Your Cloud Services Checklist: Pricing and Packaging Optimization
EXECUTIVE SUMMARY

This white paper is intended to serve as a reference, checklist and point of discussion for anyone considering optimizing the pricing and packaging model of a cloud services business. It discusses the four key components of a cloud service monetization strategy:

- Selecting a model
- Setting a price strategy
- Devising a channel strategy
- Overlaying a contract

INTRODUCTION

Today’s consumers want it all, and they have the power to demand it. Forward thinking companies offering products or services via the cloud understand this new dynamic and seek to align their businesses to their customers’ expectations. To achieve that goal many successful companies adopt a recurring revenue model for their monetization strategy.

In the process, consumer-centric companies provide greater value to their customers and their businesses.

Monetization, including billing and payments capability, has shifted from an operational necessity for cloud businesses to an important element in business strategy. In some situations these monetization services provide critical differentiation for cloud business services. As enterprises continue to embrace the cloud for outward-facing customer support and new top-line business solutions, monetization will be a make-or-break element in managing customers, partners and channels.

Not surprisingly, Wall Street greatly values businesses with stable recurring revenue models since predictable dollars are so easy to forecast. But there are many other advantages to recurring revenue models. Businesses can more easily scale revenues to costs, while lowering the costs of sales. Products and services can be bundled and more easily promoted. Companies with recurring revenue models interact more frequently with customers by dint of their regular billing processes and use that opportunity to deepen relationships, build loyalty and increase customers’ lifetime value.

SELECT A REVENUE MODEL

Consumers seek and expect immediate gratification when they buy. They want self-service 24-hours a day, seven days a week and to try new products and services before they purchase them. They do not want to pay upfront costs and prefer paying for value when it is received. And most of all, customers want to be able to change their account information or service whenever they want.

There are primarily six pricing models for cloud services businesses: Standard subscription; limited time offer; freemium; multiple edition; tiered/ volume based and bundling. Businesses often employ variations on these basic revenue model categories as you will see below.

Standard subscription

A standard subscription model provides a product or service that offers value over time. A subscriber is entitled access to the whole product or service for that period of time. With the standard subscription we see a flat-rate payment, which means payment is divided in equal installments and paid over the duration of the subscription. At the end of the subscription, which could be monthly, quarterly or annually, the subscription can automatically renew or end. Sometimes the subscription can be permanent. Companies typically offer a discount for a pre-paying the subscriptions.

Key criteria to determine if a standard subscription is right for your company:
Does your product or service offer value over time, such as a magazine or newspaper subscription?

Does your service have a usage component? If it doesn’t a standard subscription model will work for you.

**Limited time offer**

Limited time offers provide discounted services or usage for a specific term. The discounted trial is usually combined with an opt-in or opt-out requirement to automate the transition of services after a limited term. A limited time offer usually lasts between 30 days and three months and many times the service is automatically disabled after the trial period ends. Usage-based free trials typically involve an initial credit to the customer, such as dollars or a unit of service. The service is automatically disabled when the credits are exhausted.

**Freemium**

A freemium revenue model is never time bound. Theoretically the consumer can use the service as long as it exists without paying any fees. Companies employing a freemium model for their products realize a network effect as more and more people use their service, ultimately increasing its value. Nowhere is this more evident than with social networking sites such as Facebook and LinkedIn, where word of mouth led to widespread usage of these sites.

Determine whether a freemium model can support your product by considering the answers to the following questions.

- **Can the service sell itself?** Can your prospects quickly understand the value your product delivers or does it require extensive pre-sales explanation? Make sure you’re promoting both your free version and paid version of your service.

- **Is your product easy to use?** How easily can a user get started with your free service? How many of your paying customers began using your service without any help from you? If significant effort is required to configure the service, integrate data from other systems or use your standard functionality, customers may start searching for alternatives. An easy to use service with a short time to realize value is a good candidate for a freemium model.

- **Does your free trial actually promote value?** If your free trial is a software application but most of the benefits and value are provided by your paid version, your potential customers won’t get a chance to truly evaluate your paid solution. For this reason some companies offer partial or even full support and training during fee trials to increase the success and conversion rate among trial users.

- **Does your free offering cost anything to deliver?** Don’t overlook the costs of allowing users free access to your service. The incremental profit delivered by the offering must be greater than the incremental cost associated with the cost of the free users.

**Multiple edition**

The multiple edition model offers the same product at different levels of service at different price points. Typically, the multiple edition model is offered at a fixed price, matching closely with the seller’s cost relative to the benefit derived by the consumer.

The model becomes more complex when usage is applied to the equation because usage must always be measured. While usage is not necessarily a component of price with this model, it’s measured to ensure that users don’t exceed their selected levels of service. Moreover, many cloud businesses measure and analyze their customers’ usage to better understand their subscribers’ behavior and segment their customers for more efficient marketing. Suffice it to say that tracking and measuring usage is a requirement for optimizing your business strategy with a multiple edition model.

**Tiered/Volume-based**

In its most simple form the tiered/ volume-based model generally has both a flat rate and a usage component associated with pricing. Companies typi-
cally charge a subscription fee and a flat-rate for service, as well as billing for overages as extra charges.

For example, a standard mobile telephone bill generally has a base subscription, as well as a variety of usage-based services like texting, data and the number of call minutes included with the plan. The customer then pays for any usage charges that go beyond their subscription plan.

Some key considerations to evaluate with a tiered/volume-based model include:

- **Billing can get very complex with the tiered/volume-based model.** Calculating a customer’s bill amounts requires service providers to apply the service rate to the usage amount in a given period. As a result the amount customers owe can vary widely between billing periods depending on the amount of service consumed. Tiered rates may also be applied based on the amount of consumed services and by providing usage level discounts.

- **Delivering timely billing data.** The most difficult aspect of this model for providers to execute is ensuring that usage data is received in a timely manner.

- **Variable rate billing.** This model is flexible enough for variable rate billing to be used for a single product or service, or for multiple products and services. Computing billing for multiple products and services is often a complex undertaking because each service needs to be tracked independently and associated with a cost for that component.

- **Pay-as-you go component.** A variant of the tier-based model is a pay-as-you-go strategy, where no monthly flat-rate is applied and a consumer pays solely on usage.

**SET A PRICE STRATEGY**

There are four basic pricing strategies employed by most cloud-based businesses: a flat-rate structure; a tiered rate; integrating a usage component; and a pre-paid model. It’s important for businesses moving towards a recurring revenue model to understand how pricing strategies have evolved in recent years.

Take for instance the transition of pricing mobile broadband services. At one time, years ago, communications companies charged a flat fee for mobile broadband services, which worked very well for their business and customers. That is until smartphones and tablets changed the dynamic. Suddenly, users consumed more bandwidth in an hour than anyone ever before thought possible by streaming high-definition video.

That’s when communications providers decided they needed to modify their monetization strategy. The pricing models for mobile broadband subsequently shifted from a flat-fee structure to a subscription price along with a tiered or metered usage component.

A flat-fee subscription model works best when there is an inexpensive supply of the product or service and limited consumption. Think of a buffet restaurant. The food is relatively cheap, and there’s a limit to how much one person can eat in one sitting. Traditional voice services are often priced this way, particularly when they are delivered over an IP network. The supply for calls is inexpensive, and people can only talk for a certain number of hours per day.

Conversely, using the HD video analogy above, when supply for a service is expensive pricing must control unlimited consumption by customers and a tiered-
DEVISE A CHANNEL STRATEGY

A channel management approach begins with segmenting customers into logical groupings so they can be treated in a common way. This approach creates mutually exclusive offerings, enables targeted branding, and targeted communications across each channel with unique marketing campaigns.

For instance, a digital broadband provider may offer their solution to a home segment, a business segment, and a school segment allowing them to target three segments with a similar offering. With this example we see three of the four components of our monetization model. We see a standard subscription, a flat-rate price and a simple channel strategy.

When considering a channel strategy, consider:

- What resellers can you sell through?
- What specific customer or market segments do you want to sell to? Can your customer base be segmented by geography or type of business or buyer persona?
- Can different pricing and service enhancements be applied to specific segments.

OVERLAY A CONTRACT

Most phone service providers require a two-year contract with their plans, which provides the seller with a continuing, predictable revenue stream for the duration of the contract. In the case of telecommunications providers, signing a contract can be exchanged for an up-front discount on a one-time purchase like a smartphone or other mobile device.

CONCLUSION

There are many advantages to building a recurring revenue strategy for your cloud business. First and foremost, a recurring revenue strategy offers predictable revenue streams, while providing the ability to scale revenues to costs. Companies with recurring revenue models always receive higher valuations.

If a frictionless sales model can be created that enables customers to quickly get started with your offering and use it without your support it will also lower the cost of sales. Customers seek convenience, value and personalization. In addition, other services and products can be easily bundled to further increase margins.

Most importantly, a recurring revenue model strategy aligns your business to the way customers want to buy products and services. For consumers, paying every month means companies must meet their needs on a monthly basis, or the consumer can simply leave. Consumers demand to pay for value as they receive value. They want a fair value exchange and they want immediate access to products and services, 24 hours a day each day.

Lastly, a recurring revenue model promotes a continuous relationship between the seller and consumer. Each month there must be a value exchange, aligned with the common goal of providing the customer what they want and what they’re willing to pay for, which ultimately drives customer loyalty.
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