SOMETHING OLD, SOMETHING NEW

THE HISTORY AND FUTURE OF PRICING

m3ter

WITH SPECIAL THANKS TO OUR PEER REVIEWERS:
JAMES WOOD - *Senior Vice President, Pricing Strategy at Insight Partners*
ARIELA BITRAN RICH - *Director, Pricing Strategy at Chargebee*
KYLE POYAR - *Operating Partner at OpenView*

INTRODUCTION

THIS DETAILED WORLD MAY BE ONE SHAPED BY DIGITAL TOOLS, BUT IT RESTS ON PRINCIPLES THAT PREDATE THE INTERNET BY NOT JUST DECADES BUT CENTURIES.

Pricing today feels more sophisticated than ever.

As consumers we are accustomed to navigating a world of personalized offers, surge rates and last-minute deals from the comfort of our smartphone screen. While as business buyers, we are increasingly likely to manage an expenditure down to the last detail of a product's implementation and impact – not simply forking out for an up-front cost or a regular subscription.

This detailed world may be one shaped by digital tools, but it rests on principles that predate the Internet by not just decades but centuries. The subscription model on which the modern software industry has built its success has existed in one form or another since at least the early 1600s. The dynamic pricing system that underpins digital marketplaces like Amazon and Uber is – at its core – an algorithmic version of the haggling for price that has been familiar to market traders since the dawn of time.

Some of our ideas around pricing are as old as the hills, and others are newer than we might expect: the principle of a fixed price in retail, for instance, only became popular in the mid-19th century. The upshot is that pricing appears to be an area of business that is constantly changing, while resting on some foundations that go back to the very beginnings of commerce. Any business owner or manager whose job includes pricing would benefit from improving their knowledge of how today's ideas and strategies came to be, the historic approaches they emerged from, and the methods that were tried, discarded or improved along the way.

In that spirit, this paper will provide a whistle-stop tour of some of the developments that have brought us from then to now.

We will look at the 17th century origins of the subscription model, the religious roots of fixed pricing, the rise of usage-based models with the arrival of modern household amenities, and how the Internet era has given new impetus to some old ideas.

In the process we hope to show there is something to be learned from the history of pricing as well as the debate that currently surrounds it. Companies that are wrestling over how to find the right balance between attracting and retaining customers, providing outstanding service and expanding profit margins should reassure themselves that they are far from the first to have struggled with exactly these questions.

Nor are they the first to have come up with answers.

01

SUBSCRIPTION'S EARLY ADOPTERS

While today we subscribe and (hopefully) unsubscribe to services at the touch of a button, in the early days of the business model, things were a little more complicated.

The first subscribers to one of the landmark English-language publications of the 17th century, former Poet Laureate John Dryden's verse translation of the works of the Latin poet Virgil, had to meet several thresholds. They needed reasonable financial means (five guineas to spare – at least $660 today), an interest in classical literature, and even their own coat of arms – a copy of which was engraved on a plate dedicated to them in the first edition.

That was the package deal for the exclusive list of 100 initial subscribers who helped to fund the four-volume publication. A second, unlimited list was later opened for those willing to spend two guineas. The principle of subscription, committing an advance payment in return for a product or service, had been established. It would begin in the form of one-off payments, and over time evolve into the system of regular billing for a regular service that we are familiar with today.

Dryden's Virgil, published near the end of his life in 1697, was a landmark example (though by no means the first) of a path to publication that had become increasingly popular in 17th-century England. 'To print by subscription was, for some time, a practice peculiar to the English,' wrote the literary giant Dr. Samuel Johnson. The model of raising money from patrons via subscriptions to fund projects of social or cultural importance gradually gained ground – used to support the construction of theaters and hospitals, as well as to finance insurance schemes.

It formalized the long-established tradition of patronage, and the idea that a subscription was an investment with a return: supporting the development of an important work, conveying social status on the subscriber through their association, and delivering them superior access to the product (all subscribers to Virgil were given editions on better-quality paper than those who bought at the retail price).

It formalized the long-established tradition of patronage, and the idea that a subscription was an investment with a return.

18TH
CENTURY

"YES, BUT IS THERE A WAY TO UNSUBSCRIBE?"

The subscription idea had taken hold, and would become a catalyst for growth across a wide variety of industries as it remains today.

In other words, it was the **Patreon** or **Kickstarter** of its day: the coat of arms may no longer be relevant, but the principle of sponsoring a creator in return for the acknowledgement of your name in the book, and sundry rewards depending on how much you pay, is exactly the same. So too is the idea that publishers will look after their subscribers with perks and benefits, to reward them for the loyalty of being – in effect – an investor in their business.

The model used to finance poets such as Dryden was also, more directly, a forerunner to the publishing business that built up around subscription in the 18th and 19th centuries, and which remains with us today. Periodicals still in circulation, from Tatler to the Spectator, were first published in 1709 and 1711 respectively. As printing technology improved, newspapers and magazines became mass market items in the 19th century, with subscription sales (now incorporating the idea of regular payments) an important part of the business model. The Times of London grew from **a circulation** of around 5,000 in 1815 to 40,000 by 1851 and around 100,000 by the end of the century.

The way information was printed, produced and accessed had changed forever, and subscriptions in different forms, increasingly focused around the idea of recurring payments, played a central role in its evolution. Their influence would continue to grow into the 20th century, as people became accustomed to paying a subscription fee for a whole variety of things to be delivered to them, from a pint of milk to a regular supply of vinyl records. The subscription idea had taken hold, and would become a catalyst for growth across a wide variety of industries as it remains today.

02

THE INVENTION OF THE PRICE TAG

19TH
CENTURY

Wanamaker is often credited as the father of fixed pricing in retail, with his belief that, if all were equal in the eyes of God, they should also be so at his store counter.

As newspaper publishing was taking off in the mid-19th century, with the *New York Times* first printed in 1851, another milestone in the history of pricing was about to arrive.

This was a more radical and surprising move than the evolution of patronage into subscription. It marked the shift away from a world that is hard for the modern consumer to imagine – in which you could go to a shop and never know what something was going to cost. Instead you would be sized up by the merchant and given a number as the basis for negotiation. The logic of the market stall held sway, even (and perhaps especially) if the people were expensively dressed.

The obvious potential was for retailers to exploit the perceived means of their customers by upping the price opportunistically. This perceived scope for immorality meant some of the push-back against variable pricing had religious motives. George Fox, founder of the Quaker movement in 17th century England, encouraged merchants among his followers to offer one price to all, with mixed success.

But it was not until the mid-19th century that the practice was regularized and price tags became a recognizable feature of the shopping experience. When John Wanamaker, a lay leader in the Presbyterian Church, opened a men's clothing shop in Philadelphia in 1861, he put a fixed price on every suit (something of a retail innovator, he'd also publicized the opening of the store by releasing balloons across the city).

Wanamaker is often credited as the father of fixed pricing in retail, with his belief that, if all were equal in the eyes of God, they should also be so at his store counter. In reality, he was just part of a wider contemporary movement that was inspired as much by changing business practices as religious belief.

1815 – 1860

“I’LL GIVE YOU 50c FOR THIS $2 SUIT.”

AS RETAIL EVOLVED AND THE DEPARTMENT STORE BECAME A FAMILIAR FEATURE ON HIGH STREETS, FIXED PRICING WAS RAPIDLY ADOPTED.

Two years before Wanamaker’s opened, the department store R. H. Macy (forerunner of the eponymous retail brand) had advertised: ‘Best products, and same prices for all customers!’ As retail evolved and the department store became a familiar feature on High Streets, fixed pricing was rapidly adopted. It promoted efficiency, built trust with customers, and allowed for the development of new retail strategies – notably the mail order business that grew rapidly from the late 19th century.

Sears Roebuck, whose mail order catalogs symbolized this remarkable convenience and were delivered to half of American households at their peak, sold as much on reliability of price as they did the novelty of the from-home shopping experience. ‘This book tells just what your storekeeper at home pays for everything he buys – and will prevent him from overcharging you on anything you buy from him’, was the boast on the cover of some of its early editions.

Fixed pricing may have begun as a moral imperative, but it quickly evolved and took root as a commercial necessity – a foundation of how retail developed to new heights in the 19th and 20th centuries. It was far from the only significant pricing development of its era. This was a time of rapid innovation in the field: in 1863 the stock ticker arrived, an early example of pricing data being transmitted in close to real time, and how the barter system would evolve into a world of dynamic pricing. While in 1887, coupons were introduced for the first time by Asa Griggs Candler, to promote a new drink called Coca Cola. Soon he would purchase the formula and the brand, building one of the world’s most successful companies from a combination of the drink and the fresh approach to discounting he had pioneered.

03

THE CALL OF USAGE-BASED PRICING

Along with sales catalogs, the household of the late 19th century and beyond also began to receive a different and less desirable form of postage: the utility bill.

THE IDEA THAT YOU COULD CONSUMER AN INTANGIBLE SERVICE AND BE CHARGED ACCORDING TO USE HAD ARRIVED.

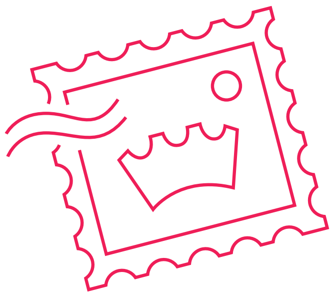
20TH CENTURY

These unwanted guests signified some important steps forward towards domestic living as we now know it – notably the march of electrification and the adoption of the home telephone.

Both progressed rapidly in the first half of the 20th century: in the UK, **just 6%** of homes were electrified in 1919, but two decades later, that was up to 67%. The landline phone advanced almost as quickly. Four years after Alexander Graham-Bell made the first telephone call in 1876, **approximately** 49,000 devices were being used in America. By 1900 it was 600,000 and by 1910, 5.8 million.

With these new toys came the widespread adoption of a new form of pricing – where the customer paid for what they had used. In the case of the telephone, the model was a hybrid one: you would pay a regular fee – the equivalent of modern line rental – for the hire of the equipment, maintenance and access to the telephone exchange. On top of that was the cost of the calls you had made, with the price depending on their duration and distance. This was a system managed through the telephone exchange: to make a call you would dial the exchange, which would physically plug in cables to connect you to the other phone, and then manually log the duration of the call for billing purposes. It was through this paper-and-pencil approach that one of the first widespread examples of usage-based pricing came into being. The idea that you could consume an intangible service and be charged according to use had arrived. As technology has replaced manual processes, this pricing approach has continued to become more precise, for instance with the advent of automated meter reading (AMR) technology in the 1970s and 80s.

Ironically, the itemized telephone bill had been beaten to this model by the humble postage stamp, which conveyed it to the household. Much like the price tag in a shop, this now ubiquitous feature arrived later than we might have guessed:



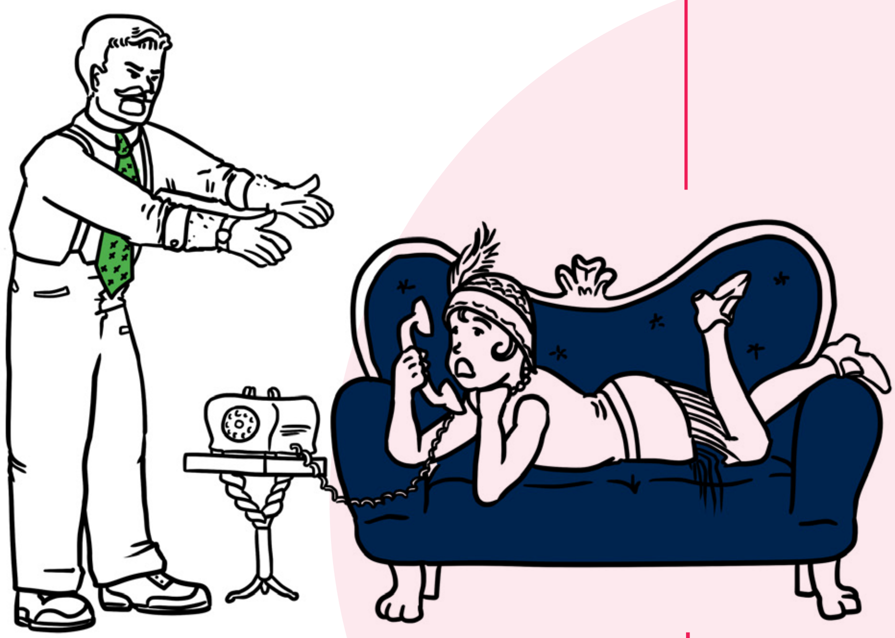
the first stamp was issued in the UK in 1840 – the Penny Black, its design updated a year later to the more lasting red. This regularized the previous system of hand stamping and allowed for postage to be pre-paid according to the weight of the letter – another early example of usage-based pricing.

It was also an important moment in the history of communication – making postage cheaper and more efficient, and therefore promoting all channels of commerce that could be done via mail. Businesses now had certainty about the price that would be charged and greater confidence that a letter – which before the Penny Black was reliant on the recipient to pay – would be delivered and received.

The humble postage stamp was, in its way, a revolutionary force: another example of how improvements in pricing methods can be a catalyst for business growth.

We continue to see its reverberations in sometimes esoteric ways: fleet companies no longer just pay for gas by the mile, but for leasing their tires from providers such as Michelin or Bridgestone.

"GET OFF THE PHONE, YOU'RE COSTING ME A FORTUNE MILDRED!"



04

PRICING GETS DYNAMIC (AGAIN)

The advent of the Internet era added another utility bill to the list of every household, and also brought about a revolution in how people consume products and services.

WHILE THE INTERNET IS IN ONE WAY A DEFINING FEATURE OF MODERN LIFE, IT HAS ALSO BROUGHT PRICING STRATEGIES FULL CIRCLE.

1980 – 1990

It has been an arms race on both sides: the consumer is increasingly able to shop around for the best deal, harness price comparison or auto-switching services and maximize their use of offers and coupons. In turn, retailers and suppliers have also learned how to play hard-ball: harvesting huge volumes of customer data that allow them to target offers and advertising more precisely, as well as developing dynamic pricing strategies that allow them to reflect supply and demand in real-time (whether through surge pricing on a taxi app, the constantly shifting cost of an item listed on Amazon, or an offer that's here today and gone tomorrow).

While the Internet is in one way a defining feature of modern life, it has also brought pricing strategies full circle. eBay popularised the art of the auction, one of the oldest forms of price discovery there is, while the likes of Amazon are essentially operating market stall principles enabled by automated systems that access real-time data at vast scale. The implementations are novel but the fundamental ideas and pricing strategies are not. Medieval merchants may not have recognized the term dynamic pricing, but they would have grasped the concept in a second.

Dynamic pricing may be an old idea enjoying a digitally-enabled renaissance, but it can also be a touchy subject where context is king. People are generally accustomed to the idea that ordering a cab ride at peak time or buying a plane ticket at the last minute will mean paying a premium: airlines have been using dynamic pricing systems since the 1980s. But what seems like a smart strategy in the boardroom can easily appear as opportunism or price gouging on the street.

"WHAT HAPPENED?"

"SURGE PRICING."

1990 – 1999

So it was with Coca-Cola, which in 1999 trialed vending machines equipped with temperature sensors, which would automatically raise the price of a drink on a hot day. Customers cried foul, competitors poured salt on the wound, and Coke quickly abandoned the idea. Fifteen years later, Uber agreed to limit its use of surge pricing in the aftermath of natural disasters or states of emergency after being pilloried for taking advantage of customers in distress.

The rebirth of dynamic pricing has not been limited to the consumer space. A version of it has also become a feature of B2B pricing strategies in recent years, with wider adoption of CPQ (configure, price, quote) systems that automate the process of producing a bespoke quote based on features, customisations, ticket size and available discounts.

*Research from Bain & Co **has suggested** that companies that embrace new, tech-enabled pricing capabilities can expect to improve profit in the region of 2-6%.*

05

GETTING SaaSy

m3ter

The work being done by B2B companies to optimize pricing strategies builds upon two decades in which many have already transformed their approach.

AS THE DIGITAL REVOLUTION TOOK HOLD, SAAS GREW LIKE WILDFIRE: IN 2008 THE MARKET WAS VALUED AT $5.56BN AND BY 2020 IT HAD BALLOONED TO $157BN.

One of the most prominent examples has been the software industry. In 2000, at the peak of the dotcom bubble, newcomer Salesforce.com declared ‘the end of software’. It was taking aim at the incumbent vendors accustomed to selling expensive licenses for their products, which often had to be hosted on a company’s own servers, managed by a dedicated IT team. Salesforce promised something cheaper, faster and easier: access to a cloud-based service for a monthly fee, aka Software-as-a-Service (SaaS).

As the digital revolution took hold, SaaS grew like wildfire: in 2008 the market was **valued** at $5.56bn and by 2020 it had ballooned to $157bn. This new twist on the old idea of the subscription service was beneficial both to vendors and the businesses they were selling to: suppliers were able to acquire customers more easily, deliver updates seamlessly and build their business models around the principle of recurring revenue. While their customers no longer had to afford significant up-front costs, and could scale their seat-based commitments up and down as needed.

SaaS companies such as the messaging app Slack grew rapidly based on pricing plans that allowed paying customers to add users as they scaled, and to upgrade where necessary to enterprise-grade features. A product beloved by start-ups and especially software developers was able to grow in sync with its customers. The company had half a million daily active users by the end of its first year of operation in 2015, and over 10 million when it went public four years later.

Software buyers are now entirely attuned to the habit of consuming services through the cloud, via subscription, but that does not mean SaaS has stood still. In the last few years, one notable shift has been away from flat subscription prices towards usage-based models.

As the software market has grown, with products becoming specialized in every vertical, companies have adopted a growing number of solutions. Yet volume has not necessarily delivered efficiency: **one study** suggests that the average firm will be employing hundreds of different SaaS solutions, but making use of less than half of them on a regular basis. The risk of companies paying for 'shelfware' – software that will never actually be used – is higher than ever.

Usage -or consumption-based pricing is one of the best guarantees that expenditure will not go to waste.

Against that backdrop, the focus is increasingly on making sure that every subscription pays its way and carries its weight. Usage- or consumption-based pricing is one of the best guarantees that expenditure will not go to waste. Under this model, customers are able to scale their spend up automatically as they grow, or to take simple steps to reduce it if their needs change. The implementation of usage-based tariffs can vary – from charging for the consumption of a service, to vendors taking an agreed share of revenue thus linking the price to business impact – but the principle is the same. The buyer is in control as never before, able to flex their usage and to see their billing alter accordingly. To return to the example of Slack, if a user becomes inactive then there will be no cost for their license in a given month.

"HOW QUICKLY CAN YOU SAY 'PRICING PRODUCTS WITH UNPRECEDENTED PRECISION'?"

LAST YEAR 46% OF SAAS COMPANIES WERE UTILIZING USAGE-BASED PRICING WITH ANOTHER 15% ACTIVELY TESTING IT, AGAINST JUST 27% WHO HAD ADOPTED THE MODEL IN 2018.

There are also good reasons for vendors to embrace usage-based models, as they have been doing with some enthusiasm: last year 46% of SaaS companies **were utilizing** usage-based pricing with another 15% actively testing it, against just 27% who had adopted the model in 2018. For some, these will be pure usage-based models, and for others, hybrids that incorporate a usage element on top of a regular subscription.

For software providers, the usage-based model brings them closer to their customers than before: monitoring their product usage in granular detail, in a way that can both support retention and identify new opportunities to upsell.

The infrastructure and data stack required to deliver a usage-based model is ultimately conducive to better customer service: enhancing how a vendor responds to feedback, facilitates billing and proactively identifies new use cases.

Not just a more transparent way to bill for services, but an entirely transformed customer experience.

WHATS NEXT FOR PRICING?

As we have seen, there is finally nothing new under the sun in pricing.

THE NOVELTY COMES THROUGH THE ABILITY OF VENDORS AND RETAILERS TO IMPLEMENT OLD IDEAS WITH MODERN PRECISION.

Subscriptions have been around for centuries and the idea of paying only for what you use is fundamental. The novelty comes through the ability of vendors and retailers to implement old ideas with modern precision. The defining feature of pricing in the present and future may be granularity: a supermarket directing personalized offers or even prices to the individual shopper, just as the software provider can devise a usage-based model attuned to the needs of each customer.

Usage-based pricing in SaaS is not so much a departure as an evolution: it continues the shift away from a traditional sales process to a partnership between vendor and customer, in which a product can earn its keep and expand its footprint over time – with both sides benefiting from one another's success. It is more transparent, more accountable and generally more efficient for all concerned. Rather than the price being sprung upon the unsuspecting customer, in a usage-based agreement the cost of a product should speak for itself.

The rise of usage-based models in various forms reflects a trend that will continue to define pricing strategies into the future.

With the ability of technology to track consumption, anticipate needs and measure progress in real time, there is no longer any room for ambiguity.

The consumer of a product or service is better equipped than ever before to know if they are getting value for money, and less likely to accept anything less than a pricing model that is accountable to business results. They will often be able to choose from a series of flexible pricing structures, according to what best suits their circumstances and allows them to realize value.

The idea of one price for all was a revolution in its time, but we have reached a point at which one-size-fits-all is no longer applicable in many circumstances.

Increasingly the tools are available to offer customers not just a price but the price: tailored to them, their usage of a product or service, and the value they have derived from it.

THE FUTURE OF PRICING SHOULD MEAN THAT THE IDEA OF PAYING FOR A SUBSCRIPTION YOU HAVEN'T USED IS CONSIGNED TO HISTORY.

While usage-based pricing can initially feel to the vendor like they may be losing control, companies that have embraced it know that it delivers financially as well as enhancing customer relationships. SaaS firms with a usage-based model **have demonstrated** improved revenue growth and net revenue retention compared to their peers.

This approach has scope to expand well beyond the software market: for instance to the gym membership or the streaming subscription that has been lying dormant for weeks or months. The future of pricing should mean that the idea of paying for a subscription you haven't used is consigned to history.

The usage-based model is customer friendly and it's good for business. As the long story of how businesses price and sell their services continues to unfold, it's an idea whose time has well and truly come.

m3ter

Interested in learning more about usage-based pricing? ***Click here***