SaaS and subscription companies have embraced usage-based pricing with open arms. Instead of making customers pay a set price upfront, these companies have flipped that paradigm to help customers only pay for what is used – whether that’s API calls made, miles driven, or invoices sent. Use more, pay more. Use less, pay less. It’s subscription 101 and the SaaS rule of thumb…right?

Not quite.

For context, there are three strategies that subscription companies mix and match to price for their products:

One-time price: A one-time payment – most commonly charged for a device, a sign-up fee, or an implementation cost.

Recurring price: A recurring payment – whether it’s monthly or annually or quarterly, paid up-front that allows customers continued access to subscription services.

Usage-based price: A variable payment – paid in arrears (e.g., at the end of a billing period) based on how much of a service was used.

What we found is, it’s true, companies that take advantage of usage-based pricing see faster growth. However, there is a tipping point where growth eventually stalls.

Let’s dig in.

**THE GOLDSOLOCKS PRINCIPLE OF USAGE-BASED PRICING**

At its heart, usage-based pricing is a way of quantifying value. The goal is to let customers pay for the value they need. All usage-based pricing is based on a certain “value metric” – it can be GB of data, miles driven, invoices sent, or any other measurable unit of measure for a service.

Simply put, a value metric should align with customer needs, grow with customers, and be predictable (for the customers and the organization).

Here’s what we found based on our learnings:

For companies with no revenue from usage, the year-over-year growth rate was 19%.

With no usage-based pricing, you limit customers and your growth. Customers lack choice in your product and can’t grow naturally within it. If they want more, they’ll churn, and if they need less, they’ll churn. Without a consumption-based pricing strategy, you’re losing out on upsell opportunities.

On the flip side, companies with over 25% revenue from usage grew 21% year-over-year.

Clearly, that’s better than having no usage at all. However, companies should be cautious of relying too much on usage-based pricing. When usage-based pricing is your main revenue source, you are entirely at the mercy of that usage. If a few customers reduce usage, then your revenue can fall dramatically. Furthermore, your customers are also less sticky since they can drop your product anytime they choose to.

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**USAGE-BASED PRICING**

*What is the right mix?*

**Authors**

Carl Gold, Chief Data Scientist, Zuora

JJ Xia, Director of Product Marketing, Zuora

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**“ALIGN PRICE WITH USE”**

– CEOS AT EVERY SAAS COMPANY, EVER.
So, what’s the right mix?

The cohort of companies that have usage-based pricing making up between 1-25% of their overall revenue grew by 25% year-on-year. That is 1.5x higher compared to companies with no usage-based pricing at all, and 1.2x higher compared to companies with more than 25% of revenue coming from usage.

It’s clear when we look at the data—subscription companies should definitely leverage usage-based pricing to drive additional growth. However, they need to keep an eye on how much they rely on usage-based pricing as part of their overall subscription revenue.

Note: This benchmark is based on anonymized, aggregated, system-generated activity on the Zuora service, a comprehensive platform for subscription-based businesses.

KEY TAKEAWAYS:

Usage-based pricing works because your customers can grow with you. If they found success with your service initially and want to use it more, usage-based pricing allows them to do exactly that. And it allows you to get more revenue as they increase their usage.

It’s important to find the right balance of usage-based growth and sustainable recurring revenue. Finding the sweet spot for your company and customers will require a Goldilocks-style experimentation, but when you do, you’ll find a new growth channel that requires little effort and reaps big rewards.
DIFFERENT WAYS TO PRICE BY USAGE

Usage-based pricing is becoming more dominant across many industries. Starting in software, it has now spread across manufacturing, retail, media, information, and publishing industries. There isn’t a one-size-fits-all model for usage-based pricing. As our data shows, you have to find the right extent of usage-based pricing to maximize growth.

6 COMMON USAGE-BASED PRICING MODELS

Let’s look at the common types of usage-based pricing:

1. **Per-Unit Pricing.** Also known as ‘pay per use.’ Pay per use is a per unit fee billed immediately after use. A pay-per-ride service like Chariot or pay-per-API offering like Amazon Web Services are great examples of this.

2. **Overage Pricing.** This pricing model gives your customer a certain quantity of included units – for example, minutes for calls per month. If your customer exceeds the quantity of included units within the billing period, the amount used over the included units is charged on a per-unit basis based on the overage price.

3. **Volume Pricing.** Volume pricing is used to charge a price based on the volume purchased. This kind of pricing makes a lot of sense with API calls for SaaS. For example, if you do 1-1000 API calls, you might charge $.10 (flat or per unit), but if you go from 1001-10,000, you will charge $.15 each. This kind of pricing can be a great incentive for a consumer to use more of the product since the price per unit gets cheaper.

4. **Tiered Pricing.** Tiered pricing is used to change pricing progressively as the volume increases. Like the volume pricing model, the tiered pricing model uses a price table to calculate the pricing. It differs from volume pricing in that the amount to charge varies progressively as volume increases, so different units may be priced differently depending on the tier they fall into.

5. **Tiered with Overage Pricing.** This charge model is similar to the tiered charge model, except there is an overage charge for any units consumed above the ending units of the final tier.

6. **Multi-Attribute Pricing.** This charge model charges customers through a variety of different metrics – such as how Zipcar charges customers through a combination of ‘time of day’, ‘type of car’, ‘day of the week’, and other attributes.
**Per-unit charging** is the most basic but also the most common type of usage-based pricing.

Salesforce was one of the first companies to use this type of pricing. For their current Sales Cloud CRM, the price is based on the number of users.

Here’s how their pricing works:
- If you sign up for the Lightning Professional plan with 10 users, you are charged $750/month (10 users x the $75/user/month charge).
- When you add an eleventh user, your monthly charge increases to $825.

The pricing scales linearly with the number of users you want to add, with users being a proxy for the ‘value’ that customers realize from the Sales Cloud product.
An overage charge model will be familiar to anyone with a cell phone. Telecom companies often use an overage charge model for each plan. For example, you may choose a 2GB, 4GB, or 8GB data plan, and then be charged a per GB data rate after you go over the included amount.

Here's how their pricing works:

- You can sign up for their Edge Delivery Pro package for $20/month and receive 1TB/month of bandwidth.
- If you exceed this, you are charged
  - $0.04 per GB over that 1TB up to 100TB
  - $0.03 per GB after that (this is considered overage pricing).

StackPath is upfront about the additional charges, so you know what your monthly cost is going to be if you do exceed the included bandwidth. If a customer is often over that amount, they also have the chance to upgrade.
With a **volume pricing charge model**, price changes depending on the total usage volume. Every customer gets the same features no matter the volume. But as the volume of the value metric increases—in this case, Monthly Customers Engaged (MCEs)—the per-MCE cost decreases.

Here’s how their pricing works:
- A customer with 40 MCEs pays $0.725 per MCE
- A customer with 400 MCEs pays $0.3225 per MCE
- A customer with 4,000 MCEs pays just $0.07475 per MCE.

A Jilt customer using the app constantly to deal with 4,000 customers is getting 10X value compared with a customer using it for ten times fewer customers.

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**VOLUME PRICING CHARGE MODEL**

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Jilt only has one plan, and it comes with every feature we have.

Instead of confusing and arbitrary tiers, we charge based on the number of **Monthly Customers Engaged** (MCEs), which is how many unique customers you engage each month. Email your customers as many times as you want and only pay for each unique customer once!

How many customers can you expect to engage each month? Use our handy MCE calculator to estimate your needs. Still have questions? Check out the FAQ.

<table>
<thead>
<tr>
<th>Features included for everyone:</th>
<th>MCEs</th>
<th>Monthly Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ 14-day free trial</td>
<td>0−25</td>
<td>Free</td>
</tr>
<tr>
<td>✓ Unlimited campaigns</td>
<td>26−50</td>
<td>$29</td>
</tr>
<tr>
<td>✓ Unlimited emails</td>
<td>51−100</td>
<td>$49</td>
</tr>
<tr>
<td>✓ Unlimited account members</td>
<td>101−150</td>
<td>$79</td>
</tr>
<tr>
<td>✓ Custom campaign scheduling</td>
<td>151−250</td>
<td>$99</td>
</tr>
<tr>
<td>✓ Multiple emails per order</td>
<td>251−500</td>
<td>$129</td>
</tr>
<tr>
<td>✓ Fully customizable emails</td>
<td>501−750</td>
<td>$149</td>
</tr>
<tr>
<td>✓ Responsive email templates</td>
<td>751−1,000</td>
<td>$179</td>
</tr>
<tr>
<td>✓ Powerful rich email editor</td>
<td>1,001−1,500</td>
<td>$199</td>
</tr>
<tr>
<td>✓ Email open tracking</td>
<td>1,501−2,000</td>
<td>$229</td>
</tr>
<tr>
<td>✓ Detailed campaign analytics</td>
<td>2,001−2,500</td>
<td>$249</td>
</tr>
<tr>
<td>✓ Dynamic coupon codes</td>
<td>2,501−3,000</td>
<td>$279</td>
</tr>
<tr>
<td>✓ Email from your own domain</td>
<td>3,001−4,000</td>
<td>$299</td>
</tr>
<tr>
<td>✓ Five-star customer support</td>
<td>4,001 or more</td>
<td>Contact us</td>
</tr>
<tr>
<td>✓ Additional engagement channels coming soon!</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
This model is one of the most common and is now starting to be seen outside of SaaS as the Subscription Economy expands into other industries. It is a core component of Ford’s new auto subscription service, Canvas:

The “value metric” in this volume pricing charge model is miles driven. The more you drive the car, the more value you get, and the less you pay per mile driven.

VOLUME PRICING CHARGE MODEL CONTINUED

• 500 miles are included, free of cost.
• If you purchase an additional 350 miles, the new cost is $0.10 per mile.
• If you purchase an additional 750 miles, the new cost is $0.09 per mile.

TIERED PRICING CHARGE MODEL

At first glance, a tiered pricing charge model looks identical to a volume pricing charge model. Both are going to have a price table broken into tiers with different pricing per tier. But with a tiered pricing charge model, the cost accumulates.

Let’s look at this per GB pricing example through 2 lenses:

<table>
<thead>
<tr>
<th>Tier</th>
<th>Usage</th>
<th>Price Per GB</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1-250 GB</td>
<td>$0.20</td>
</tr>
<tr>
<td>2</td>
<td>251-750</td>
<td>$0.10</td>
</tr>
<tr>
<td>3</td>
<td>751-5,000</td>
<td>$0.05</td>
</tr>
</tbody>
</table>

In a volume pricing charge model, a customer using 1,000 GB is in Tier 3 and is charged $50:

Tier 3 charge: 1000 GB * $0.05 per GB = $50

In a tiered pricing charge model, a customer using 1,000 GB is also in Tier 3, but would be charged $112.50

Tier 1 charge: 250 GB * $0.20 per GB = $50
Tier 2 charge: 500 GB * $0.10 per GB = $50
Tier 3 charge: 250 GB * $0.05 per GB = $12.50

Sum for all charges: $112.50
In a **tiered with overage pricing charge model**, if a customer goes over 5,000 GB, then they will have to pay an overage of $0.02 per GB.

<table>
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<tr>
<td>3</td>
<td>751-5,000</td>
<td>$0.05</td>
</tr>
<tr>
<td>Overage</td>
<td>5,000+</td>
<td>$0.02</td>
</tr>
</tbody>
</table>

**Multi-Attribute Charge Model**

A **multi-attribute charge model** calculates the final cost of usage based on many different variables. Let’s look at Zipcar as an example.

Zipcar charges renters per hour to rent a car. However, that price depends on:
- The location. The car make and model.
- Peak seasons and peak hours.
- Individual plans, Business Plans, or University Plans.

Depending on all of those attributes, Zipcar is able to provide a ‘per hour’ rate for the car rental.
ALLOWS CUSTOMERS TO GROW WITH YOU

Usage-based pricing works because your customers can grow with you. If they found success with your service initially and want to use it more, usage-based pricing allows them to do exactly that. And it allows you to get more revenue as they increase their usage.

However, make sure to find the right balance of usage-based growth and sustainable recurring revenue.

Finding the sweet spot for your company and customers will require a Goldilocks-style experimentation, but when you do, you'll find a new growth channel that requires little effort and reaps big rewards.

The Subscribed Institute

The Subscribed Institute is a dedicated think tank focused on the most critical business problems of the Subscription Economy. It serves as a unique source of ideas, data, and connections for business leaders and their organizations. More at www.subscribedinstitute.com