

# PREQUATE

strategic finance *for* business impact





# How to price your SaaS

2019

*Disclaimer:* This paper is a property and copyright of Prequate™. No reader should act on the basis of any statement contained herein without seeking adequate professional advice. The authors and the company expressly disclaim all and any liability to any person who has read this paper, or otherwise, in respect of anything, and of consequences of anything done, or omitted to be done by any such person in reliance merely upon the contents of this paper. The intention of this Whitepaper is to educate and is not meant to be exhaustive in any manner. The opinions of expressed are those of the authors and do not necessarily mean to be prescriptive either. Discretion is advised.

Companies have woken up to the fact that people want outcomes, not ownership. They want customized experiences, and they want continuous improvement, not planned obsolescence.

- Tien Tzuo  
Founder & CEO, Zuora



SaaS (Software as a Service) has singlehandedly emerged as the single largest disruption in business model in the last decade. SaaS companies suddenly made available enterprise quality technology to people (and businesses) across the world. SaaS public companies made ~\$70Bn (at a ~70% gross profit) while adding ~\$700Bn in MCap on the Nasdaq.

But there is one thing that sets SaaS apart. A 70% gross profit means that the every \$1 of revenue can add \$0.70 to your profits & \$9.5 to your enterprise value. Which makes for – **Pricing**, the single largest needle spinner (after the product and service, *of course*) in a SaaS companies life. Looking for that one small thing that makes a big change? **Start here.**

*Disclaimer:* Please note that these are our views are based on our experience in being advisors and working hands-on with various organizations. They are for the limited purpose of educating the leaders of a company. The rationale and the procedure to be followed can vary significantly based on the context, stage, exact nature & size of the business.

# Why pricing for SaaS? Why today?

Do you need to be thinking SaaS today too?



**PRE**  
**QUATE**



# Why is SaaS pricing so important?

---

Every business has certain levers that are some of the most important areas that the business needs to consider. For a manufacturing company, it could be scale-up costs, raw material costs and marginal cost. In a SaaS business, it becomes a lot more complex as the marginal cost could be as low as 0 with the initial outlay in the millions of dollars. Lets challenge some fundamental assumptions that SaaS companies don't follow. Lets play a game of Myth/Truth?.

## Statement #1

Changing the pricing is a bad idea because my customers will churn out and I will end up loosing market share

---

## Statement #2

An increase in pricing will make my customers drop me and switch over to my competition

---

## Statement #3

Changing pricing strategy can only change my LTV marginally, so its better to consistent than face blowback

# Math of napkin

---

For simplicity sake, using NASDAQ listed enterprises as a benchmark:

---

An additional  
\$1 per user per  
year



at a

GP of 70% (say)



is worth

**\$9.5**

of enterprise  
value/ valuation



# Why is SaaS pricing so important?

## Statement #1

Changing the pricing is a bad idea as no one does that and its bad practice

**MYTH**

## Truth

**2/3** of all companies changed their pricing in 2017

## Statement #2

An increase in pricing will make customers drop me and switch to competition

**MYTH**

## Truth

**0%** of companies that increased pricing by 25% saw any decrease in retention

## Statement #3

Changing pricing strategy can only change my LTV marginally

**MYTH**

## Truth

**98%** of companies that changed pricing saw an immediate increase in LTV

# The Value of 1%?

The value of 1% increase in each of these growth levers means how much of an improvement in bottom line?

▼ **1%** = ▲ **3%**  
in CAC in PBT

**Acquisition cost**

▼ **1%** = ▲ **7%**  
in churn in PBT

**Retention Rate**

▲ **1%** = ▲ **13%**  
in pricing in PBT

**Monetization**



**PRE**  
QUATE

# Then how does one price today?

Is there a better way than I have been doing?

# So what do companies do now?



## COST-PLUS APPROACH

— *We know what it costs us. Lets make more than that. Simple.* —>

**10%**  
of companies still do this



## COMPETITION LED APPROACH

— *Lets just copy what they are doing!* —>

**25%**  
of companies still do this



## GUT FEEL & NOT AN APPROACH

— *I have a strong feeling that this will work!* —>

**26%**  
of companies still do this

## It falls short.

### Its all about Us.

- x** ignores efficiency
- x** ignores customer
- x** no link for sales goals
- x** contains LTV

### Its all about them.

- x** ignores customer
- x** makes selling hard
- x** kills competitive edge
- x** increases sales effort

### Its all about me.

- x** subjective
- x** reduces accountability
- x** makes selling hard
- x** increases sales effort

# Value Based

Instead of looking inside, Value Based Pricing looks at the inherent value of the solution to the customer. While this takes more dedicated effort to achieve, it could significantly improve the speed of adoption and retention of the solution in the long run.

## Advantages

- ✓ Sensitive to customer's needs
- ✓ Makes you rethink your product, *continually*
- ✓ Linked to outcomes = pain points/ savings/ revenue

## Disadvantages

- ✗ Needs a lot more dedicated scientific effort
- ✗ May need expert assistance

# How to put it in motion?

## #1 Understand your customer first

What is the primary benefit that my customers are paying to receive?

Primary benefits



say, Mailchimp

My customers use it to stay connected with customers through email.



Ability to pay

Is this a customer segment that can afford to pay for your product/ solution?

Majority users are B2C businesses who can pay > \$100 pm.

Are my customers used to paying for this product or for solving a problem or saving a cost?

Willingness to pay



Users already spend/ understand value of email marketing.



Secondary benefits

What other benefits do my customers receive using this product?

Helps organize communications, contact lists and study ROI.

# #2

## Understand how your customer uses your product

*say, Mailchimp*

### How often?

*How many times a day, a month, a year or a minute*

*My customers use it 2-3 times a month on average.*

### For what?

*To achieve what goal, to replace what, to improve what, to gain what*

*My customers use it to engage with their customers.*

### How long each time?

*What kind of interaction, stickiness, ease of navigation*

*Users mostly use this 2-3 hours each time they login.*

### What features?

*What areas of the product does he use most often, what is important*

*Users mostly use the mailing features and functionalities.*

### Why you?

*What about your product makes it mean that much more for him/her?*

*I make it really easy for my non-marketing user to also do marketing.*

# #3

## Ascribe value to the benefits it provides



### Primary benefits

What is the primary benefit that my customers are paying to receive?

### Cost saving?

$\$X$  per month/ per transaction/ resource cost/ per instance

### Increasing revenue?

*Incremental*  $\$Y$  per month/  $\$Y$  per transaction/  $\$Y$  per instance

### Improving efficiency?

*Incremental*  $\$X$  saved per month/ per transaction/ per instance



### Secondary benefits

What other benefits do my customers receive using this product?

### Improving effectiveness?

*Improvement of*  $\$X$  per month/ per transaction/ per instance

### Removing redundancy?

$\$X$  cost saved per month/ per transaction/ per instance



# Price your SaaS product

**PRE**  
QUATE



# Identify

#1 **Buyer personas**

#2 The Pain Point

#3 The Value Metric

#4 Revenue Model

#5 Your costs

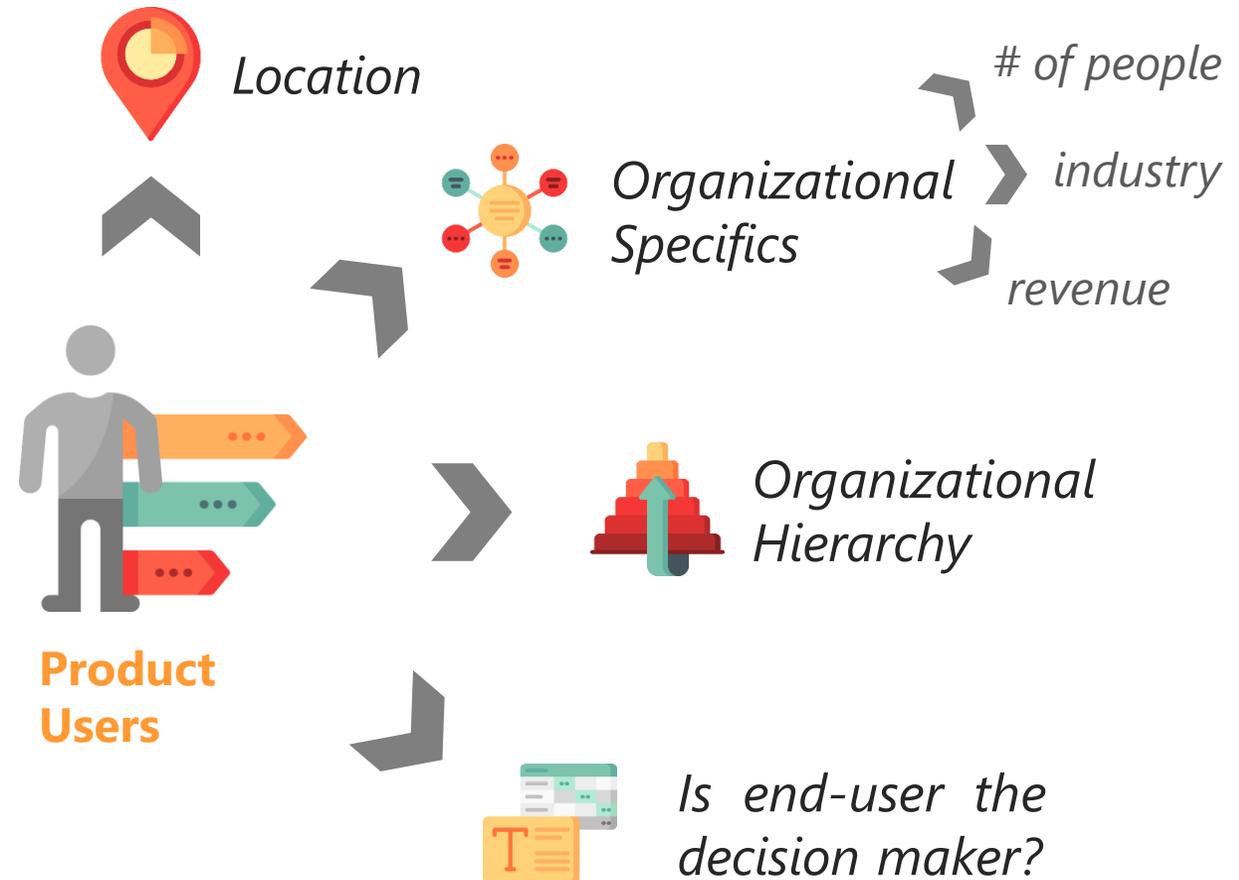
#6 Alignment

#7 ROI

#8 Repeat from #1

## 1A Create Customer Segments by identifying the right qualifiers

Creating buyer personas allows you to look at monetization separately based specifically on the pain point it addresses for them.



# Identify

#1 Buyer personas

#2 The Pain Point

#3 The Value Metric

#4 Revenue Model

#5 Your costs

#6 Alignment

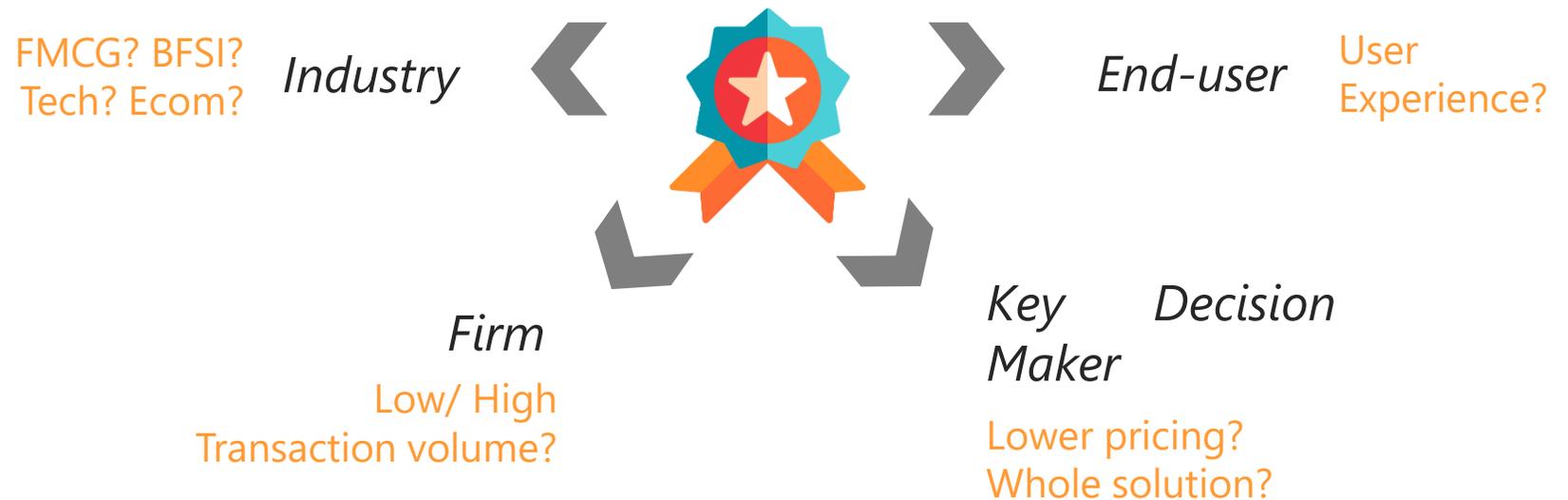
#7 ROI

#8 Repeat from #1

## 1B Each customer segment has specific & unique requirements

Each buyer persona will have specific requirements based on factors such as size, nature of business, kind of clientele, expectations from solution and how integral this solution is to their whole business.

What is the value to the:



# Identify

#1 Buyer personas

#2 The Pain Point

#3 The Value Metric

#4 Revenue Model

#5 Your costs

#6 Alignment

#7 ROI

#8 Repeat from #1

PRE  
QUATE

## 1C Create Buyer personas based on what they value as a customer group

#1 Buyer personas based on a user's customer grouping based on intended use

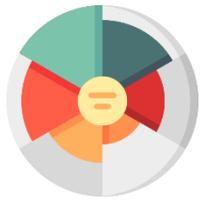
#2 Buyer personas tagged to specific primary benefit

#3 Capabilities extended for specific secondary benefits

	Amateur	Pro	Popular	Agency	
#1	Free BROWSE VIDEOS Good for everyone who wants to start creating videos online	\$14 per month billed annually SUBSCRIBE Good for individuals who need just a few videos from time to time	\$29 per month billed annually SUBSCRIBE Good for YouTubers and businesses who create videos constantly	\$39 per month billed annually SUBSCRIBE Good for resellers, businesses who do create lots of videos	\$49 per month billed annually SUBSCRIBE Good for companies who are in need of large amount of videos per month
#2	Unlimited 360p videos Up to 3 minute videos	5 HD720 Videos per month Up to 5 minute videos	20 HD720 Videos per month Up to 15 minute videos	40 HD720 or 20 HD1080 Videos per month Up to 30 minute videos	100 HD720 or 50 HD1080 Videos per month Up to 60 minute videos
#3	500 MB storage Limited number of music tracks Watermarks on everything Free logos in PNG	Up to 10 GB storage 30+ commercial music tracks No watermarks on HD videos No Vector Logos	Up to 20 GB storage 50+ commercial music tracks No watermarks on HD videos 1 high quality vector logo per month	Up to 40 GB storage 80+ commercial music tracks No watermarks on HD videos Create unlimited logos	Up to 80 GB storage 120+ commercial music tracks No watermarks everywhere Create unlimited logos

Courtesy: Renderforest.com

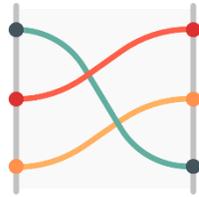
Ask customers to rank features. Calculate a relative score for each feature by using the formula.



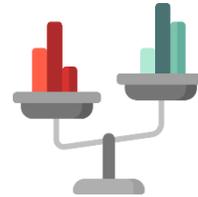
## Conduct a relative Preference Analysis



## Plot relative scores for each feature



## Discover willingness to pay for a feature



 <p>Identify Overall what feature is most desired vs what has the lowest score.</p>	 <p>Conduct an analysis by Buyer Persona to determine what is of value to each type</p>
--	--

# Identify

- #1 Buyer personas
- #2 **The Pain Point**
- #3 The Value Metric
- #4 Revenue Model
- #5 Your costs
- #6 Alignment
- #7 ROI
- #8 Repeat from #1

Identify features from the relative preference analysis to qualify as a value metric, which should pass both the following tests:

It must be  
**easy to understand**

by end users and decision makers



**Identify low level components** (sign-ins, logins, users, dashboards, etc.) with a high value proposition.



**Perform a test to validate simplicity** – Customer should know exactly what he is paying for and why

&

It must  
**grow over time**

with more adoption and usage



**Define thresholds** for the chosen value metric based on what feature would be needed how frequently and when.



**Test continually** based on the ability and willingness to pay for a certain feature considering buyer persona

# Identify

- #1 Buyer personas
- #2 The Pain Point
- #3 **The Value Metric**
- #4 Revenue Model
- #5 Your costs
- #6 Alignment
- #7 ROI
- #8 Repeat from #1

Are there onboarding costs involved in deployment of the solution?

Is the entire solution with its capabilities being provided on Day 1?

**Upfront Fees**

Am I required to keep the solution up-to-date/maintain it?

**Annuity License Fees**

Do I have an incremental time based costs (such as server costs etc.)?

**Monthly Fee**

Do I have an incremental cost with each new user (say, login ID x User data)?

**User Fee**

Do I have an incremental cost with each transaction transacted?

**Transaction Fee**

Do I have a cost for each new instance/ permission granted?

**Instance Fee**

Do I have an incremental cost with each output generated (say, queries)?

**Variable Fee**

# Identify

- #1 Buyer personas
- #2 The Pain Point
- #3 The Value Metric
- #4 Revenue Model
- #5 Your costs
- #6 Alignment
- #7 ROI
- #8 Repeat from #1

# Identify critical cost metrics

Identify & measure fixed, variable & scale-up costs for growth



# Make effective Pricing Decisions

Decide on gestation, investment recovery & cash surplus

## L1 Surplus

Direct cost of customer acquisition

Direct cost of servicing/ support

Direct cost of usage or adoption

Ideally recovered in current year from current revenue

## L2 Surplus

Recovery of cost to build/ develop solution

Recovery of marketing/ BTL costs

Recovery of operational/ running costs

Ideally recover from L1 Surplus in first 18 months

## L3 Surplus

Fixed costs and step-up costs

R&D costs

Cost of capital deployed

Ideally recover from L2 Surplus in 18-36 months

# Identify

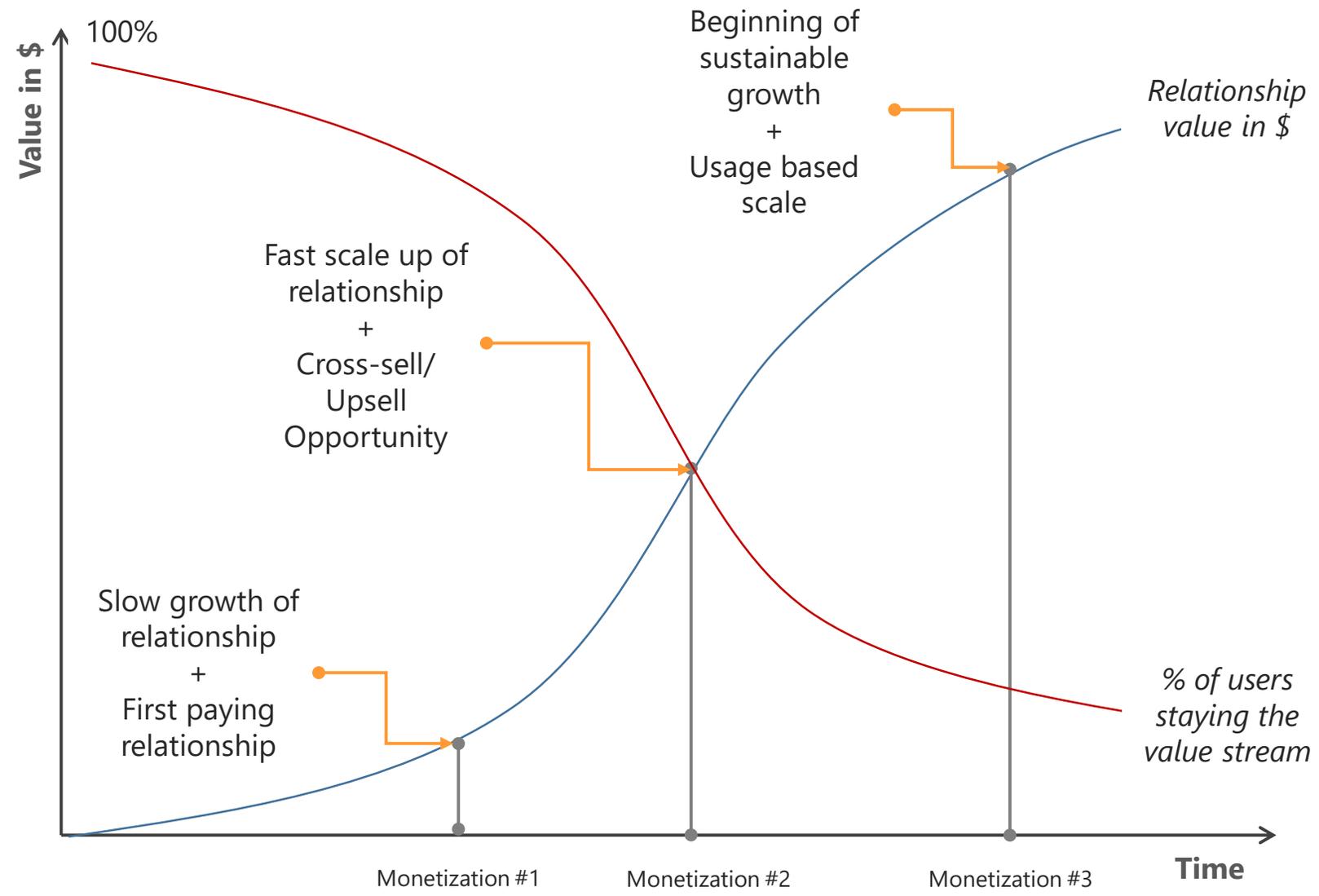
- #1 Buyer personas
- #2 The Pain Point
- #3 The Value Metric
- #4 Revenue Model
- #5 **Your costs**
- #6 Alignment
- #7 ROI
- #8 Repeat from #1

# Identify

- #1 Buyer personas
- #2 The Pain Point
- #3 The Value Metric
- #4 Revenue Model
- #5 Your costs
- #6 **Alignment**
- #7 ROI
- #8 Repeat from #1



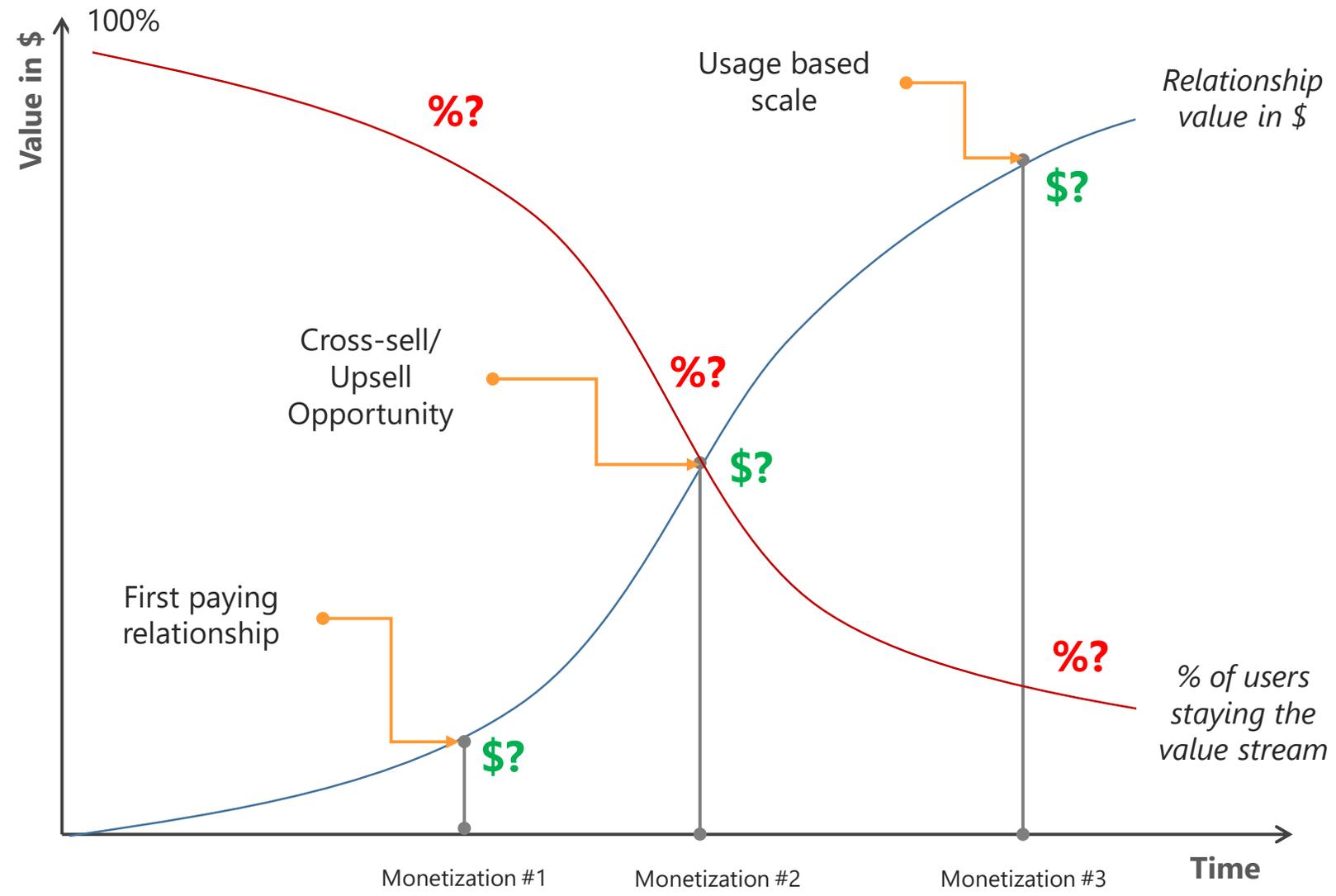
## Draw out your relationship journey for each buyer persona



# Identify

- #1 Buyer personas
- #2 The Pain Point
- #3 The Value Metric
- #4 Revenue Model
- #5 Your costs
- #6 **Alignment**
- #7 ROI
- #8 Repeat from #1

# Assign \$ value to opportunities

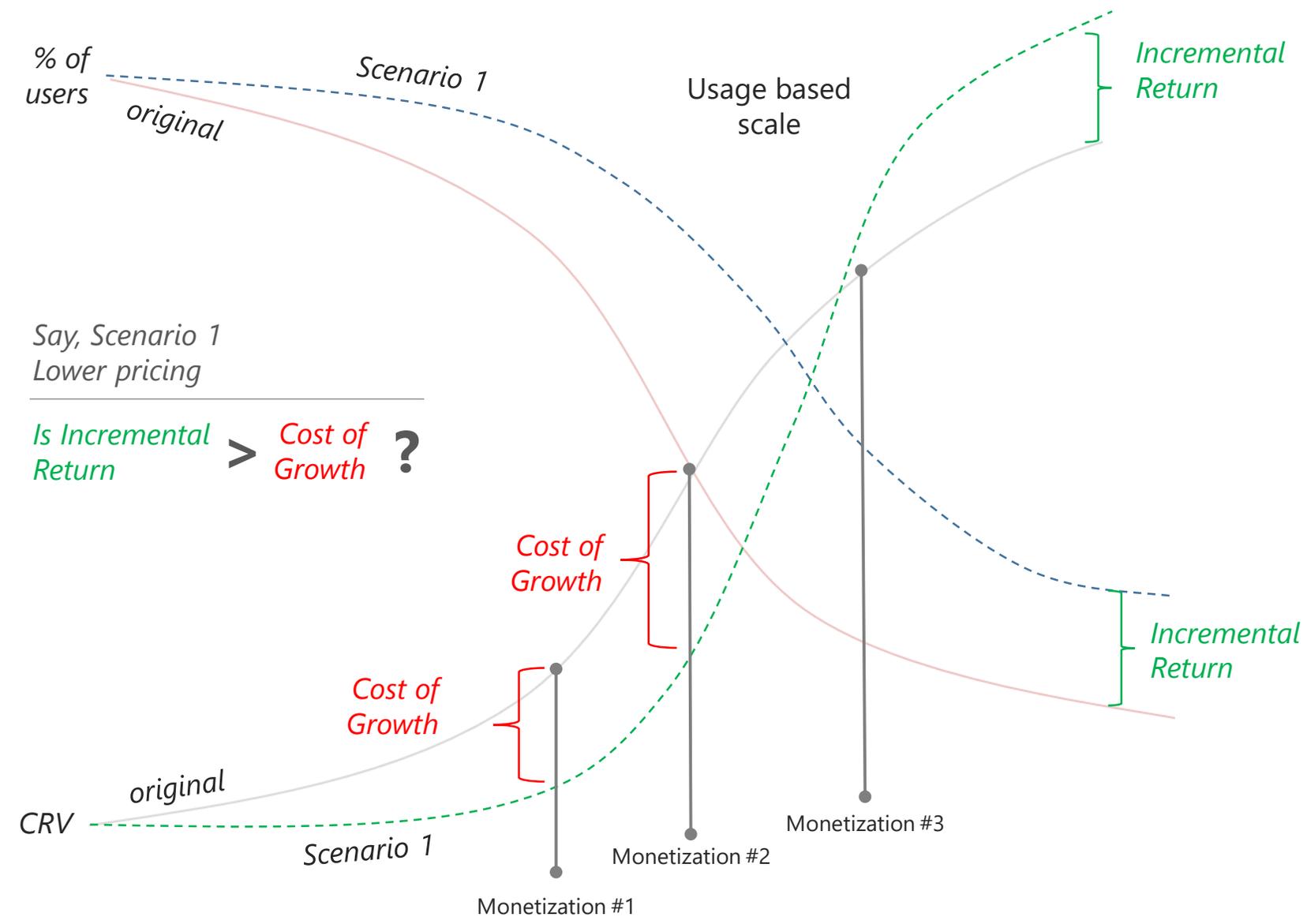


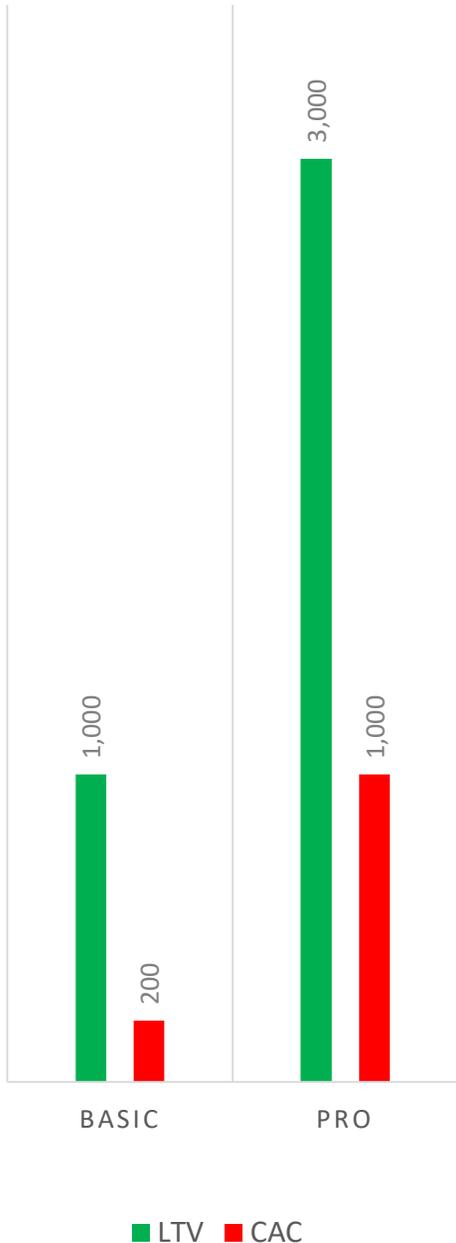
# Identify

- #1 Buyer personas
- #2 The Pain Point
- #3 The Value Metric
- #4 Revenue Model
- #5 Your costs
- #6 **Alignment**
- #7 ROI
- #8 Repeat from #1



# Arrive at pricing based on scenarios for each buyer persona





## Analyse the ROI by studying LTV to CAC for each buyer persona

In the example to the left, the 'PRO' buyer persona has a higher LTV per customer but also a higher CAC. In this example, the LTV/CAC is 3.0x.

*Recommendation:*

(1) Augmenting revenue based on Willingness to pay or (2) Reducing CAC over a period of time.

The 'BASIC' version on the other hand has a LTV/CAC of 5x, though in \$ terms is lower.

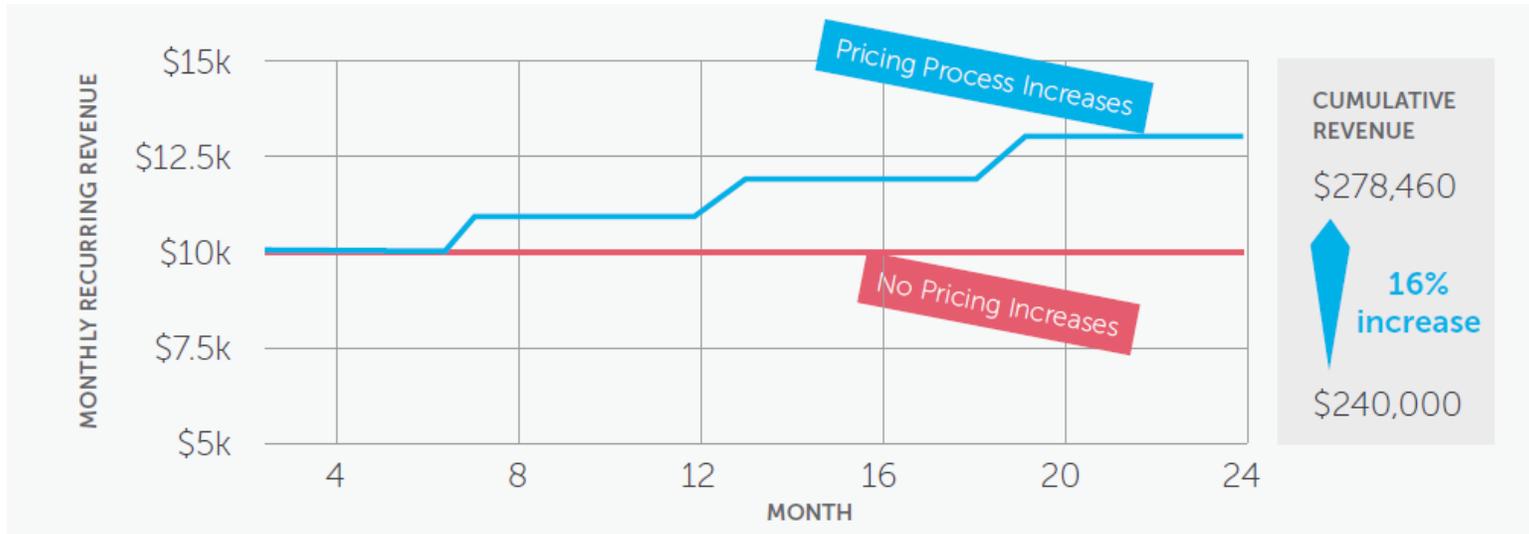
*Recommendation:*

(1) Focus more sales effort on 'BASIC' buyer

## Identify

- #1 Buyer personas
- #2 The Pain Point
- #3 The Value Metric
- #4 Revenue Model
- #5 Your costs
- #6 Alignment
- #7 **ROI**
- #8 Repeat from #1

# Deploy. Evaluate. Reiterate.



Courtesy: Price Intelligently: The Anatomy of SaaS pricing

TEST      Ideally,      EVALUATE      CHANGE

Every month



Every 6 months



Every year

## Identify

- #1 Buyer personas
- #2 The Pain Point
- #3 The Value Metric
- #4 Revenue Model
- #5 Your costs
- #6 Alignment
- #7 ROI
- #8 Repeat from #1



**PRE**  
QUATE

## How about some case studies?

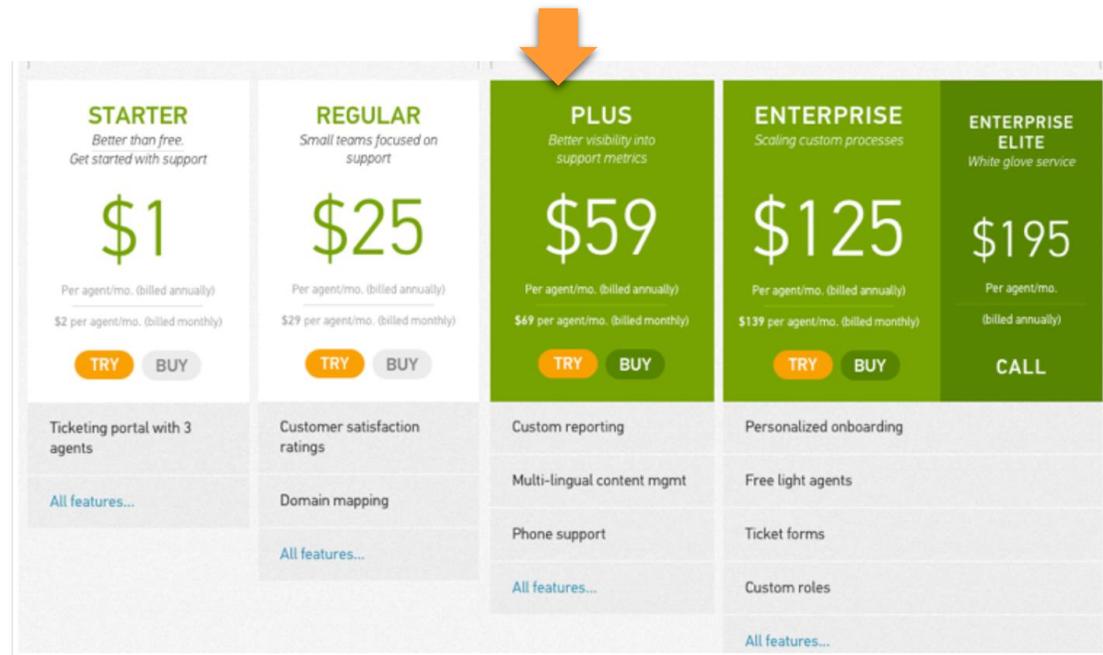


Pricing is what you pay.  
Value is what you get.

Warren Buffet  
Berkshire Hathaway

# Case 1

## Zendesk: Pricing to the customer



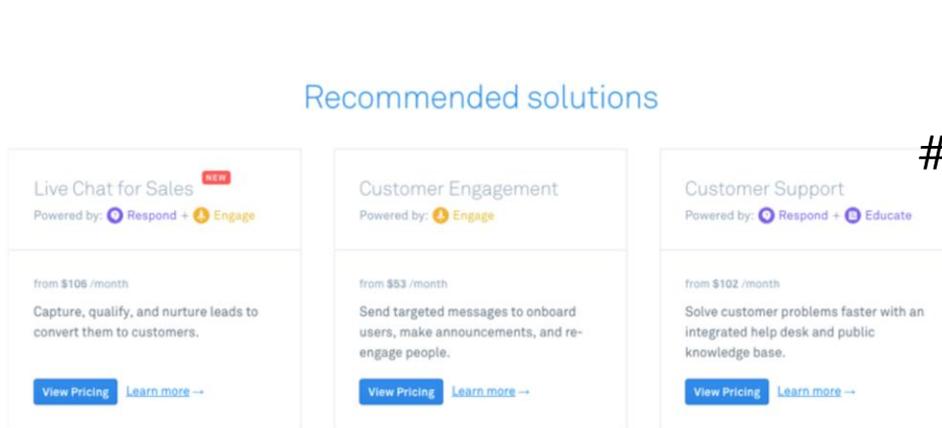
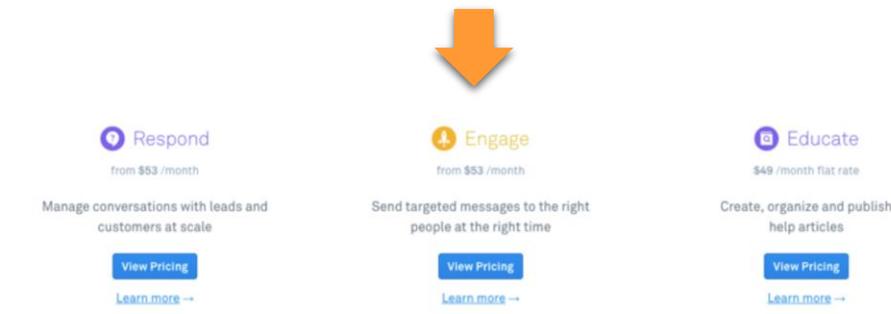
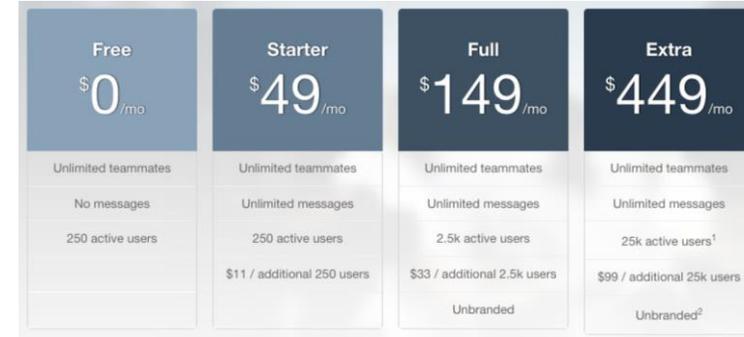
**#1** Change from # of agents to customer groups

**#2** Change to focus on primary and secondary benefits

**#3** Change based on customer onboarding costs

# Case 2

## Intercom: Pricing to the customer



**#1** Change from feature based pricing to benefit based pricing

**#2** Change from plan based pricing to use based pricing

**#3** Change from standard to stakeholder based pricing

Now, can **Prequate** help?

# Of course



**VALUE METRIC ANALYSIS**

**BENCHMARK STUDY**

**REVENUE AUGMENTATION STUDY**

*strategic management*

**PRICING POLICY**

**PRICING AUDIT**

**PRICING REVIEWS**

**ROI ANALYSIS**

**Credit:**

1/ Price Intelligently, The Anatomy of SaaS Pricing Strategy

2/ OpenView Partners, 2018 Expansion SaaS Benchmarks

3/ Chargify Blog, How Innovative SaaS Companies Leverage Pricing And Packaging To Beat The Competition



**Disclaimer:** This paper is a property and copyright of Prequate™. No reader should act on the basis of any statement contained herein without seeking adequate professional advice. The authors and the company expressly disclaim all and any liability to any person who has read this paper, or otherwise, in respect of anything, and of consequences of anything done, or omitted to be done by any such person in reliance merely upon the contents of this paper. The intention of this Whitepaper is to educate and is not meant to be exhaustive in any manner. The opinions of expressed are those of the authors and do not necessarily mean to prescriptive either. Discretion is advised.

The best way to understand how we can engage with your organization, is to speak with us.

A single click can go a long way.



*To write to us by email,  
< click*

[connect@prequate.in](mailto:connect@prequate.in)



*To set up a quick discovery talk/  
request more information  
< click*

[+91 988 63 44 590](tel:+919886344590)



**PRE**  
**QUATE**

