The 5 Dos and Don’ts of Digital Subscription Pricing

Introduction

The Age of Subscriptions

For businesses in all sectors, the switch from traditional one-off licenses to an ongoing commitment drives stronger and longer relationships with their customers, and creates repeatable, predictable revenue streams. And with what seems like an infinite amount of information available online today, customers are beginning to turn to paid-for content to cut through the noise and surround themselves with relevant - and often more trustworthy - sources.

The alignment of these incentives, with both the firm and the consumer searching for deeper relationships, has led to an explosion in digital subscriptions across all mediums and industries. Peloton, the at-home fitness class provider, doubled its subscriber base last year; Netflix recently passed 200 million members and The New York Times, despite falling readership within the newspaper industry as a whole, is on track to reach 10 million paying digital subscribers by 2025. Whether you're looking for workouts, movies or current affairs, you're sure to find a plethora of companies willing to service your content needs in return for a monthly fee.

Put simply, subscriptions have come to dominate the business landscape.
The Subscription Economy Index, tracked by Zuora, outperformed the S&P 500 by a factor of six over the last decade. The rise of subscriptions is no longer a trend prediction, it's a commercial reality.

Introduction

The Importance of Pricing

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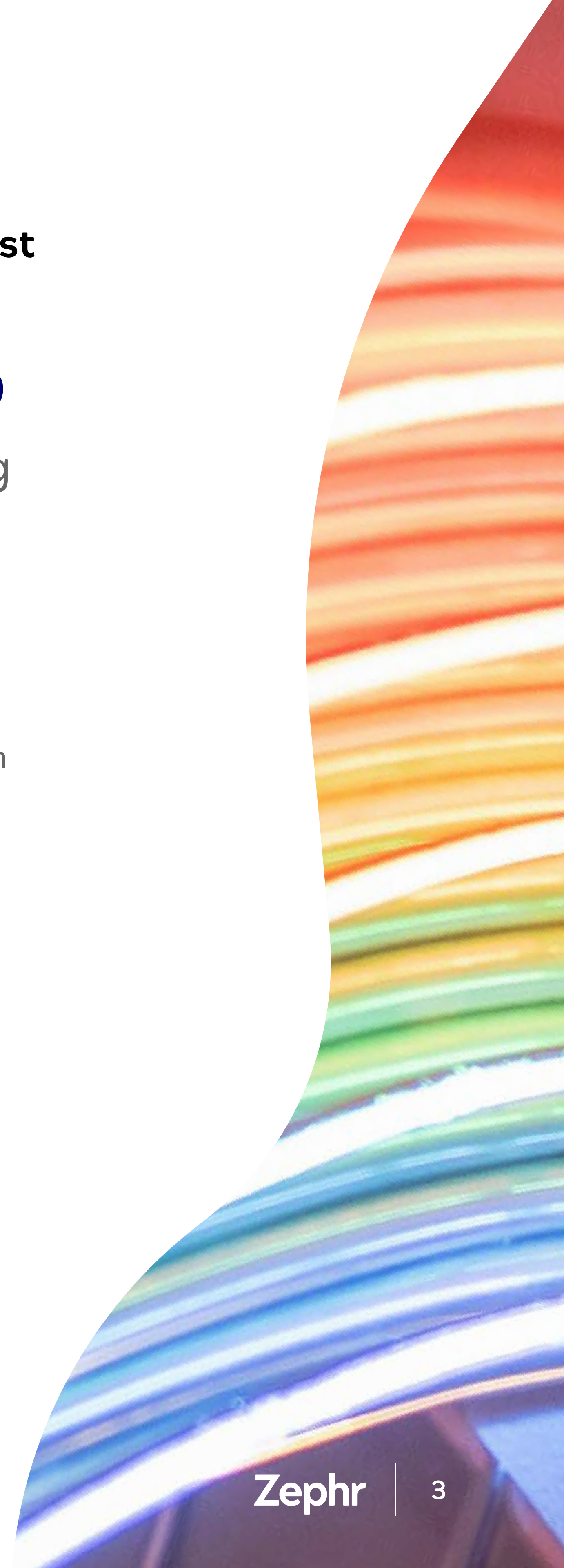
This might seem like an obvious point, but pricing your product or service is *really* important. Even those who already know this may not be actively aware of how influential pricing decisions are on their company's bottom line. An infamous Harvard Business Review study by Michael Marn and Robert Rosiello found that a 1% improvement in pricing led to an estimated 11.1% increase in operating profits. A 1% improvement in volume (i.e. how many units sold) led to a lesser 3.3% increase in profit, meaning that **pricing optimisation is over 3x more influential to your earnings than increases in sales.**

And yet, very little time, effort and money is invested in pricing strategies, at least when compared to the investments made towards lowering costs and maximising output. In fact, according to ProfitWell, the average business spends just 6 hours in its entire lifetime planning its pricing. When you consider that pricing has an effect on not just revenue and profit, but acquisition costs and retention rate too, half a day on pricing strategies seems massively underwhelming. Prices are even more important to get right for subscriptions, compared to one-off purchases because the customer will be locked in at this price-point until the next billing period, which may be up to 12 months later. Setting the wrong price at the beginning of a subscription can lead to an unprofitable account no matter how much value you provide.

So, whether you are looking to price your digital subscription for the first time or as part of a continual review (which we wholeheartedly recommend you do), let us take you through 5 of the best-practices, and costly mistakes, to consider when putting together a pricing strategy.



1. Do: align price with value

The goal when pricing subscriptions is to attract customers willing to pay regularly and long term. Value-based pricing does that far more effectively than other models such as competitor or cost-based pricing.

Competitor-based pricing

If you peg your prices to undercut your competitors, not only will you be relying on sheer volume to get into profit, you won't be focused on what customers are willing to pay for your specific value proposition, and value is what will retain subscribers. Competitor-based pricing is an ineffective method because it doesn't take into account how your business operates. It fails to capture what sets your offering apart from the rest of the market, be that strong branding, superior product or high-levels of customer service.

Cost-based pricing

Prices decided on cost are similarly misinformed. Adding a margin to your costs might get you into profit but leaves no room for growth. And once more, your strategy will be focused on volume rather than value. Those looking to price their subscription for the first time often use 'cost plus' (i.e. cost plus margin) pricing because it's safe and leaves you with a predictable profit. It is imperative that you fight the temptation to fall into cost-based pricing because it limits any development into genuine commercial success, capping your profit margin at whatever arbitrary figure you decide to add on. Beyond that, since your total revenue per purchase is not set in stone, and depends on how long the customer stays, cost-based pricing that takes a quarter or a year's revenue and adds a margin might leave you in the red if the customer churns earlier than expected.

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Companies that review their prices yearly grow twice as efficiently as those with no price-function, and those that continually optimise their prices grow over six times as fast

Value-based Pricing

Value-based pricing is all about the customer, what they think about your product, and how much they are willing to pay for it. At the end of the day, the end-user doesn't care about how much it costs you to provide the good or service - although they might feel over/undercharged if they knew - nor what your competitor costs, **as long as they are getting value from your offering**. Of course, this is no easy feat, and as we have mentioned before we suggest spending more time researching and defining your value proposition to help price more efficiently.

A key part of this research involves pinpointing what your 'price levers' should be. These are the features or aspects of your service that customers may want more or less of depending on their requirements. For digital subscriptions, the most common price lever is seats (i.e. the number of logins a customer has to access your content), although this isn't the only option. The New York Times used this method when they set the standard for subscription-based news back in 2011. However, it's worth noting that they could have gone down another path - charging per hour spent on the site, or per article read, for example. They spent over 14 months building their first paywall and presumably a lot longer than 6 hours on their pricing strategy!

And this isn't to say that value-based pricing will sweep up the entire market for years to come. Aligning value with offering attracts and converts the right customers and is the best option available, but if a competitor comes along and massively undercuts the market then that's unavoidable. Stooping to their level will leave you both at a loss, so **avoid a race to the bottom and focus on increasing your perceived value through your product and your brand where possible**.

Once you know your levers, understand your value offer and have A/B tested different price points for different subscription journeys, don't get complacent. Value-based pricing gives you the best opportunity to upsell customers as your relationship deepens, and a continual optimisation of your prices keeps them engaged and happy in the long run. According to a survey by Price Intelligently, companies that review their prices yearly grow twice as efficiently as those with no price-function, and those that continually optimise their prices grow over six times as fast. Can you really afford not to do it?

2. Don’t: forget about your metrics

There is a certain circularity in the relationship between metrics and pricing. It is important to research and fully understand your customer metrics to inform your pricing decisions, and once prices are set it is important to track how your metrics change, and then use these new metrics to update prices, and so on.

The metrics relevant to your business are the ones that directly link to each aspect of your value proposition. Keep an eye on the following when setting new prices and packages and track how they are affected by changes going forward.

Customer lifetime value (CLV)

The holy grail of SaaS metrics in particular, the basic calculation for CLV is to multiply the value of a subscription by the average subscription length. This metric isn’t everything, and doesn’t take into account the intangible value of a customer, such as the benefit gained if they recommend your product to a potential client. However, it is an important metric to track, and, all things equal, to try to increase over time. CLV is directly tied to prices since the monthly revenue per customer is simply the price of the package they have bought. Increasing the price by 10%, whilst keeping the retention rate the same, increases CLV by 10% too.

But increasing price isn’t the only way to drive higher CLV, and this is often overlooked by commercial decision-makers. Accurate value-based prices inevitably mean that customers are willing and able to stay longer with your brand, since what they get from you is aligned with what they are paying. **Lowering your prices to fit your value proposition may lead to a higher CLV if it results in even longer subscriptions periods**.

The moral of the story is to know your current and forecasted CLV when reevaluating your prices, but not to let it discourage you from value-based pricing. As we will discuss later, you don’t need to find a one-size-fits-all price that captures the whole market for the long-term, and breaking down customers into segments with similar willingness to pay (and therefore potential CLV) is the best way to stop visitors falling through the gaps.

2. Don’t: forget about your metrics

Customer Acquisition Costs (CAC)

To calculate CAC, take the total cost of everything involved in the sales process: marketing, sales teams, creative costs, advertising, etc; and divide it by subscribers converted. This metric should be keenly observed because if customer acquisition costs eclipse CLV, and therefore profits, your value proposition is wrong.

CAC has a similar relationship to pricing as CLV. Although we discourage cost-plus pricing methods, it is necessary to know if your CAC is higher than your current prices, since pricing below CAC guarantees you will make a loss on each customer. If you are using value-based pricing and hope to upsell or bring costs down over time, then this is manageable in the short-run whilst you capture more of the market (remember: Slack, one of the largest subscription companies out there with nearly $1bn in revenue, has yet to turn a profit). But in the long-run, having CAC creep above your prices is unsustainable.

However, pricing can also have a significant effect on CAC. The majority of the sales and marketing costs that your business incurs come at the top and the middle of the funnel - e.g. paid media, PPC, website costs, content marketing, etc. The leads that fall at the last hurdle, i.e. the qualified leads that fail to convert, are therefore the most costly in terms of opportunity missed. And these last-mile fall-throughs are more often than not caused by prices, either because they don’t align with your perceived value, or because they are too complex or hard to find. Getting your prices right (even if this means making them higher) through value-based pricing turbocharges your conversion rates, therefore reducing your CAC, having a double-whammy effect on your LTV/CAC ratio.

2. Don’t: forget about your metrics

Churn rate

If your churn rate is high, your customers are unhappy. This metric will directly affect your CAC because unhappy customers like to tell other people who might otherwise have subscribed just as happy customers encourage others to join them. Then not only are you trying to attract new customers, but you also have to replace the ones you’ve lost. **low levels of churn - known as natural churn - are inevitable, but it’s worth minimising excess churn as much as possible since it costs 5x more to acquire a new customer than to renew an existing one.**

When customers do leave, make sure you have a feedback mechanism in place to inform future pricing and packaging decisions. Have a question or two that evaluates your current prices, and how much perceived value the customer was getting, and whether this caused them to leave. If a large proportion of your churn is due to misaligned prices, then there’s no better gauge of what your prices should be than what your customers think they should be.

Churn data and evaluation should help inform your pricing strategy, as well as help catch disengaged customers before they leave with a new offer or even a downsell opportunity. **Retention begins at acquisition, and getting prices right at the start can prevent customers leaving later down the line, saving you time and effort to focus on providing maximum value.**

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Profit margin

If your profit margin is barely paying the bills then something needs to change. You need to find the balance between pricing and volume which will mean taking a few risks and some A/B testing with messaging or package options. If you raise prices, you may lose subscribers but the value of those that remain might increase your profit margin. Experiment with both sides of the scale to see how much you can push the price without losing too many subscribers.

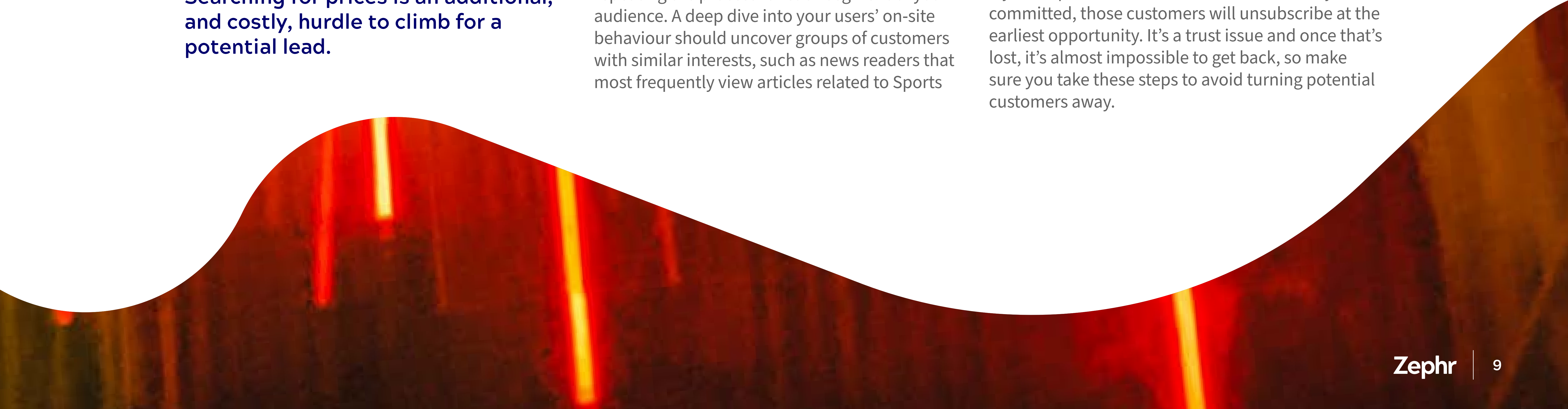
Low prices with a high volume of customers may work for new companies looking to make a name for themselves. But how many subscribers would you need, and for how long, if you are trying to reach a certain revenue figure with such a low price point? For some, the route to 1m MRR is a million £1 subscriptions, for others it’s a hundred times fewer customers but for £100 each. What works for you, again, ties back to your value proposition, and whether your offering is premium or mass market.

3. Don’t: make your prices complex or hard to find

There seems to be a taboo around transparent pricing. Many companies hide their pricing until the last minute due to the fear that potential customers might be put off early. In reality, the opposite is true: an open and simple pricing structure makes it far easier for the customer to decide whether they want to subscribe or not. Searching for prices is an additional, and costly, hurdle to climb for a potential lead.

When we say simple, however, this does not necessarily mean easy. What customers are shown should be a handful of clear, distinct packages with appropriate prices. What this means for you, behind the scenes, is large amounts of data analysis, research and experimentation. As mentioned before, not every customer has the same amount to gain from your content, which is why value-based pricing needs to apply to each package you offer, even if this means repeating the process for each segment of your audience. A deep dive into your users’ on-site behaviour should uncover groups of customers with similar interests, such as news readers that most frequently view articles related to Sports or Politics, or SaaS customers that use particular features more than others. If you have accurately aligned prices with value then each package you offer should be clearly defined.

And these packages, and their prices, should be easy to find on your website. **When you make potential subscribers search for costs, or have complicated add-ons, you are making it unnecessarily hard for them to convert**. Similarly, if you surprise customers with costs after they’ve committed, those customers will unsubscribe at the earliest opportunity. It’s a trust issue and once that’s lost, it’s almost impossible to get back, so make sure you take these steps to avoid turning potential customers away.



3. Don't: make your prices complex or hard to find

No hidden costs

Make sure the price subscribers see is the price they'll pay so they're comfortable with paying it regularly. Hidden costs instantly reduce the value of the subscription they signed up for, and since you should have aligned value with prices, there is no need to hide parts of the cost anyway.

Be transparent

Subscribers should be able to see clearly what's included in the price and the basis on which they'll be paying it, such as weekly, monthly or annually. If subscribers discover they're not getting what they thought they were, your churn rate will skyrocket.

Make your pricing structure easy to understand

For customers to decide what they're willing to pay, they need to understand each value proposition and make the right decision for their needs. If you have a complicated structure, you're putting up barriers to new subscribers and potentially long term customers. Make sure you have only a few (or even better, just one) pricing levers. Otherwise, users will be overwhelmed by options. For example, imagine buying a subscription to your preferred newspaper where you have to choose the number of logins you want, the topics of coverage you want to see and the number of articles you will view in a month. These are three separate levers and combining all three becomes complicated for the customer and messy for your back-end data analysis.

4. Do: keep prices flexible

Meeting your customers' needs and offering value in return for their money means recognising that one size won't fit all. Offering a single, all-in-one subscription with a value-based price point narrows the market significantly. If a subscription package is too broad, potential subscribers might feel it's too much to pay when they're only interested in a small percentage of it.

Most subscription businesses offer 3-5 packages, ranging from a free or trial option all the way up to a premium package and perhaps a multi-login B2B account too. By staying flexible, customers can easily place themselves in the category that resonates best with their interests, lowering the risk that they won't engage with your content.

There are several ways to offer simple flexibility whilst still offering value based on willingness to pay:

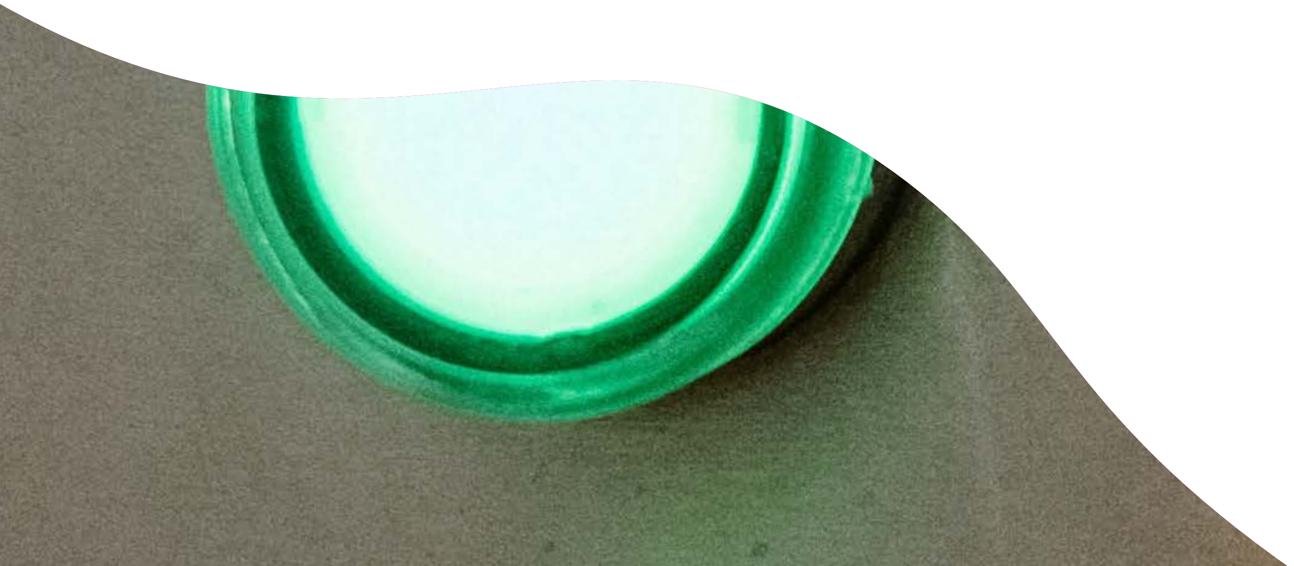
Tiers

For many organisations, these packages cover basic, middle and top tier subscriptions with increasing value and prices. This gives customers a choice based on their needs but it also allows basic or unconvinced subscribers to move through the tiers as they become more familiar with your brand. This allows you to 'build and grow' your relationship with even the most sceptical of readers.

Build buyer profiles

Analyse your ideal customers and segment them into types of buyers - for instance, browser, professional and news junkie, or whatever best fits your customer profile.

This strategy allows customers to dip their toes in the water and experience the value but makes it easy to move to another package for even more value. Offering subscriptions based on buyer profile meets your customers where they are right now and where they might be in the future.



4. Do: keep prices flexible

Additional packages

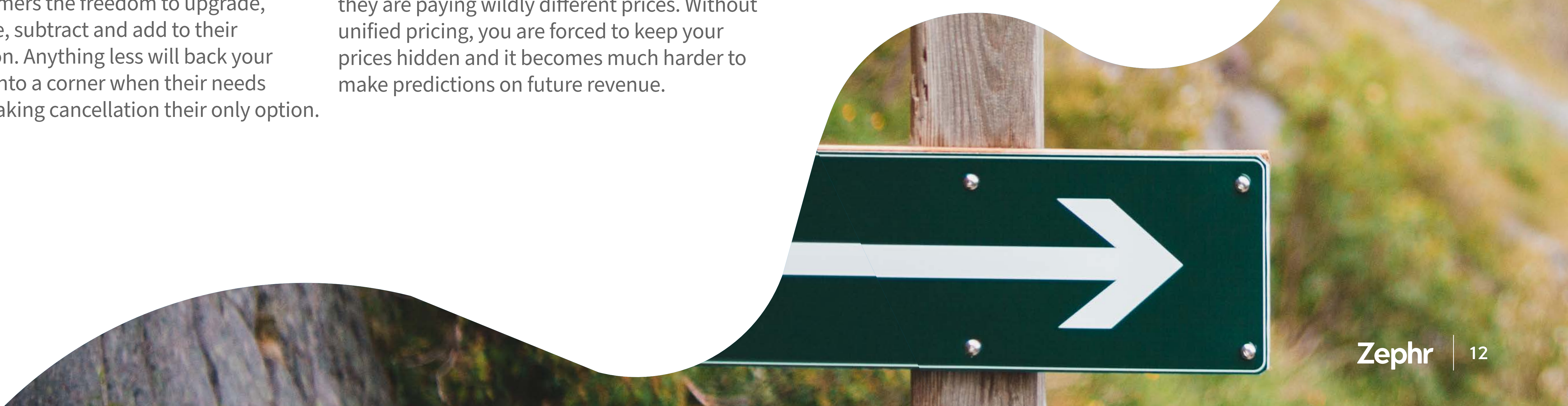
Another way of meeting individual needs is to segment packages by content. This means customers get exactly what they need at the price they're willing to pay because if packages include content they find irrelevant, value for money drops. Imagine a news reader that buys a mid-tier package that covers basic access to all your content, but who can then pick and choose which topics they want premium or exclusive access to.

Remember that flexibility also means giving your customers the freedom to upgrade, downgrade, subtract and add to their subscription. Anything less will back your customer into a corner when their needs change, making cancellation their only option.

But: Don't be *too* flexible

It is worth noting here that flexibility is needed **within reason**. Particularly for smaller businesses with a high price point - for instance, one that sells niche B2B premium content - it is easy to fall into the trap of bespoke pricing for each new customer. At the beginning, whilst you are still figuring out your value proposition and want any business you can get, this is understandable. But it is not scalable, and the longer it continues the more issues you will have later down the road when two customers with similar products find out they are paying wildly different prices. Without unified pricing, you are forced to keep your prices hidden and it becomes much harder to make predictions on future revenue.

The theory of value-based pricing needs to be taken with a pinch of salt: you won't be able to match price to willingness to pay for every single customer. This is called first-degree price discrimination and it it unsustainable over the long-term. What is sustainable is a handful of well-defined product packages that fit the needs of different segments of customers, that are easy to find and understand, and that are as relevant for your first users as your millionth.



5. Do: offer bundles

Bundling is a way of maximising revenue by selling more than one subscription (greater value) for less than a customer would pay for each package combined. For the customer, there's a clear financial benefit to buying a bundle whilst you receive more revenue than you would if you'd sold a single subscription. Often, bundles can cross-sell across organisations too: The Washington Post and Hulu used to run a joint bundle for $99 a year, as did The New York Times and Spotify for $203 a year. **Whenever a subscriber to one service opts-in to bundle with another, especially when that service offers a different content medium, i.e., music vs news, it gives the second company a new conversion with a very low CAC**. Both companies split the revenue gain and benefit from a new customer, and the customer gets a discount on the aggregate full price of both services.

Demographics and geography can have a big impact on bundling, too, with local news coverage being a popular add-on for many publishers. The reason localisation is such an important differentiated feature in news comes down, once again, to customers' differentiated preferences. Each reader values updates on events in their own postcode, but cares very little about local news in any other.

Aside from the revenue gained from bundles as a promotional offer, the data generated is incredibly useful for future analysis. Keep an eye on what features or partnerships are attracting new subscribers or pushing people to upgrade and which customer segment is attracted to which bundle. As we think we have made clear by now, any insight into what the customer values is goldust. From there you can play around with price and combinations to maximise value for your customer and maximise profits for you.

Conclusion

To summarise in a sentence: pricing is really important to get right, yet very few subscription businesses know exactly what they are doing. Misunderstanding your value proposition, failing to research your customers' willingness to pay or packaging your offers incorrectly has a detrimental effect on all aspects of your commercial goals, including conversion rates, churn rates and profitability.

Whether you are pricing your subscription for the first time, or as part of a regular pricing review, make sure you hit every point on this checklist:

Align prices with value - find out what part of your offering customers value the most, how much they are willing to pay for it, and how you can package it.

Understand your metrics - analyse and track your KPIs, including CLV, CAC, churn rates and profitability to inform your pricing strategy. Keep an eye on how these change with changes in prices, too.

Keep it simple - the customer should be presented with a handful of well-defined, easy to understand packages and price points that nudge them into their category of usage, features, or topics of interest.

Find the balance between flexible and bespoke - your offer won't be perfect for every customer, nor will it capture every penny they are willing to spend. But fully bespoke packages take too long to negotiate and won't work at scale, so focus your efforts on creating clear segments of users and catering to their shared needs.

Be creative - pricing needs to be simple, but it doesn't have to be boring. Bundling subscriptions gives the customer extra value and helps your business upsell, or cross-sell, customers with another organisation.

Ultimately, the amount of data available today on every potential and current customer means you have no excuse not to personalise your offering. Customisation and localisation should occur across the entire subscription experience, and this includes pricing and packaging. Finding and condensing your business' value into distinct packages that cover the full spectrum of customers isn't easy, but it's worth it. Failing to do so is sure to cost you.

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