

Digital Price Pack Architecture: A Fresh Look at Software Subscription Pricing

How much attention does pricing get at your organization? Could you be losing sales because some customer segments aren't quite willing to pay your current price? Are you leaving money on the table because some customers would pay more? Do you understand which specific attributes or features of your software are most valued in the eyes of the customer?

Many software as a service (SaaS) businesses developed with very simple price and bundle structures, or ones that were set years earlier, when the product was relatively nascent. Having jumped to the cloud, many SaaS businesses see significant early growth and focus on winning and retaining customers, but that life-cycle growth begins to slow down eventually, and then it is critical to look to other levers to create value. Rethinking the architecture of the different packages available and how each is priced can be a critical way to enhance revenue and profitability.

Given that pricing improvements drop straight to the bottom line, getting pricing right can be the most effective and quickest way to increase profits. Optimizing pricing and packaging is not new in technology or SaaS, and customers readily accept the approach in order to get the best value for themselves. Even something as ubiquitous as Microsoft Office creates a broad spread of price points with different functionality and flexibility to retain high share and optimize revenue. Yet for the most part, fine-tuning pricing is a relatively low priority for small-to-midsize software companies, many of which don't have dedicated pricing resources. A focused insight- and data-based review of pricing and packaging options, however, can quickly lead to a strong understanding of what drives value in the eyes of different customer segments and, in turn, produce a new architecture with the potential to significantly increase profitability.

L.E.K. Consulting's Price Pack Architecture approach

L.E.K. helps software organizations optimize their pricing structure using an approach called Price Pack Architecture (PPA). PPA is the art and science of unlocking short-term, margin-accretive innovation in your portfolio.

PPA is an approach that uses rigorous analysis of consumer preferences and product attribute trade-offs to re-architect available bundles and optimize pricing to achieve higher revenue and margins.

Our approach, which draws on a toolkit honed over years [across end markets](#), starts with the "voice of the customer," in all its nuances. We then use rigorous quantitative analysis to yield a set of actionable product bundling recommendations.

The approach comprises four key steps (see Figure 1).

Step 1: Internal diagnostic

During this step, we hold discussions with leaders in a range of functional areas about what they believe customers value and how this affects pricing strategy. These conversations also help us identify whether there are any constraints on which features and functionalities can be flexed in order to design optimal packages. We combine this information with an analysis of customer-level pricing data to create a baseline product articulation — a verbal description of product bundles — that can be tested in the marketplace.

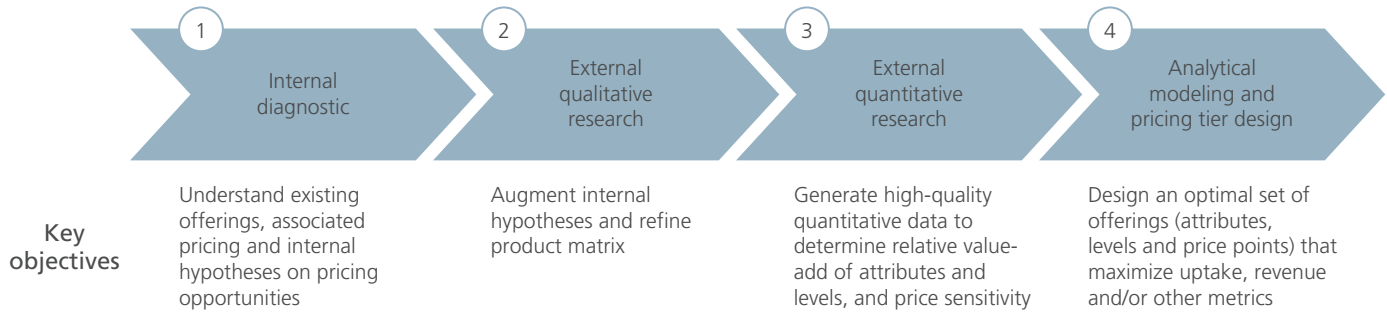
Step 2: External qualitative research

This step is aimed at gaining an understanding of customer needs, satisfaction with current solutions and perspectives on current value-add. To determine whether our product articulation resonates with the market, we conduct a series of interviews with existing and potential customers to hear their feedback. This information helps validate and refine our product articulation before the more quantitative testing phase, and gives us an early read on which product attributes are most valued.

Step 3: External quantitative research

By the end of the second step of our process, we have isolated a set of five to seven high-value attributes associated with

Figure 1
L.E.K.'s PPA price optimization approach



the offering, as well as potential different “settings” for each attribute. We then develop an online survey targeting customer and noncustomer decision-makers to use multiple triangulated research approaches to delve into which attributes and levels are most critical to their businesses, how much they are willing to pay, and what kinds of trade-offs they would make between price, attributes and levels. The result is high-quality quantitative data that we can use to model each option.

Step 4: Analytical modeling and pricing tier design

The last step is where the rubber meets the road. We take all the data we have collected and run it through multiple analytical tools. While conjoint analysis is central to our approach, using more than one analytical method (see Figure 2) helps us surface important nuances in the customer response and allows us to triangulate on a more accurate set of recommendations than using one approach alone. We are also careful to fine-tune quantitative results with certain “real world” adjustments. For example, we are able to make “stated to actual” adjustments by including reference products that have concrete, known values. The results include a set of pragmatic product recommendations and clarity regarding the plan to test and validate the recommendation.

Figure 2
L.E.K.'s PPA model leverages a range of analytical tools

	Analytical tool	Key question analysis is used to understand
Price-agnostic demand	“TURF” analysis	If price were taken out of the equation, what product features do customers care about?
Price elasticity	Van Westendorp Price Sensitivity Meter	At what self-stated price would customers be willing to purchase?
Optimal package design	Conjoint analysis	Simulating real-world possibilities, what is the take-up for different products and packages at specified price points?
Ecosystem impact	Trade-off analysis	How will the introduction of new products impact usage and subscriptions to existing products?

PPA solution recommendations

The result of L.E.K.'s PPA approach is a set of data-driven pricing and bundling recommendations for both new and existing products that optimize a client’s revenue generation potential. We derive a number of important insights on our path to these recommendations, including a sense of how the market is likely to evolve based on customer preferences, and a strategy for bringing in consumers for whom current products and prices are not appealing. By deconstructing product bundles with different features, we can quantify potential impact on sales, volume and margins, and gain a deep understanding of sources of cannibalization from different products. This leads to recommendations that have a measurable effect on a client’s bottom line.

We have leveraged our PPA approach for many clients — both software companies and a broad array of consumer-focused companies. For example, we helped a leading sports league



Technology Solutions

optimize its portfolio of digital direct-to-consumer products, leading to a doubling of revenue over its legacy products. In another instance, we worked with a major health club software vendor to develop tiers of products appropriate for different parts of the market. Using our PPA methodology, we delivered a detailed set of product tiers, along with prioritized features and recommended pricing, giving the company the support it needed for a successful product launch.

For SaaS companies, a PPA process quickly turns pricing from a blunt tool into a fine-tuned instrument. By combining category diagnostics, ideation, conjoint testing and simulation, we can

determine which product bundles are likely to yield the best results — knowledge that has the potential to deliver a big boost to a company's bottom line.

Contact

Digital Price Pack Architecture: A Fresh Look at Software Subscription Pricing was produced by **Robert Haslehurst** and **Neil Menzies**, Managing Directors, and **Stephen Matthews**, Principal, at L.E.K. Consulting. For more information, contact strategy@lek.com.