Bessemer Venture Partners + SIMON • KUCHER & PARTNERS Strategy & Marketing Consultants

The Startup Pricing Journey

How to efficiently monetize products and services

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Introduction

Over the past 50 years at Bessemer, we've had the privilege of partnering with a number of exceptional founders and investing in them as they've scaled world-class companies. Despite all of these successes, one challenge we've heard consistently from our CEOs is how to efficiently monetize the new products and services they have created. In short, they've wrestled with pricing.

Pricing is a challenge at emerging technology companies regardless of industry or stage. The scope and nature of these challenges inevitably evolve over time as businesses mature. As we illustrate in this paper, pricing should be thought of as an ongoing journey. It is an exercise that requires constant iteration. When approached thoughtfully, pricing remains a work in progress rather than a moment-in-time project.

While we are launching this content in a truly unprecedented time, we have fielded questions, provided guidance, and thought about how we can provide better support on pricing for years prior to writing this paper. COVID-19 will undoubtedly have a lasting impact on how businesses interact with customers and how they think of risk. Despite these changes, however, we believe that the pricing tenets we outline will persist and serve as a solid foundation managing some of your commercialization risks going forward.

In an effort to understand how CEOs and management teams are approaching these topics, we partnered with Simon-Kucher & Partners, a leading pricing strategy firm, to dive into what the pricing journey looks like at different stages of growth. We interviewed over 30 companies from the Bessemer portfolio, including early-, mid-, and growth-stage companies, to learn about their decisions and build a set of learnings that can be applied to help guide others at the beginning of their own pricing journey. We have also added an appendix to provide additional insights related to what challenges companies are seeing and hearing from their customers, along with some of the tactics being employed to accommodate customer demands during the COVID-19 crisis.

We are excited to share what we have learned.

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Where to Start?

Even in the best of times, growth-stage businesses could be described as organized chaos. When revenue is beginning to scale, there are typically a series of thorny, multi-dimensional challenges facing the broad go-to-market motion. Pricing becomes just one of a series of sub-optimal pieces in a much larger puzzle. These components include going to market with a suite of products, creating multiple product tiers, selling through direct and indirect channels, and balancing SMB and enterprise customer segments.

Naively at the start of this effort, we hypothesized that for an earlier-stage company this all might be much easier. Early-stage companies are typically laser-focused on one product, a few customer personas, and one simplified GTM motion.

This assumption proved to be wrong, and the pricing challenges facing early-stage companies are equally as pronounced, especially when factoring in the simultaneous lack of supporting data and of resources.

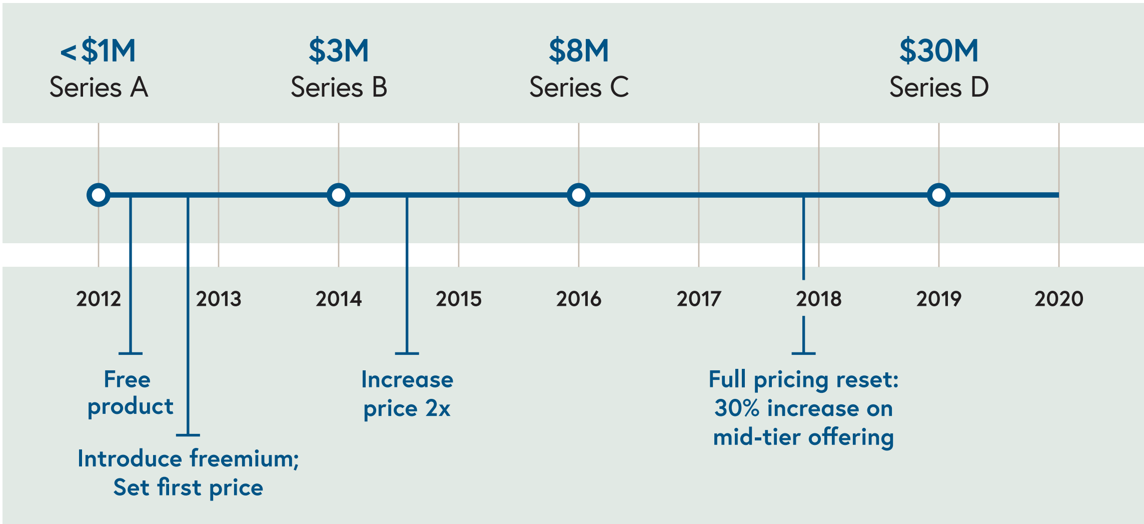
Key Pricing Takeaways

1. Because pricing at all stages of company growth is hard, pricing is never done. The faster early-stage companies create an iterative and collaborative culture around pricing, the better off they will be.
2. Initial price discovery is usually a data-light decision, but it shouldn't be a complete shot in the dark.
3. Create pricing feedback loops that span the organization. Avoid setting and forgetting after the initial price decision, and avoid functional silos that skew pricing in one direction.
4. Pricing is more than just the price level you set – it's how your offer is packaged, what segments of customers are served, and how your product is positioned and communicated. As such, pricing is a multi-functional discipline needing an executive-level champion.

Companies Wait on Pricing, But Why?

Many of the biggest tech companies in the ecosystem have taken a "wait and see" approach to pricing. Companies that have quickly ramped ARR past the $100M mark and achieved unicorn status multiple times over are typically focused on several traditional levers for growth. However, pricing deep dives are often deferred for years following the initial price determination. As one example, Stripe, the market-leading digital payments company, hired their first fully dedicated pricing leader nearly 10 years after inception.

Case Study / Company A



Key Learnings:

- Launched a premium version for $10 more than an inferior product.
- Following market demand, increased price to $39, then left pricing alone for years.
- Effectively didn't change pricing for six years and then managed to get a 30% boost on their most popular offering.

Company A has historically had a consumer-focused product that recently released a suite of features aimed at businesses and teams. In 2012, the company released their first product to the public for free and saw very quick adoption. The following year, Company A introduced a Freemium offering that allowed users to continue to use a majority of the features for free, but charged $20 per year for a premium feature. The $20 price point was agreed upon a week before the product launch, and was largely driven by noting the success of a competitive company charging $10 a year for a less robust offering. Following market demand, the team quickly increased their initial price to $30 without much impact on conversion metrics, and after a year decided to bump the price of their core offering to $39 per year in mid-2014. For the next four years, Company A's price remained fundamentally unchanged. Aside from the occasional experiment with multi-year discounting ($79.99 for three years or $99.99 for five years), the company continued to deliver product innovation, without the ability to monetize those additional features. In late 2017, nearly five years after rolling out the initial pricing structure, it became apparent that a ground-up reevaluation of Company A's pricing was needed. The company retained Simon-Kucher and seven months later, in 2018, went live with a brand-new Good-Better-Best pricing structure that more closely reflects the willingness to pay of different customer cohorts by creating tiers of features.

FREE
$0
Get Free

- Single device
- Cap on features
- Two-factor authentication
- Personalized alerts
- 30-day trial of Premium

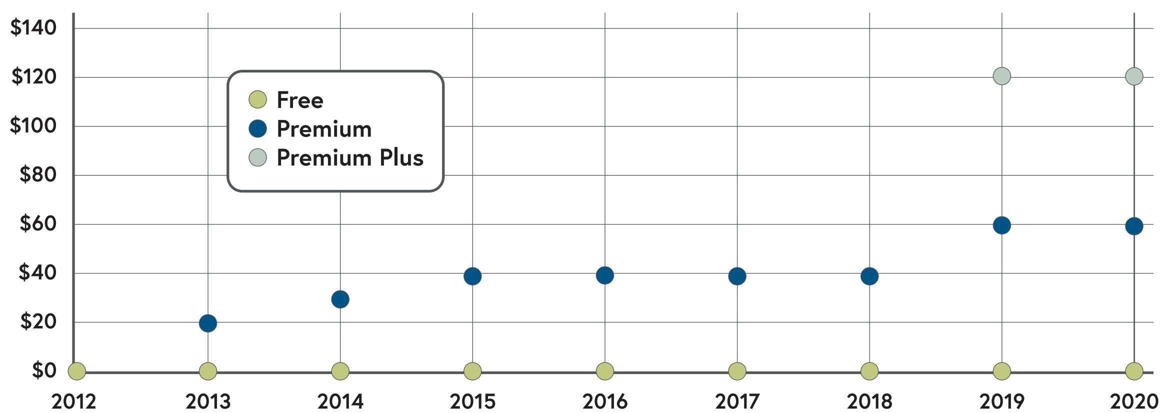
Premium
$4.99/mo
Get Premium

- Unlimited devices
- Unlimited features
- Two-factor authentication
- Personalized alerts

Premium Plus
$9.99/mo
Get Premium Plus

- Unlimited devices
- Unlimited features
- Two-factor authentication
- Personalized alerts
- Premium Plus features

Company A - Prices Over Time



Throughout our interviews and as we dug into these delays, we found that unsurprisingly, many early-stage companies are focused on product development, identifying customers, and putting the teams in place to drive adoption.

This north star of product adoption subsequently drives most strategic choices. In parallel, we observed that pricing is usually viewed as a point-in-time decision and in some cases even considered an inhibitor to adoption rather than an accelerator of revenue. Founders may want to revise this perspective, as this "necessary evil" that serves as yet another hurdle to be climbed before getting a product in the hands of a consumer is in fact one of the more important decisions they will make.

Four factors that commonly drive the delay of pricing exercises:

Adoption at all costs: With many founders coming from a product-led or technology-led background, there's often an unconscious bias toward focusing resources on delightful customer experiences. Both founders and their teams feel they understand these objectives, are well-equipped to tackle them, and enjoy make measurable progress in those areas. Additionally, as many of these companies are venture-backed, growth is typically objective number one, juxtaposed with churn as the most evil of all perils.

Multidiscipline: Unlike most strategic initiatives that can fit tightly within one silo of responsibility and thus one senior leader, pricing necessarily requires input from all corners of the company. We heard that because, by design, it's harder for a CEO to delegate to a team member, these pricing projects often get delayed. It becomes unattractive or untenable for a CEO to consider imposing the project tax across the entire leadership team.

Light data: When new products are released or new categories are created, it is tempting for teams to assume that because there are no customers (yet) and because there are no true comparable offerings (there usually are), it's impossible to use data to inform this decision.

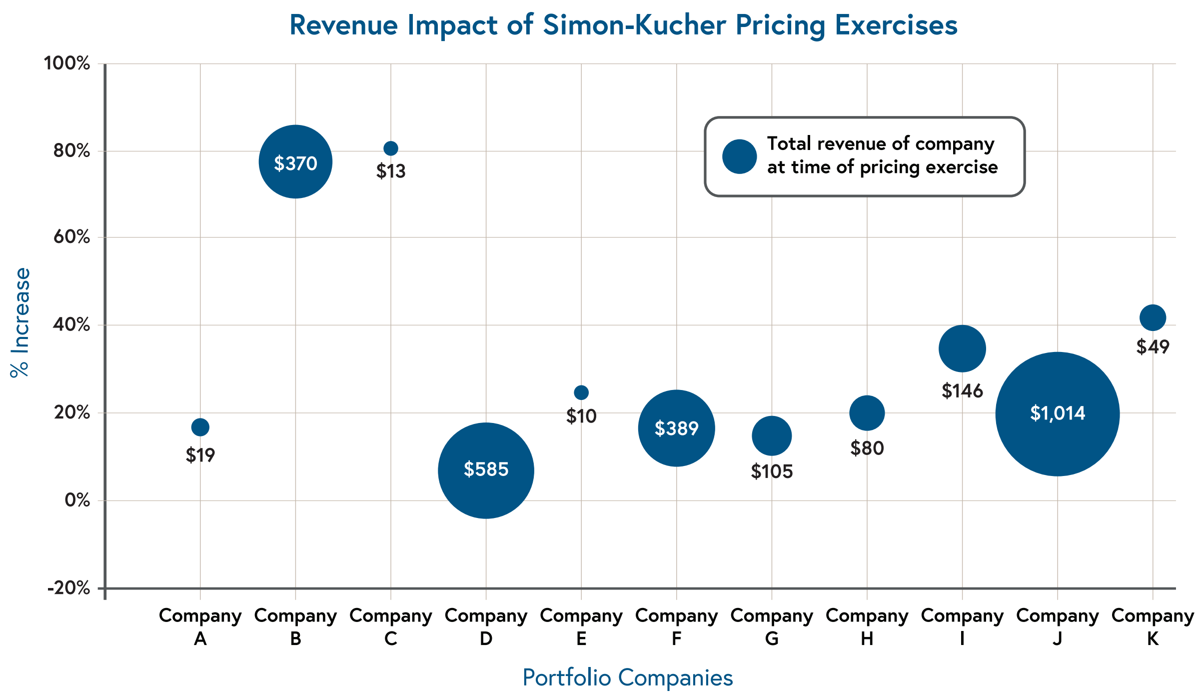
Pricing is a moving target: A customer's willingness to pay (WTP) is the guiding force for all pricing decisions. However, during the early stages of a company's formation WTP is dynamic and generally increases as the product matures and customers gain a better understanding of the value proposition being delivered.

Why Does This Matter?

If pricing is as hard as advertised and even the world's leading companies wait for years to circle back on pricing, why should early-stage companies care? A pragmatist might argue that after wrapping up the initial pricing work, it should be placed on the back burner in order to free up capacity to tackle the most pressing needs of the business.

However, by applying a relatively straightforward ROI lens to the various levers a business might tweak in pursuit of growth, it becomes clear that one of the most efficient means for incrementally driving revenue growth is indeed by focusing on pricing.

Across 11 case studies between Simon-Kucher & Partners and Bessemer portfolio companies, the results are material:



There are clearly many other ways for companies to drive value. However, most of these initiatives cost significant investments in both capital and time:

Better products: Creating and improving products that provide increasing value to customers requires talented product managers and engineering teams capable of executing on that vision.

New logos: Exceeding revenue goals requires experienced sales leaders and account executives to chase down new accounts, while also selling larger deals.

Strong renewals: Generating more net new opportunities is usually only one part of the puzzle, and all great businesses are driven by a mix of recurring revenues, upsells, and net new business. In order to keep churn low and upsells high, a highly responsive Customer Success organization is needed.

Demand generation: A marketing organization that not only builds a brand that stands out from the crowd of noisy competitors, but also informs motivated customers about your solution, while generating robust leads to feed the top of funnel, is required.

Partnerships: Creating a supplemental engine for growth requires finding and establishing new channel and service partners, while also enabling them.

Ultimately, pricing is comparatively cheap. Best-in-class teams are usually able to pair one to two dedicated hires with analytical support (either from Finance or Engineering). While this must also be complemented by a culture of leadership buy-in and cross-discipline engagement and support, when compared with other strategic programs the necessary inputs seem quite manageable. When we looked at the results, 32% revenue uplift on average, the math starts to seem quite compelling. Because of the cross-functional nature of pricing, the output of pricing improvements is not mutually exclusive of these other initiatives. The pricing changes Company A made helped to inform other initiatives such as creating better products, strengthening renewals, and supporting demand generation with a new product and pricing scheme that met more customer needs.

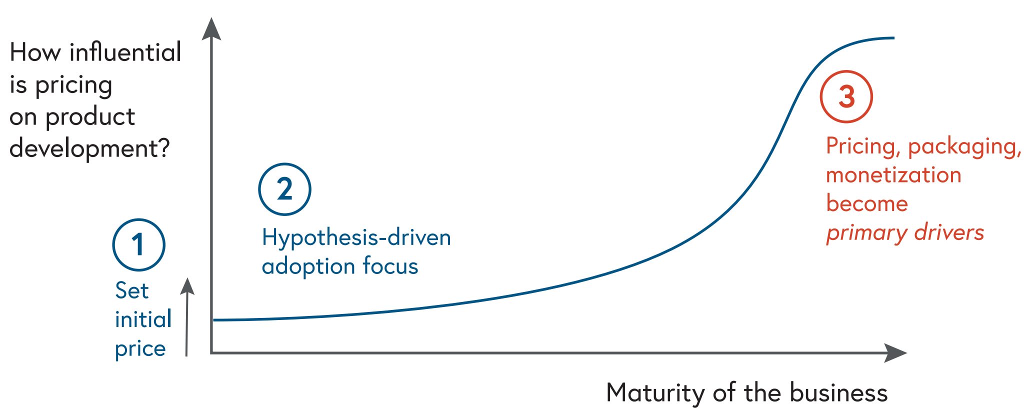
In the words of one of our leading portfolio Chief Product Officers, "when compared to all the other choices in front of us, pricing was the highest ROI lever we could pull by far while also the one we ended up waiting much too long to tackle."

How Does the Role of Pricing Change?

The collective bandwidth spent on pricing and its trickle-down influence across the rest of the business naturally ebbs and flows over the life cycle of a company. Traditionally, pricing work is top of mind for a short period of time, typically through the selection of the initial price metric and price setting, and then is generally moved to the back burner.

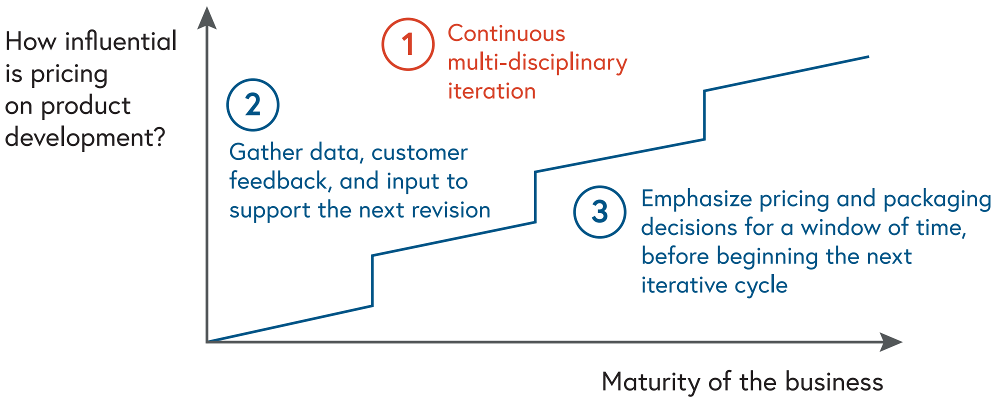
Conventional best practices, from experts like Simon-Kucher, suggest that in more mature industries and companies, price should come before product. This approach suggests that price should play a primary driver in determining the product roadmap and that most companies would benefit from shifting priorities from a product-first orientation to a more customer-centric perspective.

In early-stage startups, this prioritization is often switched. The early days are typically guided by hypothesis-driven product decisions aimed to optimize adoption and drive traction. Over time as the business matures and product-market fit is achieved, go-to-market motions become more repeatable and the business begins to scale, and pricing and packaging re-emerge as the largest untouched growth levers.



This off-on transition is best illustrated by an S-curve, as seemingly overnight companies realize that pricing and packaging need to be revised in order to capture additional value from customers. Often this is a lagging process and in an ideal world should be a continuous reevaluation effort following the initial pricing work.

Leading companies depart from trajectory by building a tight feedback loop between the Product team and the impact their decision-making has on revenue. These companies are instead gathering data, customer feedback, and input to support the next incremental improvement in the product and repeating the cycle many times as the company grows.



Instead of the set-it-and-forget-it mindset that is the hallmark of many companies today, set it and embrace a **mindset of continuous iteration** supported by a **multidisciplinary** set of your leadership team.

The Startup Pricing Journey

Throughout the course of our conversations, we identified several distinct stages that businesses move among as they mature. Below is an illustration of the pricing decision points that a company can expect to go through as they grow, coupled with the corresponding business challenges associated with those stages. Despite the layout, we've found that this is typically not a linear process, and instead the typical pricing journey for a startup is cyclical and stages are bounced among as new products are brought to market and new customer personas are unlocked. Some examples of this cyclicality include:

- Having an initial revenue model that enables early growth, but needing a more sophisticated model once there are multiple products in the portfolio.
- Entering a new market and subsequently reverting to Stage 1 with that new product while being in another advanced stage for legacy products.
- Companies who are in Stage 5 for part of their product portfolio are often continuing to inform Stage 4 and 3 as their business and products continue to grow.

Stage 1	Stage 2	Stage 3	Stage 4	Stage 5
Finding the product-market fit	**Finding the right revenue model**	**Segmentation of the customer base**	**Drive cross-sell of multiple products**	**Optimize prices and processes**
Company is focused on figuring out what customers want and how to deliver it	Company needs to decide how its pricing model is going to grow with its customers	Market is growing; company needs a pricing model that scales with customer size and sophistication	Business is taking off; there is a product line and business diversification	Company is focused on figuring out what customers want and how to deliver it

In addition to providing a perspective on key questions to be asking within each stage, we think it's valuable to have a mirror to look around the corner and understand what potential future challenges lie in wait, in order to help inform planning, updating, and optimizing price over time.

In this paper, we will be focusing on Stages 2-5, but felt compelled to outline the full scope of the evolution. Much ink has already been spilled on achieving product-market fit and rather than add to the existing body of work, we are assuming that companies beyond this stage have some degree of traction or validation from the market. Because finding the right revenue model is so foundational to the ultimate success of a company, a majority of our efforts revolve around illustrating how the type of company informs both the external and internal factors that will go into that revenue model discovery process.

Stage 2: Finding the Right Revenue Model

This is one of the hardest stages for companies on their pricing journey. More than likely, there is not a robust amount of customer data to inform the decision and despite the temptation to only solve the short-term pricing need, it is essential at this stage to consider how the product will likely evolve in order to leave room for flexibility in the model.

Simon-Kucher often tells their clients, "How you charge is more important than how much you charge." For high-growth, early-stage technology companies we tend to think both are equally important, but certainly it's not just picking the right number.

(a) Price Discovery
(b) Selecting a Price Model and Value Metric
(c) Setting the Price Level

This multistep process largely needs to be driven internally because pilot testing and resources for external validation are limited or not possible.

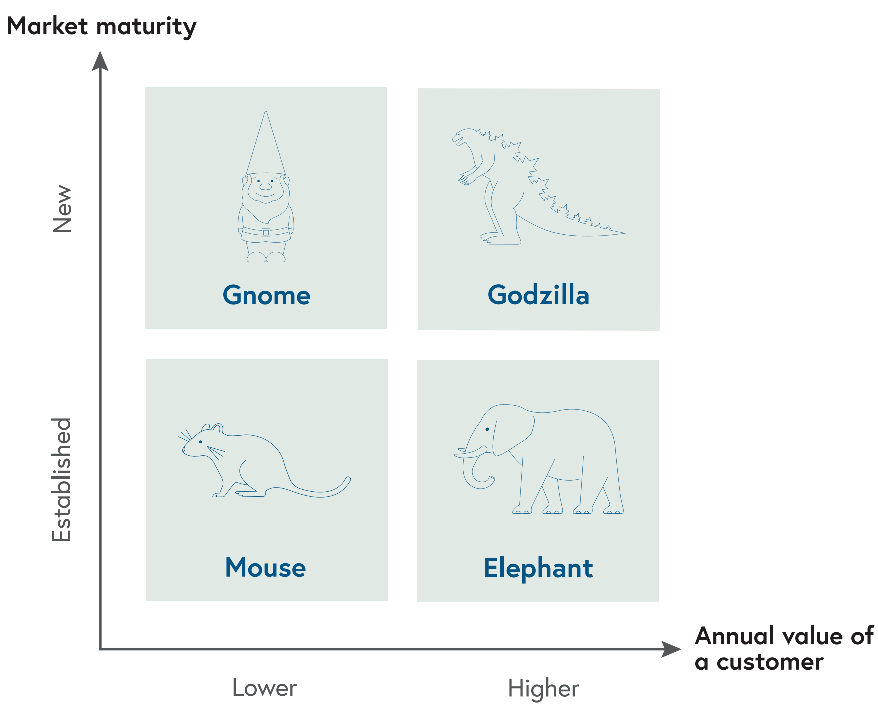
(a) Price Discovery

Price discovery is just another way of describing the process through which companies explore their customers' or potential customers' willingness to pay (WTP). Despite the presumed simplicity of that task (just ask?), determining the maximum price a consumer would pay for your product is a difficult undertaking at an early stage, because of the number of factors that affect both the approach and the ultimate price determination. We found that there are two significant vectors that can provide high-level guidance on the approach taken to determine WTP. These vectors can also provide context around the value assumptions customers are likely making about a product.

- **Market maturity:** Is this a true category creation moment where an entirely nascent product, service, or concept is being introduced, or is this a product targeting a mature market with one or several incumbents? The answer is likely a spectrum. However, understanding if you're closer to the former or latter is helpful.
- **Annual value of a customer:** What is the expected annual value of each account (e.g., $500, $10,000, $100,000)?

Discovery Archetypes

Using these two axes as a simplified framework, startups can plot themselves and begin determining what price discovery archetype is likely more relevant for them. To help highlight differences in approach, we have illustrated four archetypes that can provide examples for how a price discovery process might unfold. As depicted below, the four archetypes are: Gnome, Mouse, Godzilla, and Elephant.



Mouse

Characterization
A mature market that understands your product well and features a number of competitive peers and likely several mature incumbents. Given the relatively low value of customers, this is likely an inbound or inside-sales-led, go-to-market motion with a fast sales cycle.

Pricing Approach
Typically, a product-led exercise, primarily focused on using comparable products and services as a tool to understand relative willingness to pay.

Elephant

Characterization
A mature market that understands your product well and features a number of competitive peers and likely several mature incumbents. Given the high value of customers, this is likely an outbound enterprise sales motion with long lead times.

Pricing Approach
Typically, a collaborative exercise between sales and finance, in some cases creating tension with product and engineering teams. The best teams understand that they're capturing qualitative data from their direct and indirect sales channels, creating systems to organize, interpret, and process this data.

Gnome

Characterization
A market that is unfamiliar with your product and unaware of your company. There likely are some adjacent companies, but those may confuse customers more than act as comparables. Can typically do a statistical WTP exercise with current users or likely customers.

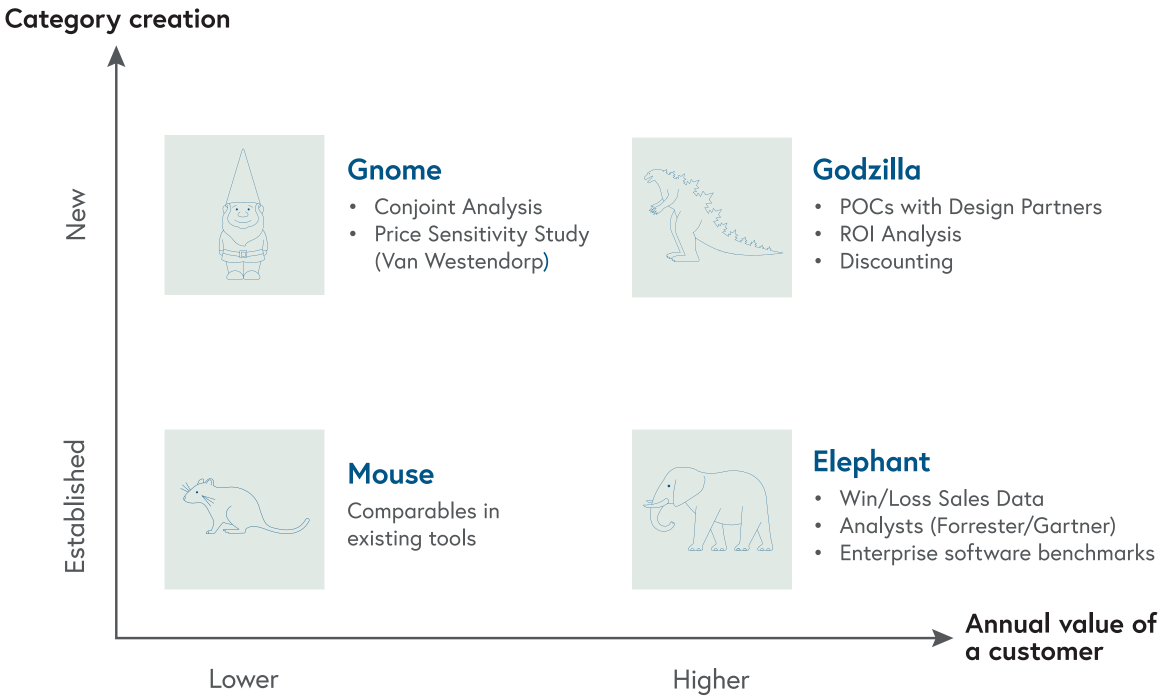
Pricing Approach
Typically, product-led, with rarely any input from the sales and marketing organization. In experiment mode for a long period of time, followed by an analytical price reset down the road.

Godzilla

Characterization
A market that is unfamiliar with your product and unaware of your company. There likely are some adjacent companies, but those may confuse customers more than act as comparables. Often, an outbound sales motion with long lead times.

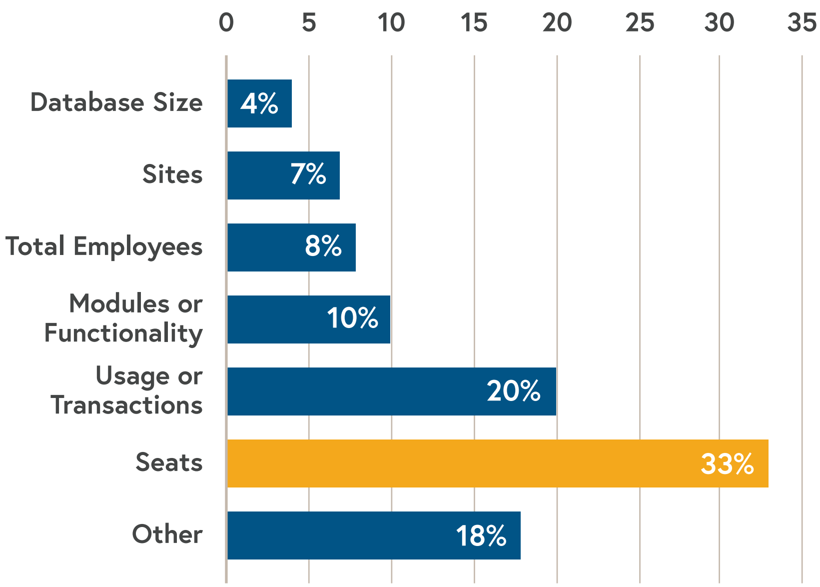
Pricing Approach
A deeply collaborative model between sales and product, typically with finance playing referee. Iterative approach to proactively search for a market-clearing price through sales and discounting and systematically capturing and applying the information discovered.

Typical price discovery options for each archetype



(b) Selecting a Price Model and Value Metric

As software[1] has evolved from the legacy days of perpetual licenses and per-seat models, a plethora of options have been unlocked that enable companies to more closely capture the value they are delivering. Seat-based pricing is still the prevailing model within SaaS companies, and according to KeyBanc's 2019 SaaS Survey, accounts for 33% of respondents' primary metrics. However, it is interesting to note that over the past ten years there has been a material increase in alternative pricing models. The 2011 version of the same survey indicated that nearly 50% of companies had a model where customers paid per seat.



The primary downside of charging per seat is that it often creates a structural impediment to broader adoption within an organization and is very disconnected from the ultimate value being delivered. However, per-seat contracts have very much become the norm and because it is so ingrained in most procurement offices, sales processes can be meaningfully shortened by using per-seat over a more nuanced pricing metric.

For many businesses, the price model will be an easy choice – a natural extension of the service or solution being provided. However, we talked to many companies who at an early stage were choosing between several viable pricing models, and made very intentional choices that have paid dividends down the line.

Key Considerations

- Having a sustainable metric at an early stage, one that scales as the business grows, is much more important in self-serve models vs. sales-driven models where there is much more flexibility to adjust the price model as more data points are collected.

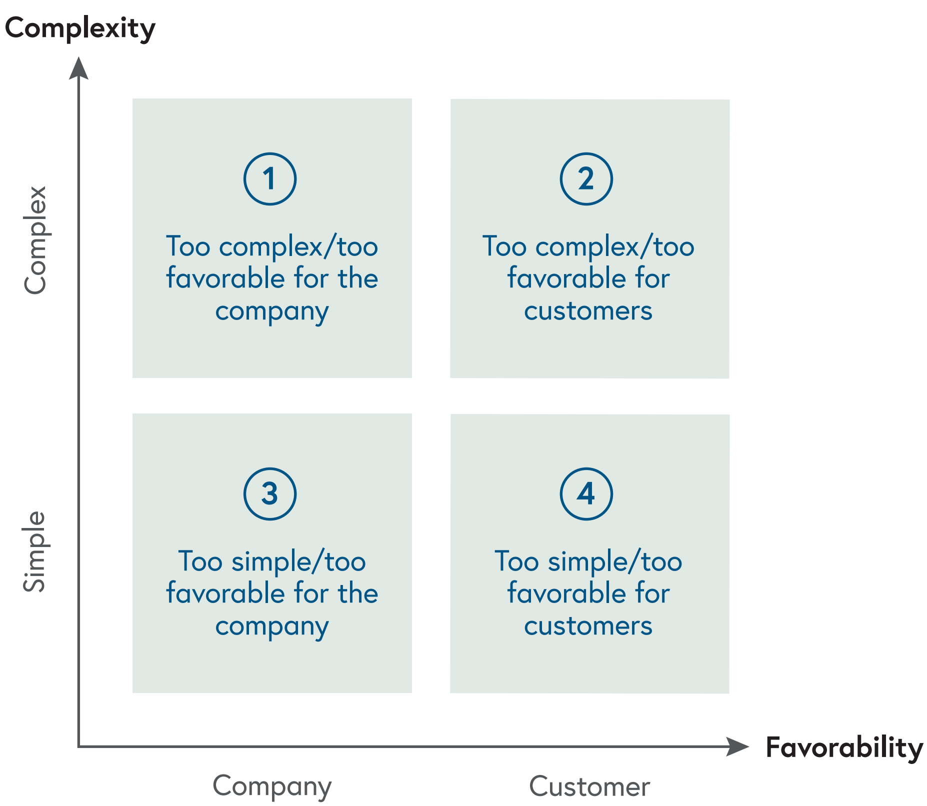
[1] KeyBanc 2019 SaaS Survey Results

- Predictability and transparency from a customer perspective are key factors that need to be weighed.
- Important that the price metric does not detract from the customer experience.
- Focus on a metric that can scale with growth, but does not impede adoption.
  - Do not want to create a tax on the behavior you're most hoping to drive, but instead want to incentivize more usage.

Price Model Pitfalls

Of course, not every company is going to get their pricing model correct on the first try. As companies shared their pricing journey stories with us, we found that when resetting price from an initial model to a new model the correction was often driven by a combination of Complexity and Favorability.

These pitfalls are patterns we have seen as challenges for price models retroactively, but it is useful to understand the patterns companies can fall into when they are creating their price model. Trade-offs need to be made when price models are created, and the primary dimensions of those trade-offs are the amount of complexity and who the model favors. While these categories are all framed as "pitfalls," each individual category in and of itself is not a negative — a complex pricing model that is favorable to the company can be fine as long as it is intentional and meets the goals it was set out to achieve.



How to avoid these pitfalls:

I. Too complex/too favorable for the company

This comes in a few flavors – lack of price transparency, too many components, usage-based pricing that is difficult to predict usage of.

- This happens often when a price model is a grassroots effort, e.g., experienced sales people are given leeway to determine what price they are going to sell the product at – avoiding this can be as simple as aligning on a price structure.
- There is such a thing as over-engineering a price model – if the product and price structure can't be explained on a napkin, it's probably too complex at this stage.
- While other quadrants recommend usage-based pricing, it is possible for that type of model to be too unpredictable for customers to be comfortable with it – gauge how predictable it is, and consider tiering usage to provide some amount of predictability to the model.

II. Too complex/too favorable for customers

- Often things like overages are a manual process and as such never get enforced, which customers can take advantage of – consider whether or not your organization has the people to handle these price exceptions or the ability to be OK with not enforcing these complex, manual processes.

III. Too simple/too favorable for the company

This typically manifests in having a metric that does not align with the value customers receive.

- Consider your customer's customer – is there a way you can align payment so that costs can just be passed along?
- Check to see if your price model is driven by the costs you incur instead of the value derived by the company – e.g., razor/razor-blade models lock people in, but then monetize later as customers realize the value of what they initially purchased.

IV. Too simple/too favorable for customers

This is probably the most common pitfall area and it is difficult to diagnose because there is no mechanism to say whether you've fallen into this category.

- Consider usage metrics that are tied to the value customers receive, but ones that don't limit engagement with the product.

- Create current and target customer profiles, with both typical and extreme cases in each, and put them through your proposed price model to see how much their prices vary. If they don't vary enough, it might be worth adding sales guidance on how to differentiate price further through more customer-specific discounting.

"I am a strong believer that if you build a good foundation that's very flexible and you spend the time to teach reps how to actually use it correctly, then it's going to reap a lot of rewards down the line."

– Director of Product Marketing

Lessons Learned: Value-Based Pricing

Value-based pricing is often heralded as the holy grail of pricing models. When executed well, it serves as a model that seamlessly allows companies to match the price they charge with numerous degrees of WTP variability among their customers.

In reality, this can be a near-insurmountable model to implement due to both external (customer) and internal (operations) factors, and one that we have yet to see an early-stage company execute successfully.

When speaking with CEOs who had ventured down that path, only to pull back, we heard a few themes:

- ROI is important to show to the customer, but basing price on ROI can lead to unnecessarily combative sales discussions.
- When comparing innovative (i.e., category creating) products against the next best alternative, it is often fruitless when the alternative answer is "do nothing."
- Inexperienced sales teams may rely on lower prices as a crutch and a discounting culture may become pervasive.

(c) Setting the Price Level

Depending on where in the Market Maturity x Customer Size matrix a company sits, setting a price level can serve as a leading indicator on how successful their first price selection exercise will be. There are several company profiles that are likely to have success selecting a first price that lands close to their initial customers' WTP, whereas there are other companies that are structurally more likely to miss the mark and need to instill processes that help them refine that initial price over time. Rather than producing a silver bullet for acing your first price, we think there is value in knowing ahead of time how your price selection process can affect your accuracy.

Mature Markets
With companies that are selling to mature markets, the presence of competitors is on one hand daunting, but also beneficial from a price selection standpoint. The existence of competitors means there are comparable models through which to gauge the market's WTP.

Case Study / Company B

Company B sells an innovative developer tool. With more than 22 million developers worldwide, the number of tools, platforms, and open-source projects vying for developer mindshare and love has grown exponentially. While the proliferation of tools makes it difficult to stand out, it also provides a rich dataset on a developer's WTP. Company B had an incredibly successful free product and was ready to launch a premium, paid offering. They leveraged comparables and feedback from users of the free version of their product to arrive at a nearly spot-on first price.

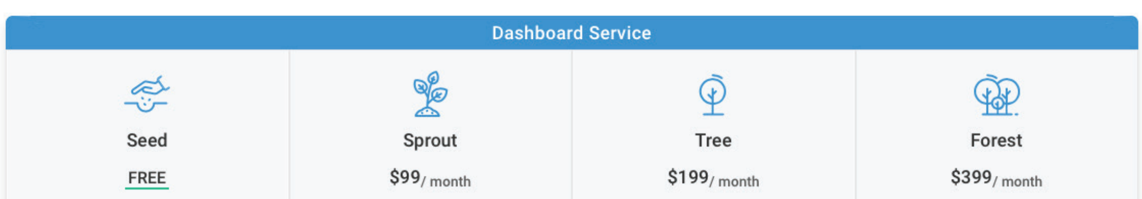
1. To arrive at an initial target price, they looked at the ecosystem for developer tools, and then looked for comparable pricing. The goal was to get a broad sense of what their target persona would accept in the market.

2. Next they launched a Van Westendorp[2] price survey with users of the free version of their product, which basically asked some direct pricing questions to understand where there were psychological price thresholds in the market.

3. The responses predicted a lower price than what they were comfortable with. The concern was around anchoring too low in the market. It also showed that they needed to increase the perceived value of the base package, so they delayed the launch of the paywalled product until that critical feature could be developed.

4. Next, they launched a conjoint analysis and used Conjoint.ly[3] to help validate their assumptions around packaging and pricing. It informed how customers would be divided into the tiers and which premium features would help drive conversions.

5. Based on their extensive preparation, they launched with a tiered model at very informed price points.



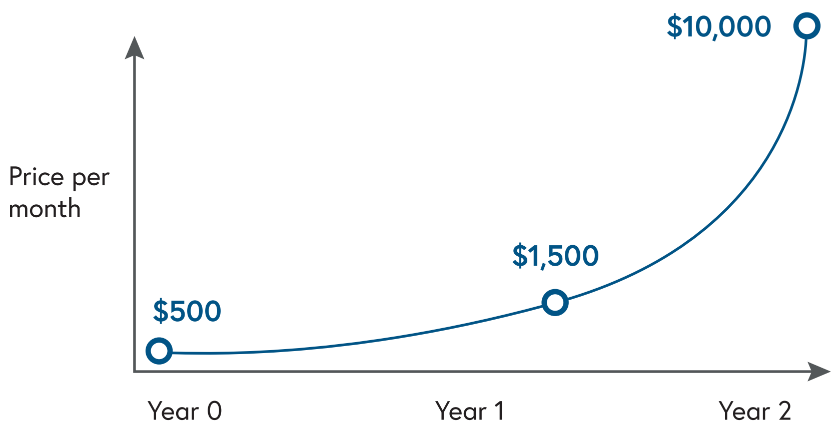
[2] https://en.wikipedia.org/wiki/Van_Westendorp%27s_Price_Sensitivity_Meter
[3] https://conjointly.com/

Category Creation

For companies that are truly releasing products that are launching new categories, there is unfortunately much less structured data to go on. Instead, the initial price point should be assumed to be a best guess, but one that will need serious refinement based on market feedback. Examples of what these refinement processes might look like are below:

- **High ACV Price Searching:** Set initial price at a fantastically high point and then discount in early conversations until you get to a "yes" and find that initial WTP. This can be as much as 70% lower than initial price.
- **Discovering New Segments:** Set high initial price, win a few deals, then realize another segment exists that wants a lower-priced product (whom you may upsell later to a higher-priced product).
- **Starting Low:** Set initial price at lower-than-expected WTP and drive adoption and learnings by removing price as a reason for rejection. Through a combination of external and internal factors, price increases over time.

Case Study / Starting Low



One of the largest gaps we observed between the initial price and the eventual market sustaining price was in a Godzilla company launching an AI-augmented Customer Success tool. They anchored their initial price point at roughly $500 per month. Over the course of the next two years, based on positive signals from the broader market, they incrementally raised the price to $1,500 per month and ultimately $10,000 per month. One day the CEO received a note from a newly signed customer who had just inked a $100K+ annual contract. The customer had forwarded along an email with their original quote from three years ago in which the customer had scoffed at the same product's $500 price point.

While comical in retrospect, the fact that this customer ultimately converted at a 20x increase to their original quote is illustrative of two broader tailwinds that all companies in category creation moments must capitalize upon.

Internal Factors and External Factors:

1. Product marketing: In the first year, the company got much better at articulating the value of their software.
2. Product capabilities: Next, a big R&D effort yielded fruit by improving the product against real-world use cases.
3. Market maturity: In conjunction with their internal efforts, customers' conviction in the broader technology category dramatically increased.
4. Blended segmentation: Mix of larger customers increased.

Learning Mode: Pricing as an Ongoing Paradigm

As we continue to emphasize, pricing is not a one-time exercise and we think that by creating a continuous feedback loop across all parts of the organization, the company will be able to capture more value over the life cycle of the business. However, as one might expect, the processes through which pricing becomes an ongoing initiative differ as a result of where the data lives and who is responsible for acting on it.

If closer to a Mouse/Elephant, given the abundance of comps, there is a high likelihood that you will make a fairly accurate guess on your initial price. The ongoing upkeep will differ slightly:

- **Mouse:** Typically, a product-led initiative. Given the low ACV and high customer count, this is a data-intensive exercise and helpful to have a BI or quant-centric person working on the trends. Particularly in self-serve models without a sales process to infer feedback from, conversion data becomes the only reliable insight into customer behavior.
- **Elephant:** Sales and Finance teams will often find themselves at odds in early-stage price optimization cycles. Sales is incentivized to produce results and may try to hang revenue misses on price, but also has real-world feedback from prospects. Finance needs to be the filter and judge which data points are most indicative of larger trends.

If closer to a Gnome/Godzilla, given the lack of market comps, there is a high likelihood that you will be fairly far off on the initial price. The corresponding evaluation of market data is much more important to be able to create a structured analysis that separates signal from noise and facilitates accelerated learning.

- **Gnome:** Typically, a product-led initiative; however, given the lack of market comps this becomes a much more difficult exercise. Essentially trying to determine WTP by evaluating value provided to end users while also determining how the buyer is deriving value.
- **Godzilla:** Through their prospecting conversations, Sales develops the most accurate picture of what value proposition and price point resonates with customers. Important to put in place the structure to capture and evaluate incoming data in an unbiased and longitudinal way. (See Appendix: Win-Loss Analysis Tool.)

Stage 3: Segmentation of the Customer Base

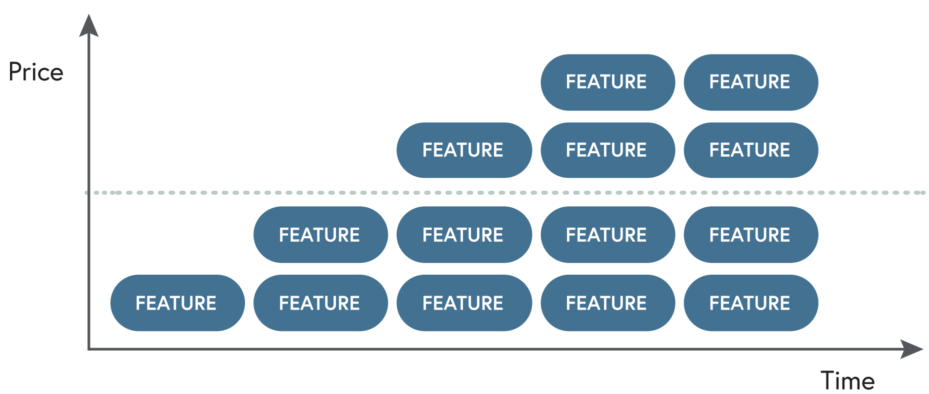
It is helpful to view segmentation and packaging as tools to express the true value you're providing to the highest percentage of potential customers.

Following a successful (1) Price Discovery exercise, (2) Price Model implementation, and (3) Price Point selection, companies will eventually begin to find themselves with one of several telling issues. More often than not, as a result of a product offering that has become much more robust than version 1.0, the company has opened up an addressable market that is much larger and more diverse than what they were originally targeting. Eventually this diversity manifests itself with several distinct cohorts of customers with slightly different WTP curves.

Key indicators that you need to start thinking about segmentation:

- Your total addressable market is growing as you are building out more functionality.
- The one-size-fits-all product that was originally created may have limitations for potential growth, and firmographics/demographics may also be changing.
- You are leaving money on the table because some customers are not paying as much as they should or would pay.
- Need to align product offering to customers' willingness to pay by differentiating the product or making it more accessible to all market tiers.

Lessons Learned: Monetizing Innovation



More often than not, companies will set a price and quickly shift toward executing on product development to build enough features in the hopes of justifying to the market that the price they set was fair. Over time, this R&D mindset and relentless pursuit of delighting the customer result in feature after feature being shipped, and eventually the value being delivered to customers far outstrips that original price point. Inevitably there comes a point when the CEO gets the nagging feeling that all of this surplus innovation needs to monetized. Fortunately, customer segmentation and packaging is the quickest way to monetize that surplus innovation.

Most people think of segmentation as the creation of subsets of a market based on demographics, common interests, and other psychological or behavioral criteria. Though this may be helpful from a marketing standpoint, this segmentation approach may not be actionable for pricing. The key term is actionable, and pricing segmentation is largely driven by identifying the WTP of customer cohorts. The ultimate goal of segmentation is to enable the company to serve customers with different WTP with different permutations of the product.

If marketing and advertising subsets are not helpful in the pricing arena, then what is effective segmentation from a pricing perspective? Companies need to segment their customer base in ways that directly apply to the product offering or based on differences that can be systematically identified. For example, are there groups of customers who are buying the same things repeatedly? It's important to focus on the commonalities of customers as they pertain to purchasing habits, or broad firmographics (company size, metrics such as number of employees, revenue). The usage of the product can also be closely aligned to various customer segments: Certain segments use more or less of the product and it's important to understand why.

Examples of pricing models:

Least flexible, but simple → **Most flexible, but complex**

	All-you-can-eat	Functional packages	Good/Better/Best	Platform + functional packages	Build-your-own
Definition	One offer with all products and features included	A base platform with add-on modules for solutions	A line-up of packages with increasingly more feature functionality	A variety of packages that are targeted at specific types of use cases/customer types	A flexible packaging approach with bundled discounts
Benefits	• Simplicity • Drives excitement and engagement	• Simplicity • Offering some customer flexibility while using some bundling to up-sell	• Forces tradeoffs on value vs price • Offerings can grow with customer needs	• Self identification	• Maximizes choice • Self selection by unique needs and WTP
When it works	• Want to drive widespread engagement and focus on maximum simplicity	• Big differences in customer (product) preferences and WTP	• Big differences in customer (product) preferences and WTP	• Benefits/services are more important to specific segments	• Customers have wide ranging needs and value flexibility • Customers can make informed decisions

Identifying customer segments is only part of the battle. Choosing how to respond to those differences via a packaging plan takes a thoughtful approach and a product that enables gated features. We heard several important takeaways throughout our interviews:

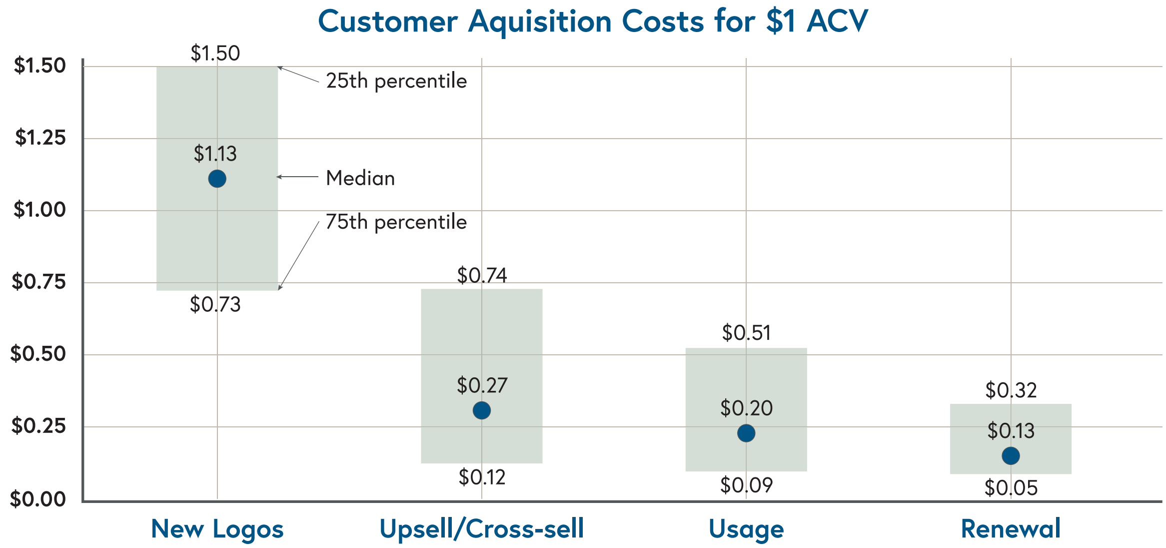
Best Practices

- **Tiered packaging:** Works as an option because customers can self-select the offering that is best for them, and packages are differentiated along price points with actionable commonalities combining features together.
- **Good-Better-Best:** Works well because it creates a lower-priced, off-the-shelf product tier available for the lower end of the market, whereas the mid-market now has a more tailored product that more closely meets their needs.

What to Avoid

- **Excessively Large Customers:** Prior to implementing product tiering, it is difficult to capture value from the higher end of the market. Upselling opportunities are difficult because there often aren't added features available for sophisticated clients who need more and have a higher WTP.
- **Bloated Product:** When creating a product specifically to delight customers, eventually there is a single product that becomes too complicated and no longer delivers equal value to all customers and doesn't allow the company to capture revenue from all customer types.
- **Complicated Selling Motion:** Rolling out feature on top of feature results in one day realizing things have become overcomplicated. This is not necessarily a problem itself; however, your sales velocity begins to slow because you're putting more work onto the sales rep, who now has to explain a very confusing product.
- **Hesitancy:** Widespread feeling that companies should switch to tiers earlier, but they typically take an extra year to do so. If a company is a value buy, they often are hesitant to make meaningful price updates. Occasionally these concerns can be alleviated once more credibility in the market has been achieved.

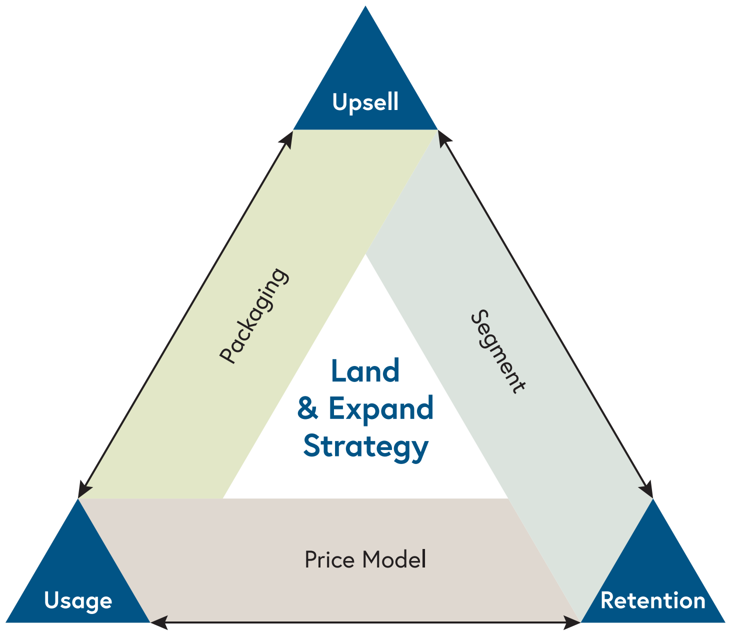
Stage 4: Drive Upsell & Cross-Sell



At the risk of stating the obvious, new logo acquisition is the most expensive way for most companies to increase their revenue. As illustrated in the chart above, on average it is much more cost-efficient for SaaS companies to rely on upsells/cross-sells and renewals to help bring blended CAC costs down. The most efficient SaaS companies all have net retention scores over 100% for this reason. In fact, the top 20% have net retention scores of over 120%.

All too often, upselling and cross-selling are conflated. However, it is essential to keep in mind that they each serve as unique subcomponents within a broader land and expand strategy. A successfully implemented land and expand strategy is impossible to execute without intentional collaboration across all parts of an organization. Sales, Product, Marketing, Engineering, and Customer Success must each operate in lockstep in order to iteratively deliver on the functionality, features, and framing that enable customers to maximize value from the full product offering.

To help drive the land and expand strategy that is the hallmark of high net retention scores, you need to be able to dynamically drive toward three independent but interrelated goals: Upsell, Usage, and Retention. Unfortunately, there is not a one-size-fits-all approach, and more often than not, these three goals are trade-offs to one another, meaning the packaging, segmentation, and price models that facilitate one may impede the other(s). As an example, pricing that is designed to drive retention can make it difficult to increase usage (implement metering) or push for upsells. At any pricing or packaging decision point, it is critical to evaluate both the first-order effects (new logo growth) and second-order effects (net retention) to help build a point of view around the short- and long-term tradeoffs you're implicitly making.



Fencing
Do you have clear limits to enable upsell and avoid cannibalization?

Seeding
Are your premium features introduced at a relevant point in the customer journey?

Use cases & roles
Are you targeting specific customer decision makers with your offerings?

Price increases
Are you able to quantify churn risk and differentiate price increases?

Structure
Are you overcoming budgeting hurdles?

Metering/licensing
Are you drafting on organic growth?

Case Study / Company C

Key Learnings:

- Complex pricing models don't necessarily drive up ASP.
- Can't let anecdotal sales suggestions completely inform pricing.
- Difficult to quickly roll out a new pricing model for a dramatically expanded product offering.

Company C sells a popular Customer Success platform to SMB and enterprise customers. Fairly early on, after the company started enjoying some breakout success, it became clear that pricing had not been strategically prioritized like feature delivery and sales execution. As a result, the pricing model had grown overly complicated with hundreds of SKUs and seemingly a new model for each new segment. The fundamental belief that informed this bloat was that complexity could help increase upsells by driving up the potential ASP. Without a dedicated pricing lead, anecdotal sales suggestions had created a pricing model without cohesion.

Despite this complexity, the underlying truth was that Company C was still trying to sell the whole platform to an SMB for a relatively low price without any levers to drive Usage, Upsell or Retention.

After identifying the pricing problems, the Product Marketing team undertook a robust examination of customer use cases and competitive analyses over the course of four months to deliver a pricing model that worked for SMBs and enterprise customers by creating multiple levers and a coordinated discount schedule. Following this rollout, the cross-sell, upsell, and expansion opportunities they were lacking before increased materially.

Following a successful pricing change, Company C acquired a company to expand their product suite to a number of new user personas. The team took a two-phased approach to adapt their previous pricing plan to this new offering. In order to speed their time to market with an expanded offering, Phase 1 simply took their existing model and used that as a template to create stand-alone pricing and packaging for these new complementary products. Phase 2 aims to go back to core principles and start from scratch by eliminating the current model and building a more integrated solution.

Based on our observations, it's unlikely that version 1.0 of any rollout of a land and expand strategy will hit the mark completely. It's important to take a long-term perspective on putting these building blocks in place, essentially relying on an iterative test-and-reevaluate approach to eventually find the optimal combination that unlocks prolific cross-sell dynamics. Version 1.0 is also unlikely to hit the mark because the three goals of upsell, usage, and retention can be trade-offs to one another – pricing that wants to drive retention can make it difficult to increase usage.

- **Prioritize Research:** Effective cross-selling comes from creating the best new product types and configurations for use cases. To ensure success, there is a lot of research that needs to be done in terms of determining buyer and persona types whenever new market or industries are unlocked.
- **Specialization:** Sales specialization is crucial when thinking about the differences in selling motions between target verticals.
- **Product Marketing:** Investing more in product marketing earlier on pays dividends down the road.
- Understand Your Limits: Once the product offering is broad enough, it's important to understand the use case overlap so you don't waste time trying to sell to the wrong people or have the wrong expectations in regard to what you are able to achieve by cross-selling.

Stage 5: Optimizing Price

By this point in a company's life cycle, product packaging and the price structure have typically been strategically defined, but maintenance is required to make sure prices are refined, new features are incorporated correctly, and competitive moves are taken into account and countered accordingly. All of those tasks require more and more information and typically at least a dedicated individual to help manage.

Generally, at this inflection point there is a broader need for the company to become more of a data-driven organization. This need for more structured and refined processes is typically felt when:

- There are lots of hypotheses about how pricing can be refined, but no solid information to support it.
- There are too many cooks in the pricing kitchen and no clearly defined strategy for how pricing fits into broader corporate strategy or long-term goals.
- The company is looking to ensure that pricing and packaging efforts will stick, and be consistently optimized.

Best Practice: Create an optimization check-in every two quarters to look back at all the new opportunities created and evaluate two things: the discount rate and the win rate. Try to identify areas in which the win rates were too low or the discount rates were too high and potentially reduce the price or vice versa. Be sure to couple it with a qualitative insight.

What you need to support ongoing optimization:

- Appoint a dedicated pricing point person to consistently monitor pricing for the company.
- Appoint a pricing council to take the lead on major pricing decisions and to respond quickly in case of major competitive changes.
- Systematic capture of price achievement and customer characteristics.
- Competitive landscape and moves need to be monitored constantly to track new trends and changes.
- Discounting data monitoring and framework set in place to properly encourage more usage from customers.
- Escalation process is in order to avoid ad hoc sales discounting.
- Consider instituting a price increase program to properly monetize.

- KPI monitoring and dashboard implementation to ensure that pricing decisions are being followed.
- Systematic customer information recording and monitoring, as well as satisfaction and feedback.
- Executive buy-in and support.

Case Study / PagerDuty

PagerDuty is a SaaS company that sells real-time operations and incident response tools, and went public in 2019. In 2017, having already implemented a Good-Better-Best model, the team was reevaluating this pricing structure and wrestling with a broad strategic challenge: "How are we going to monetize new innovation when we come out with it?" The company was coming out with new features at a fairly rapid pace while also moving into adjacent markets, and their core product was relatively difficult to feature gate. There was a pervasive feeling that as the company was facing this important inflection point, evolving from a single product to a more robust platform offering, the building blocks were not in place from a pricing standpoint.

On top of the current pricing challenges, two years prior PagerDuty had already rolled out a pricing change that had meaningfully increased the price across all tiers, driving some customers to either churn or downgrade. Given the importance of nailing the next pricing evolution, PagerDuty decided to turn to third-party consultants and eventually selected Simon-Kucher & Partners to assist.

Lessons Learned:

1. The biggest challenge is providing the data that answers all of the initial pricing-related questions. Typically, this info lives in separate, distinct silos, so finding and organizing the data as requested is a fairly resource-intensive process.
2. Context is critical. Having an internal resource who has been with the company for a long time is helpful to provide SKP with the context around historical trends in the data.
3. Once the recommendations come back, execution and implementation take a long time. For PagerDuty, it took a full year.
4. Need to keep in mind that any pricing-related changes could mean significant lifts for the product and engineering teams. There is always a trade-off between new features and a stable foundation.
5. Overhauling entitlement management, provisioning, and billing systems required a large amount of work.

6. If you're in a competitive market, pricing has to be fairly fluid. It is important to keep revising your approach. Competition changes and the environment around you changes, so you need to monitor all of these signals.
7. If you can set up your product and your finance functions, and your billing and IT infrastructure in an agile way to quickly implement changes, you can more quickly accommodate pricing changes.
8. Hire a dedicated pricing person to operationalize pricing analysis coupled with a Pricing Executive Committee to review and approve changes.

Discounting: How to Execute

Discounting is an essential component of an effective outbound sales organization, particularly as the deal size increases. We found a high degree of variance around how companies implemented discounting strategies. When executed well, a discounting strategy should be centrally controlled and leveraged as a strategic tool rather than a reactive approach.

- In the absence of a pricing function, anecdotal sales suggestions can fill the vacuum which results in an ad hoc, overly complex, and suboptimal discounting model.
- Create an internal Configure Price Quote (CPQ) tool that allows for salespeople to quickly quote a price while still on a call. Speed is key to drive internal adoption.
  - By creating this discipline and moving away from salespeople pricing deals based on their own intuition or their own limited insight from the deals that they have done in the past, you create a smaller discounting spread.
- Be strategic in when you show a discount to a customer.
  - Train the sales organization to anchor the deal and then be able to know how to discount it so there's still an optimal price at the end of the day.
- Get a sense of how specific feature packages drive value for which personas and determine which matchups should be discounted and which should not.
  - There will inevitably be situations where you should almost never discount and others where you should.

Conclusion

Pricing remains one of the last levers even successful operators think to optimize, and we believe that should change. As we've hopefully illustrated, pricing is a hard but vitally important component of company building that is all too often overlooked.

At its best, pricing can be a precise science and at its worst, a complete shot in the dark. The faster we can nudge all companies closer to the former, the healthier the broader startup ecosystem will be.

We look forward to hearing about your progress and your feedback.

Please don't hesitate to reach out.

Appendix

What's happening with customers during COVID-19?

We set out to better understand what SaaS companies were seeing from their customers during this complex COVID-19 economic and public health crisis.

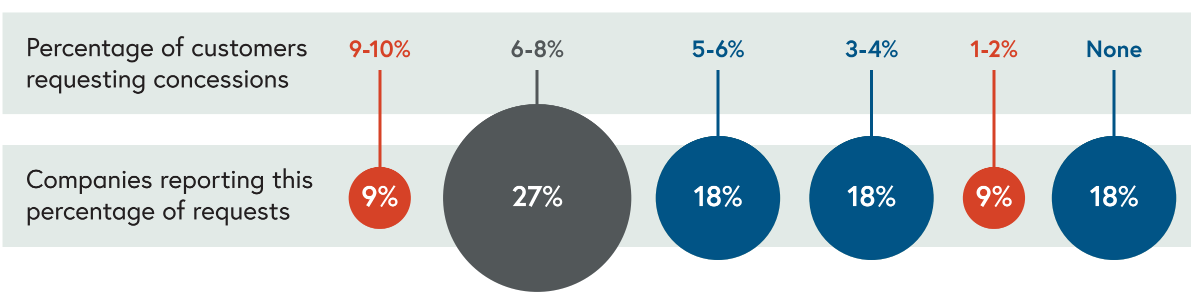
The section below captures market intelligence related to what companies are seeing and hearing from their customers, along with some of the tactics being employed. The scale of these businesses is vast, ranging from $5M in ARR to $250M+, but remarkably a number of the themes we heard about were consistent across the 20+ companies we spoke with.

While the impact for many of these companies has been quite modest so far, nearly all of them are cautious and concerned that more challenging times may lie ahead due to the time lag between the difficulties faced by their customers and their own sales and renewal cycles.

Let's begin with a benchmark. One question that we asked each company was, "Approximately how many of your customers have already come to you and asked for some type of economic concession or adjustment to their contractual terms?"

- No surveyed company has yet seen more than 10% of their customers request this.
- However, over a third (36%) of companies are seeing over 6% of customers make a material request.

Of surveyed companies, the proportion of customers asking for concessions, e.g., 27% of companies surveyed, saw 6-8% of their customers asking for concessions.



A select set of the surveyed companies' customers are coming to them and asking for material concessions to existing contracts. The primary requests that our companies are seeing, catalogued in the benchmark above, include:

- **Deferred payments –** primarily 60- and 90-day requests, evenly split in frequency.
- **Migration from an annual plan –** generally to a quarterly plan, but in some cases monthly.

- **A complete pause on the product –** e.g., "We'll stop paying you and you can turn off the product for three months."
- **Discounts –** on the order of 20-30% more for a renewal, relative to what was typical in the prior periods.
- **Adjusting contract durations** (i.e., discounting, by another name) – most typically extending 12 months to 15 months to grant a three-month "free period."
- **Downgrades –** in particular for SMB segments with significant cash flow issues; they're asking to be moved to a lower pricing tier and in some cases with the same functionality preserved.
- **Delayed decision-making –** maintaining the current pricing, but moving a renewal decision, including any automatically triggered price increase, out, typically by one quarter.
- **Early cancellations, without penalty –** in some cases, very recently closed new customers asking to back out of an annual agreement.

The debate between proactive and reactive

One area where there wasn't consensus across the surveyed companies was regarding how proactive to be with customers. Two arguments were prominent:

- **We need to get in front of this:** These companies were primarily focused on setting a clear expectation and anchoring their customers to a certain set of concessions. Typically, this was in an effort to balance minimizing the financial impact to the business, but also demonstrating a high-touch, customer-centric approach. In some cases, companies were able to do this in a highly targeted way – even going as far as building predictive models around customer churn using internal and external data sources – in order to communicate with a subset.
- **We don't want to offer terms where we don't need to:** The balance were typically those companies that weren't yet seeing a significant volume of inbound requests. Their primary concern was avoiding both (a) setting any sort of precedent and (b) overreacting and penalizing the financials of their own business (e.g., cash flow, revenue) by exposing too many customers to concessions.

On this debate, there's no silver bullet and each business is unique. Most companies doing unilateral outreach, or something close to it, are leveraging their Customer Success teams to softly test the waters around overall customer health rather than leading with a discount or extension. In cases where your customer segmentation models and analytics allow for it, we do agree that selectively engaging high-risk accounts feels prudent.

Specific Tactics Being Used

The surveyed companies are utilizing a range of creative tactics, which we've summarized here. Our original intent was to categorize by tactics for existing customer renewals and moving new business through the pipeline, but in practice we found the approaches similar and overlapping so instead have prepared a single list.

While the existing customer data above suggest these requests are coming in from only 5% of customers on average, those benchmarks likely reflect the natural renewal cycles of cloud software companies. For new customers, these concessions and tactics appear to be surfacing in over two-thirds of customer discussions.

- **Launching a self-serve product:** A number of companies have used this opportunity to bring a lightweight, lower-end product to market, typically offering this via a self-serve page to assist with lead generation.
- **Catch-up fees:** Granting deferred payments or pauses to the contract, but asking for a fee on the backend as compensation (e.g., half-month).
- **Deferring price increases:** Allowing customers to avoid automatic price increases or continuing discounts that otherwise would have expired.
- **Moving to free trials:** Companies that were averse to free trials in the past ("We didn't do those") have significantly loosened those restrictions.
- **Complementary offerings:** Those customers with adjacent products and newer products are finding themselves increasingly adding these into deals at no additional cost.
- **Support upgrades:** In cases where companies offer tiered support models, they're frequently closing renewals with premium support offerings.
- **Relaxing minimums:** Where product tiers have minimums (e.g., users, instances), many companies are relaxing those – in many cases with a specific and upfront agreed-upon duration, rather than going forward.
- **Longer implementation grace periods:** Allowing for considerably more flexible and generous, usually unpaid, rollout and implementation periods.

- **Trading terms:** One tactic, which we think nearly all of our CROs and CFOs should at least consider, is to extend generous payment terms at the cost of the customer giving up their discount. Obviously, this is more impactful when the trade can be contractually committed and not just a handshake with a sales leader.
- **Expanding key relationship touchpoints:** A number of CROs were concerned about key customer contacts losing their jobs, given the economic volatility, and are working with CSMs and AEs to expand and map more customer relationships to mitigate this risk.

On reflection, three things stand out as particularly noticeable here:

1. The surveyed companies have been able to avoid, nearly across the board, any major and explicit discounting behaviors, managing instead to roll in other concessions to preserve the price.
2. We do advise teams to be cautious about overdoing it because, while cash today is king, these concessions will have longer-term anchoring results with customers that may not be favorable. It's, of course, a balancing act.
3. When concessions are made, companies are fighting to have customers choose one or the other. However, in several cases we're seeing "double-dipping," where a customer is able to negotiate two or even three concessions in parallel, resulting in a significant impact to the financial value of the account/contract.

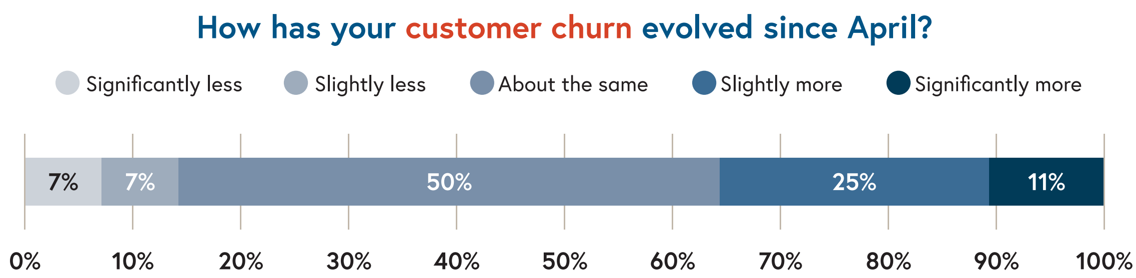
CFO Commentary

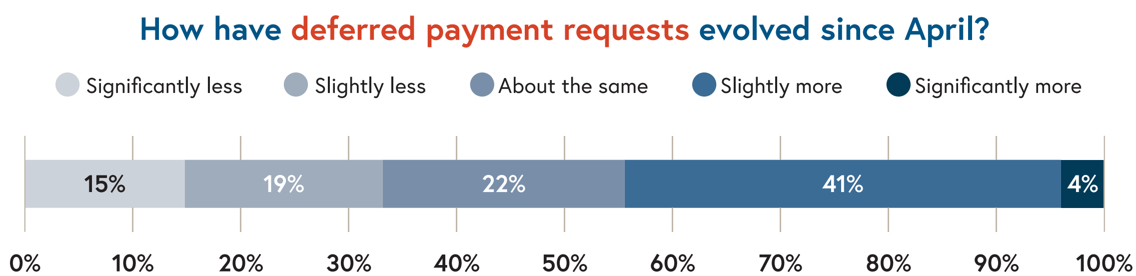
Throughout a hybrid of CRO and CFO discussions, a few topics are worth citing from the latter:

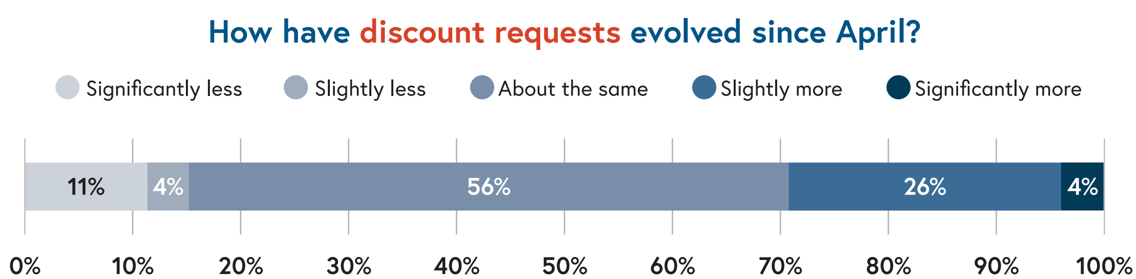
- **Churn:** Only about a third of the companies were seeing material churn increases as of mid-April 2020. In most cases, these represented an approximately 2-2.5x increase in the overall levels of churn compared to Q4 2019. Additionally, the velocity of change was quite dramatic, with churn rapidly evolving week over week. One company well over $50M ARR was seeing the climate worsen 50% week over week.
- **Quotas:** While many CFOs are considering adjusting quotas to reflect the current climate, much of this work remains to be done and only two of the surveyed companies had already completed and rolled out new quotas to their teams. In particular, these quota edits have seen shifts from new business to upselling existing accounts.
- **Delinquent payments:** As you might expect, we're hearing about 1.5-3x increases in delinquent payment rates. As it relates to proactive outreach, a number of Finance leaders are building in rules (e.g., if they're X days overdue, offer to extend Y days of terms).
- **Loosening typical discount approval policies:** Several CFOs mentioned they're approving out-of-policy discounts at double the frequency from Q4 2019 baselines.

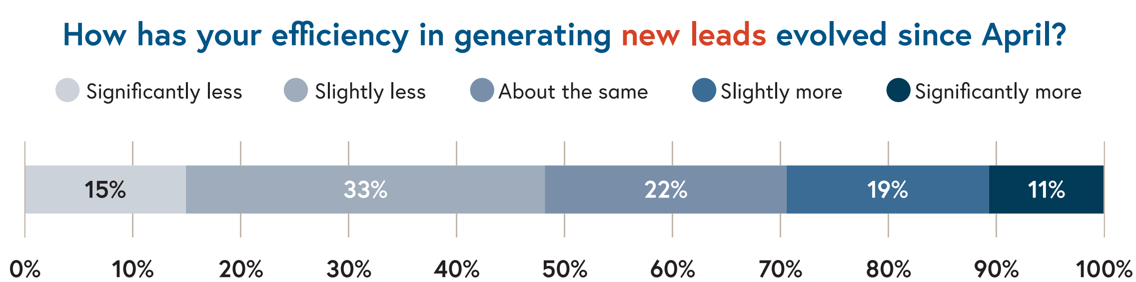
Summer 2020 update

In late July we conducted a follow-up on our initial survey to better understand how customer dynamics have evolved since the early innings of the COVID-19 crisis. Below is a snapshot on the shifting forces impacting our cloud software companies.









A look ahead

- **Budget Concerns -** We have heard from a number of companies whose customers have indicated that budget has been pulled for new projects in 2020 and beyond. There is a continuing concern that the lag between the difficulties being faced by customers and a company's own sales and renewal cycles might lead to additional contraction in the future.
- **Slowing Velocity -** Even for companies that have continued to meet revenue goals some are seeing early concerning signals from the market through sales cycle elongation.
- **One size doesn't fit all -** Companies selling into a variety of industries have had to implement vertical specific concessions for those industries that have been more adversely impacted by COVID-19 eg: hospitality, airlines, restaurants.

Win/Loss Questions

OVERVIEW DRIVER	SPECIFIC DRIVER
High-level Questions	Outcome
	Primary competitor
	Why did we lose/win
	Primary use case
	Persona
Product and Solution	Overall capabilities and features
	Depth & accuracy of discovery
	Limited to SaaS
	Integration quantity
	Integration depth
	Actionable insights/reporting
	Contract Object & Concierge
	Security of the platform (e.g., SOC 2, GDPR)
	Roadmap
	Support & SaaS Consultant
	Ease of implementation and getting started
Sales Experience	Sales process and follow-up
	Sales team knowledge and expertise
	Sales team listening and communication

Sales Resources	Analysts
	Events
	Executive team involvement
	Marketing content and sales materials
	Partners
	POC
	Solutions Consultant
Pricing & Packaging	Perceived ROI
	Pricing clarity and transparency
Our Company & Brand	Company presence (company size, geographic footprint, user base, etc.)
	Company reputation, leadership, expertise
Not a fit/Not now	Budget and timing
	Client organizational influences (personnel changes, M&A activity, etc.)
Internal buy-in	Ability to access/influence decision makers

Tools:

Conjoint Analysis

- Conjoint.ly: https://conjointly.com/
- Sawtooth Software: https://www.sawtoothsoftware.com/

Win-Loss Analysis tool

- Clozd: https://www.clozd.com/

Pricing Strategy

- Simon-Kucher: https://www.simon-kucher.com/

Bessemer Portfolio Pricing Leaders

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