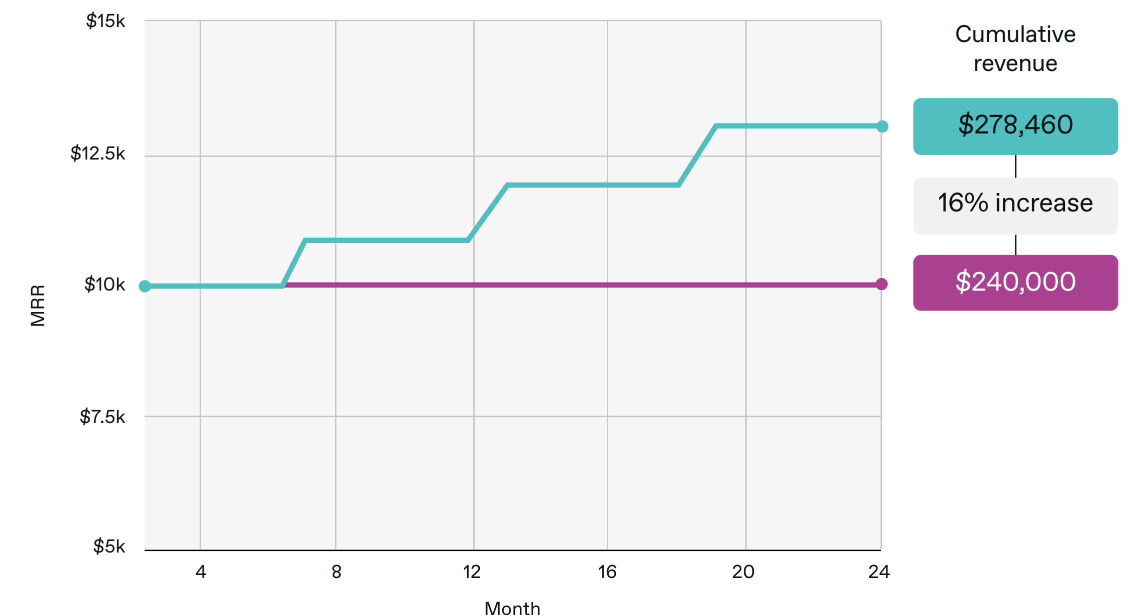
Whenever you make a product change, you should be recalculating your value and translating that value into pricing. Movement is growth. Pricing changes don't always mean higher prices. It could be changing value metrics, shifting features within tiers, or even just changing the language on your pricing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

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

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

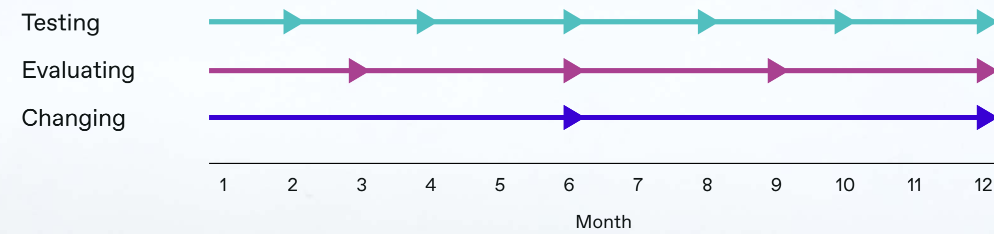
Pricing improvements with staggered price increases



Aligning your team around pricing

Building a pricing process isn't hard.
You just need a defined cadence.

Here is what we suggest:



Every eight-to-nine 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.

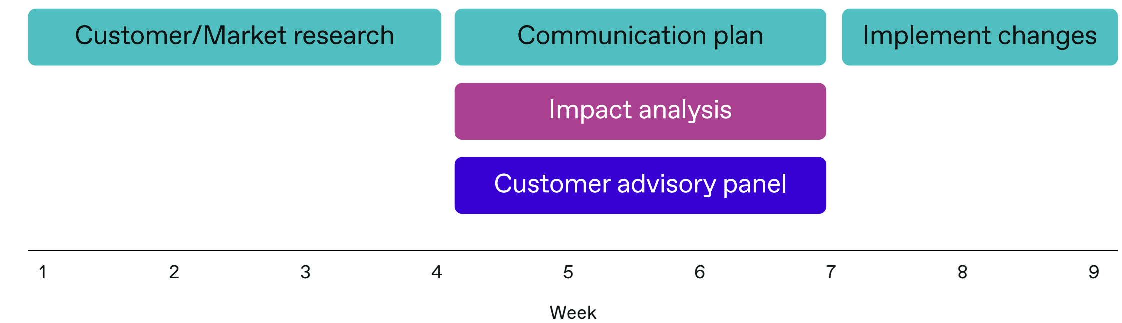
If it coincides with your larger evaluating or changing cycles, it might also include implementing any changes.

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 says, 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.

Changing your pricing



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 strategy 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 strategy, 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:

1. **Reducing your 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.

2. **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.

3. **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 a small subset of customers or prospects only, so are a great way of testing out new ideas.

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."

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:

1. **Raising/lowering prices**
   This is the big change that will have an effect on most people and will see the most pushback. But if you are offering more value, then it is reasonable to change the pricing to reflect that.

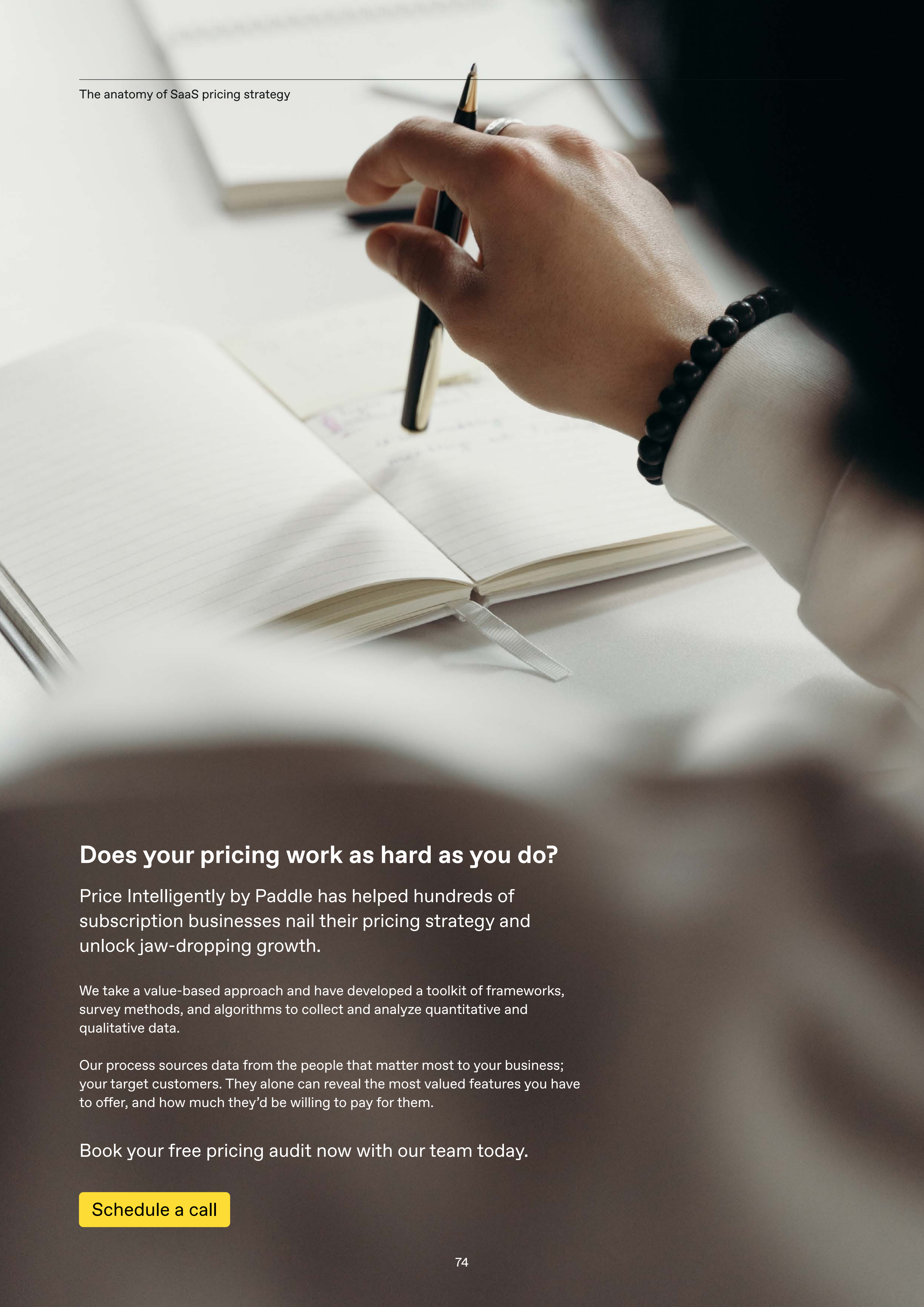
2. **Expanding/contracting tiers**
   As you get a better idea of your buyer personas, you can consider adding or removing tiers to better orient value to these people. This is one of the big changes you should be considering on a regular basis so you are always positioned effectively in the market.

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 practice strategy that allow you to put pricing at the heart of your business and turn it into the constant stream of growth it can be.



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