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THE SEVEN MISCONCEPTIONS OF SAAS PRICING – AND HOW TO DO IT BETTER!

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ABSTRACT

This article sheds light on the key challenges that companies face when monetising SaaS offerings. Despite the enormous growth potential of the SaaS business models, firms often struggle to extract the promised and generated value from their innovative services. The article discusses seven common misconceptions about SaaS pricing, including overcomplicating the offering, overemphasising price point determination, overlooking price metrics, relying solely on market research methodologies, rushing into pricing decisions, neglecting change management on the sales side, particularly when selling software with hardware, and having an insufficient KPI structure for pricing. By avoiding these pitfalls, companies can easily improve their price models, enhance value extraction, and achieve long-term success in the SaaS market.

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Digitalisation over the past years has laid the base for the strong growth of new business models in B2B and B2C around software, data and analytics, as well as other digital offerings. Many of those business models are based on „Software as a Service", or just SaaS, which is an enormously growing market globally with an expected CAGR of 8 % until 2027, according to Statista. However, the key to the sustainable success of those business models is how much of the promised and generated value by these innovative services can actually be extracted. And this is where the problem starts – value extraction or, in other terms, the monetisation of the SaaS offering, provides a substantial challenge to many firms and is unfortunately associated with many misconceptions, as we will illustrate subsequently:

1. "WE NEED TO HIGHLY DIFFERENTIATE OUR OFFERING"

In the ambition to cater to every tiny target group, firms overcomplicate their SaaS offering. Too often, we see a jungle of packages, bundles with exceptions and additional elements and upgrade options, which are hard to grasp. Instead, simplicity shall be king, particularly in a B2C environment. In contrast, in B2B offerings, support services are too often overlooked – these are typically services that make customers move to SaaS offerings and consequently can be easily monetised and boost value extraction. For instance, integration services such as setting up the solution in brownfield ERP and CRM landscapes, maintenance services, and customer or technical support shall be considered in pricing schemes.

2. "WE NEED TO DETERMINE THE RIGHT PRICE POINT"

We always notice an overemphasis with many SaaS offerings on accurately assessing the actual price point. While "price point engineering" is vital, it is only one facet of the overall offering and value extraction. Typically, there are many discussions around competitive and value-based pricing (and, to some degree, even cost-plus pricing), which should not fill the pricing manager's agenda too much. In the end, price levels shall oscillate between competitive and value-based depending on the overall strategy of the offering (penetrating vs skimming). If the price point is not hit right the first time, this should not worry too much as the actual price level can typically be easily changed - other than, for instance, the price model or metrics.

3. "PRICE METRICS ARE NOT SO CRITICAL FOR US"

Surprisingly, other than the price point, the pricing metrics do not get the attention they deserve. Nevertheless, this is typically the "secret sauce" for successful SaaS pricing and value extraction –look at the many creative metrics digital native players such as Amazon Web Services apply: Pay by gigabyte, by click, by data load, or by API calls. Applying the right price metric is vital as, especially in the pay-per-use price model, fixed costs are "variabilised" for the customer. This means that customer costs match the value created for the customer, making the offering more attractive and, consequently, granting more pricing power.

4. "WE DETERMINE PRICING WITH MARKET RESEARCH METHODOLOGIES"

The good thing is that "SaaSletees" typically want to prove their assumptions and hypotheses with data. Still, our experience with traditional price research techniques is mixed: Often, a quick online survey with random samples leveraging Gabor Granger or Van Westendorp analyses is conducted to get a feeling for the prospects' willingness to pay. Again, typically, this ignores the equally important components of the price model and price metric. On top, especially for very innovative offerings, the survey sample owns only limited competency to truly judge the value of the service provided. This is also true for conjoint surveys despite their higher validity by taking trade-offs into account. Hence, we recommend two alternatives: First, a small sample focus group approach with experts tends to yield better results, especially in an early stage. On top, A/B testing or introduction to pilot markets and a phased roll-out of a pricing concept is a much more robust approach, especially for highly innovative offerings.

5. "WE APPLY AN AGILE APPROACH AND EMPHASISE FAST GO LIVE OVER TOO LONG TESTING"

One note of caution: Do not run too fast. We have also seen very agile start-ups burning their price positioning by moving too fast. Testing features, the price model and its metrics (other than the price point!) is crucial and takes time. This requires analytical groundwork and a deep understanding of customer segments, use cases, applications, and the benefits of the respective offering. Particularly in B2B, large-scale quantitative approaches might not be necessary, but deep insights from interviews and focus groups might be sufficient. In B2C, approaching potential prospects with pricing scheme mock-ups and conducting interviews (e.g., based on "thinking aloud" methodology) typically results in profound insights and significant input for further validation rounds. Take the time to sharpen the offering with its features, the price models and the metrics, as this is much harder to change and the core of value extraction!

6."WE URGE SALES TEAMS TO SELL THE SOFTWARE WITH THE HARDWARE"

In many traditional firms now moving into the SaaS world, sales have been used to sell tangible assets like industrial equipment. In many cases, sales now need to sell the machine and software contracts that earlier might have been given away for free on top. This requires a ton of change management initiatives starting, for instance, with adapting the sales force's incentivisation but also offering training. Large organisations might even consider adjusting their organisations as sales might have been split up into hardware and software sales.

7. "WE DO NOT NEED A KPI STRUCTURE FOR OUR PRICING"

We all know the famous saying by Peter Drucker, "What gets measured, gets done" – so with SaaS pricing. Too often, however, we see that either "classic" pricing KPIs like average margin, discount, or enforced price level are measured or are neglected altogether. For SaaS, we recommend diving deeply into the digital world and building a performance indicator framework fitting your business. Typical KPIs cover customer acquisition costs, average recurring revenues, and average revenue per user (or ARPU) and always come with a "growth" twist. These KPIs shall be tracked ideally daily and compared over time to learn and quickly take action in case of deviations from the plan. Hence, a robust KPI structure and concept shall not be set up at the end but at the beginning of the SaaS price model design to measure already your pilots against those KPIs and continuously track your SaaS performance.

Of course, with all the different price models out there, there might be much more flaws but also much good practice. Based on our experience, not everything can be anticipated in pricing innovative SaaS offerings. Still, the discussed misconceptions might help avoid common mistakes and focus on the right components of your pricing model.

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