Binary Stream

Booklet

The definitive guide to usage-based billing

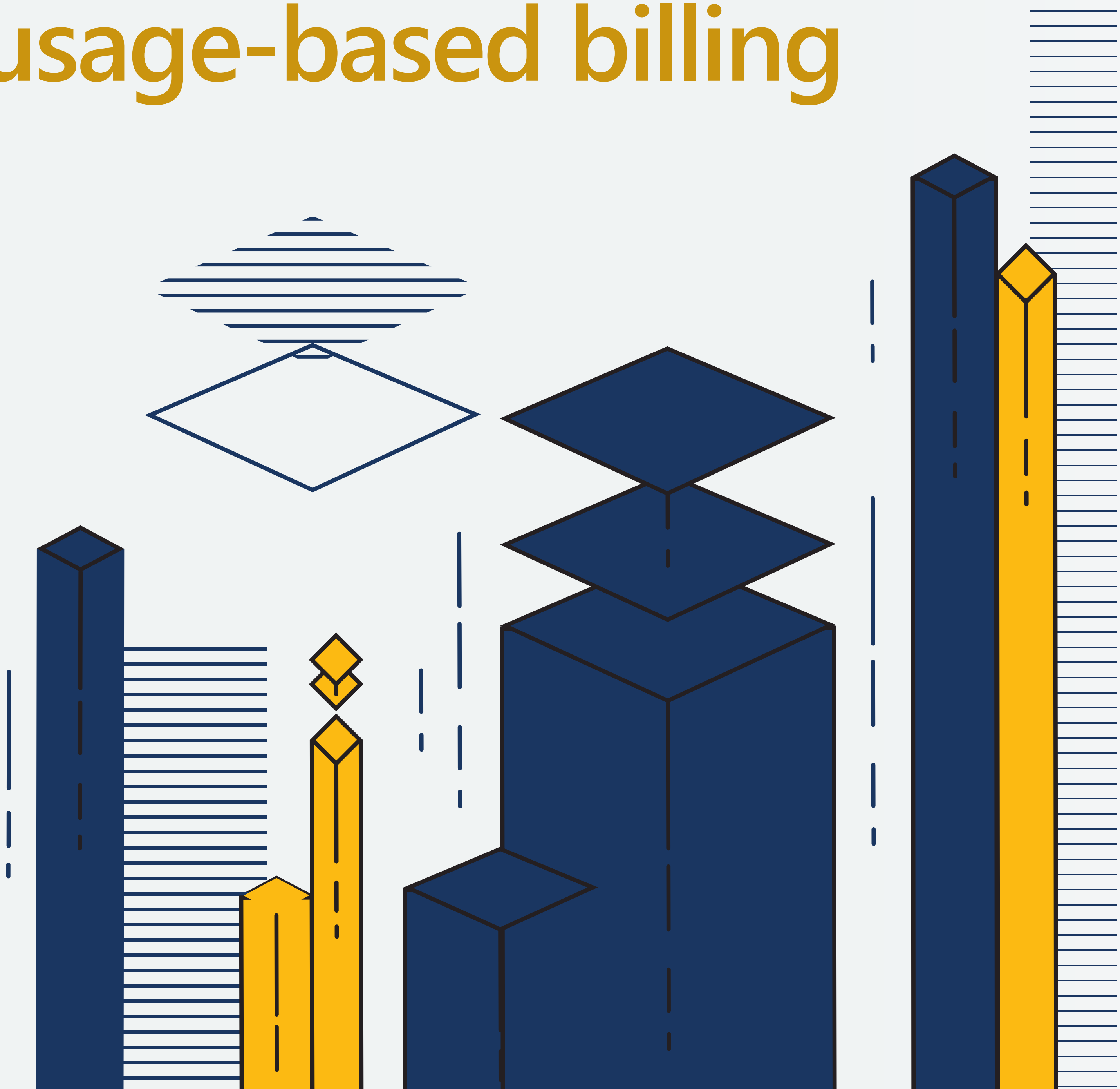


Table of contents

Introduction to usage-based billing

Usage-based billing is among the most common subscription billing strategies companies use today; it is also known as metered, consumption-based, or pay as you go billing. Regardless of the name you choose, it is a pricing model which appeals to a wide range of customers and can be used across multiple industries to help drive recurring revenue and customer acquisition and retention.

Billing reflects how much customers use your service or product. One advantage is that usage can be defined differently for various industries. Standard usage metrics depend on customer preferences and must align with perceived value. For instance, common metrics include the number of units, the amount of data, mileage covered, etc.

Companies often combine different metrics to arrive at flexible pricing that offers value based on different types of usage.

Companies often combine different metrics to arrive at flexible pricing that offers value based on different types of usage. Mixing different strategies allows your customers to have more options. However, it can come with additional complications, and implementation shouldn't happen overnight. Finding the right price points and value metrics will require experimentation before settling on the best path forward.

A quick glance at the pros and cons of usage-based billing

Pros	Cons
Less friction at sign-up	Elongates sales cycle
Ability to upsell to customers	Complicated set-up
Value easily conveyed	Struggle to calculate bills
Higher adoption	Difficulty navigating perceived value
Billing is easier	Rev rec may fluctuate
Flexibility in pricing	Off-peak pricing
Easy to discount	Scaling confusing

Understanding the pros of usage-based billing

Less friction for customers who start at a low cost

This subscription pricing strategy allows users to start at a lower level and move to higher usage when convinced. Particularly in SaaS companies, where the barrier to entry might be high if they sign up for a year or buy the software outright.

Easy for customers to understand the value offered.

Billing is based on usage, so customers can easily track, control, and predict their costs. Transparency is key here, and you will need to make sure pricing is straightforward. It also means heavy usage is charged appropriately, something which is not true of most billing models.

More individuals have access to your service

Access is more universal when compared to billing models like per-seat pricing. The result is that adoption runs deeper, with multiple people depending on the service rather than one or two.

Companies start small but tend to underestimate usage

One of the core advantages of this pricing model is how quickly usage grows over time, as customers naturally move to higher use. It's much easier to increase and bolster recurring revenue from your customer base than to acquire brand new customers.

Billing is more straightforward

Billing is easier as you do not need to engage in complicated revenue recognition and deferred revenue calculations as customers pay as they go. The service is already delivered, so you can charge and recognize revenue accordingly.

Allows for more flexibility with how you implement pricing

Whether you're trying to hone your pricing page strategy or decide between monthly or annual billing, usage-based billing can be combined with any number of tactics, giving your product and marketing teams a lot of freedom.

Easy to convey the value of discounts

When it comes to customer acquisition, you can easily offer a bulk discount for high usage. A common strategy might be three months of use at a discounted rate when you commit to six months.

Understanding the cons of usage-based billing

Potentially elongates sales cycles if the value is unclear

Customers may find themselves reluctant to sign up or find the low-usage pricing is not attractive enough. Companies will need to carefully determine how best to charge customers to make their usage-based billing a no-brainer. Metrics may seem confusing to new users, so giving context will be critical.

It can be complicated to set up

In situations where usage is based on a combination of different features, set-up can be tricky. It's worth thinking through every step of the customer journey to set up a user experience that makes customer acquisition seamless.

Customers might struggle to calculate their bills

If your pricing is not transparent, it may be difficult for customers to understand billing. Make sure you know how your customers experience the costs and ensure it's easy to calculate costs and see the value. Otherwise, you may notice high churn rates.

Difficulty navigating custimers' perceived value

It's worth conducting market research to ensure that billing for higher usage correlates with the perceived value of services/features delivered.

Recurring revenue may fluctuate more

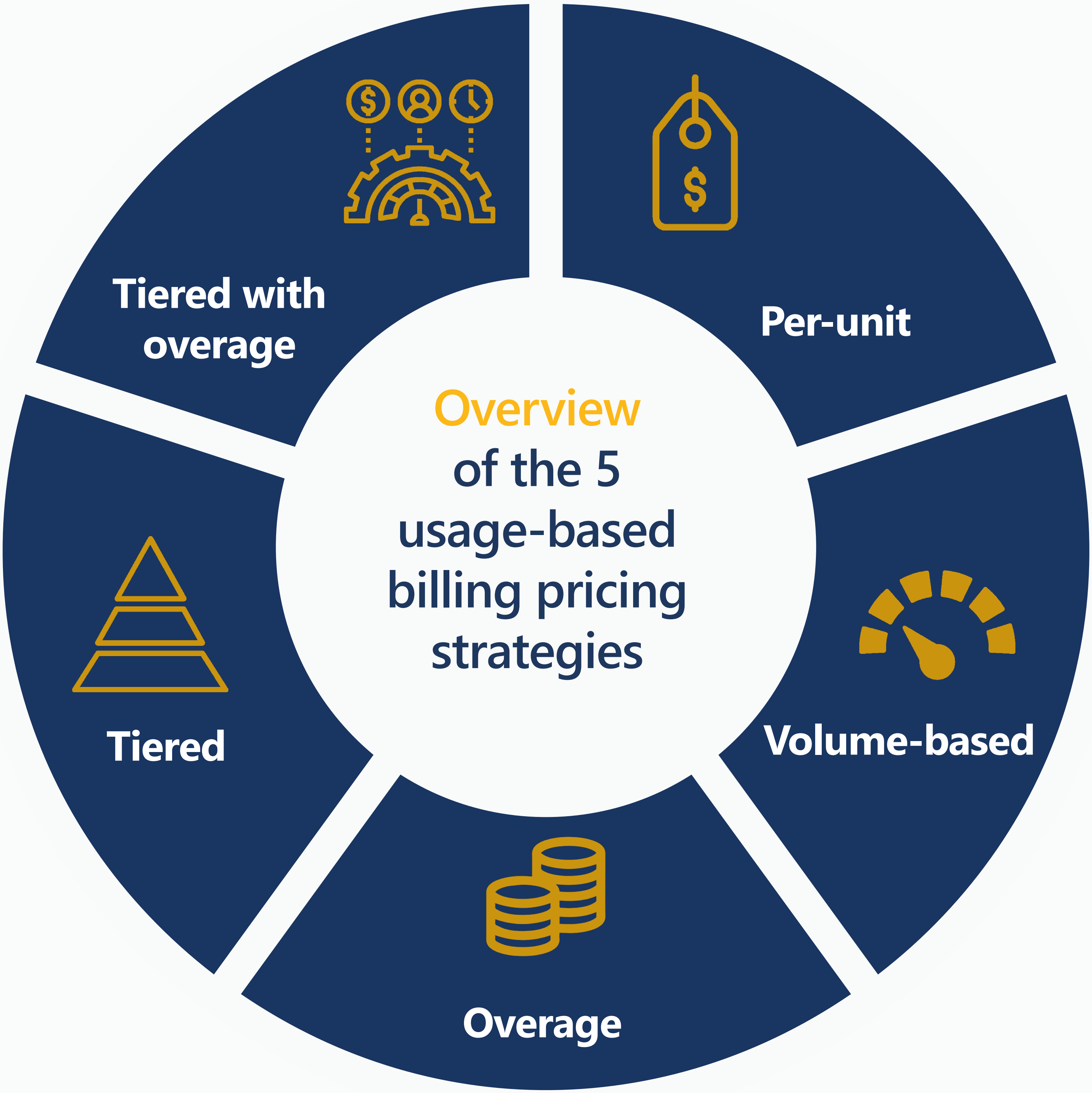
Customer retention metrics may vary wildly when you first predict usage on a month-to-month basis. You can use subscriber churn metrics to establish realistic metrics over time, but initially, you may find it hard to predict expected revenue.

Off-peak pricing may result in lower consumption

This phenomenon is easy to observe in telecom services, where users will make calls when usage is available at lower prices. For instance, they may postpone saving calls until the weekend, or in the case of water or electricity meters, postpone usage of things like dishwashers and washing machines until the evening when it's cheaper.

Metric used may make scaling confusing

One good example of this is to think about how utilities such as electricity or water are priced. Customers pay for these services based on consumption, but very few people fully understand the cost of increasing consumption. When you think about this in terms of upselling usage, you need to make sure that options for scaling are obvious and customers clearly understand the value.

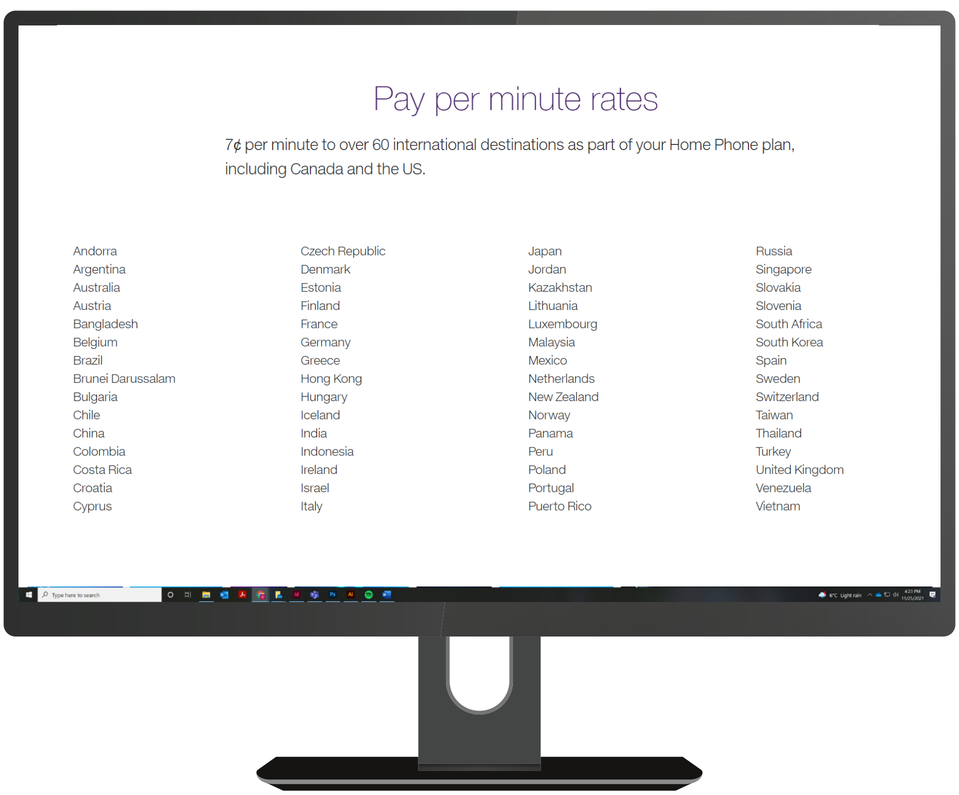

Overview
of the 5
usage-based
billing pricing
strategies
Tiered with overage
Per-unit
Volume-based
Overage
Tiered

Per-unit pricing | Explanation and example

A simple approach to usage-based billing, this strategy sets a fixed price per unit used. Combining well with other techniques such as volume-based pricing, you bill customers for the amount used of a service or product. The value metric for usage varies (e.g. data, users, events).

Companies sometimes choose per-seat or per-person pricing as the value metric to measure. However, there are several critical differences between this and other types of usage-based billing. Some of the pros and cons tend to differ. For instance, on the positive side, it's easy for customers to calculate the cost and spot hikes in usage as it will be apparent that they're adding users. But in general, companies will not reap the benefits of usage-based billing if they choose users as their only value metric.

Long distance calls from Telus are an example of per-unit pricing where they bill per minute. You can see how simple their price page is, making it easy for customers to understand the value.

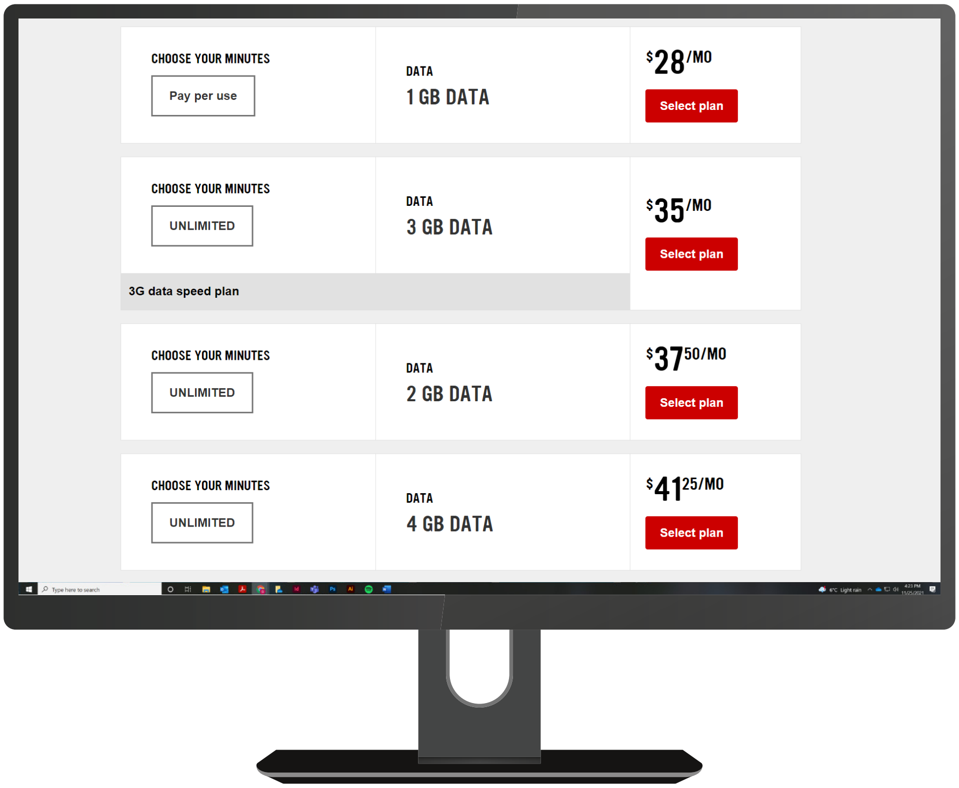


Volume pricing | Explanation and example

The volume pricing model allows the price per unit to fluctuate based on the final usage volume. So, the more units a customer uses, the less they pay per unit. Volume limits often tempt users to a higher bracket of usage and they happily pay more knowing they get a better price per unit.

Volume limits make a lot of sense for services where the value metric is an event, for instance, a phone call. Many companies will charge a higher unit per call if you make only 30 calls in a month, but if you make over 100 calls in a month, the price per unit decreases—rewarding you for higher usage. Psychologically this leads to higher perceived value.

Phone plans are often an excellent example. If you look at Virgin Mobile's phone plans, you see that the more you spend per month, the less you pay per unit of data. If you are in the market for a phone plan, it's easy to see the value of paying more.

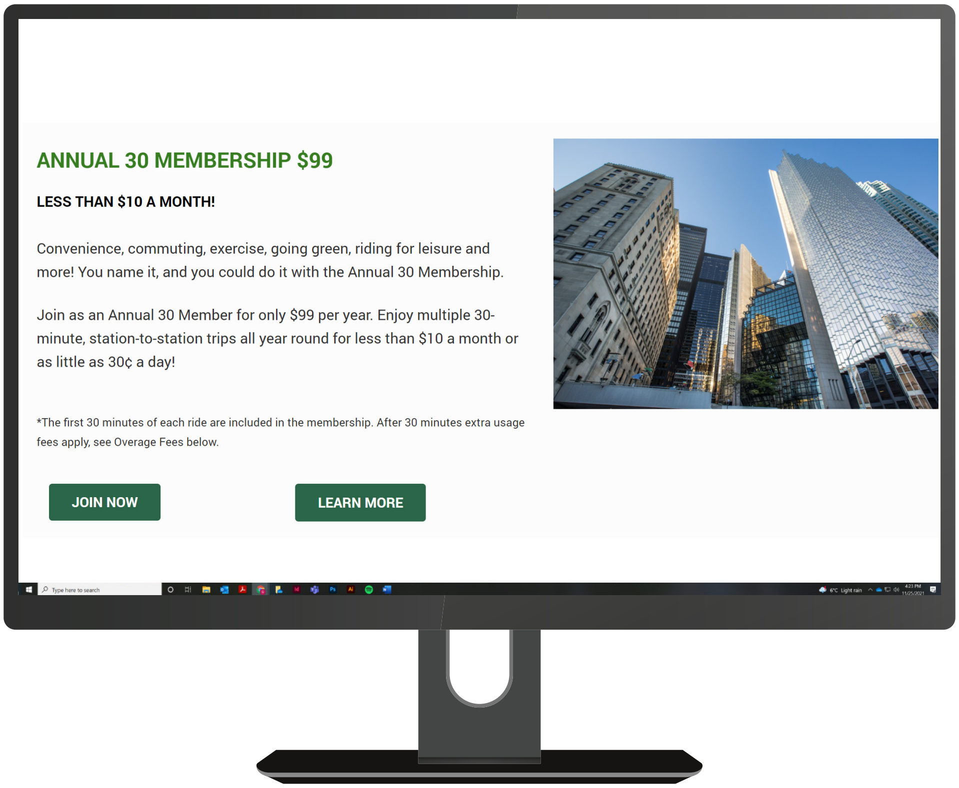


Overage pricing | Explanation and example

This pricing strategy allows customers to go over the usage limit of a particular package if they've chosen a specific volume of units per month. It introduces flexibility from the customer's perspective; however, it can be tricky not to upset customers if they exceed their monthly allocated volume and do not expect the additional charge. Many companies charge an inflated or premium rate for usage that exceeds the package limits, which can be alarming for customers who ignore the fine print. It can result in them feeling penalized for using your service, which is not ideal.

For instance, if someone signs up for 2 GB per month of data but uses 3 GB. If they're not aware of extra charges, it might feel unfair when the bill arrives. Companies should try to adopt overage pricing without making customers feel penalized, keeping rates fair and providing clear communication when users exceed volume limits.

Bike Share Toronto (in fact, bike share services worldwide) are an example of overage pricing. They work by charging customers an annual fee for an unlimited number of rides per year. However, the catch is that those rides should be under a set amount of time. So rather than unlimited use of the bike, customers pay for unlimited use of bikes in 30 or 45 minutes stints. After this, overage fees apply.

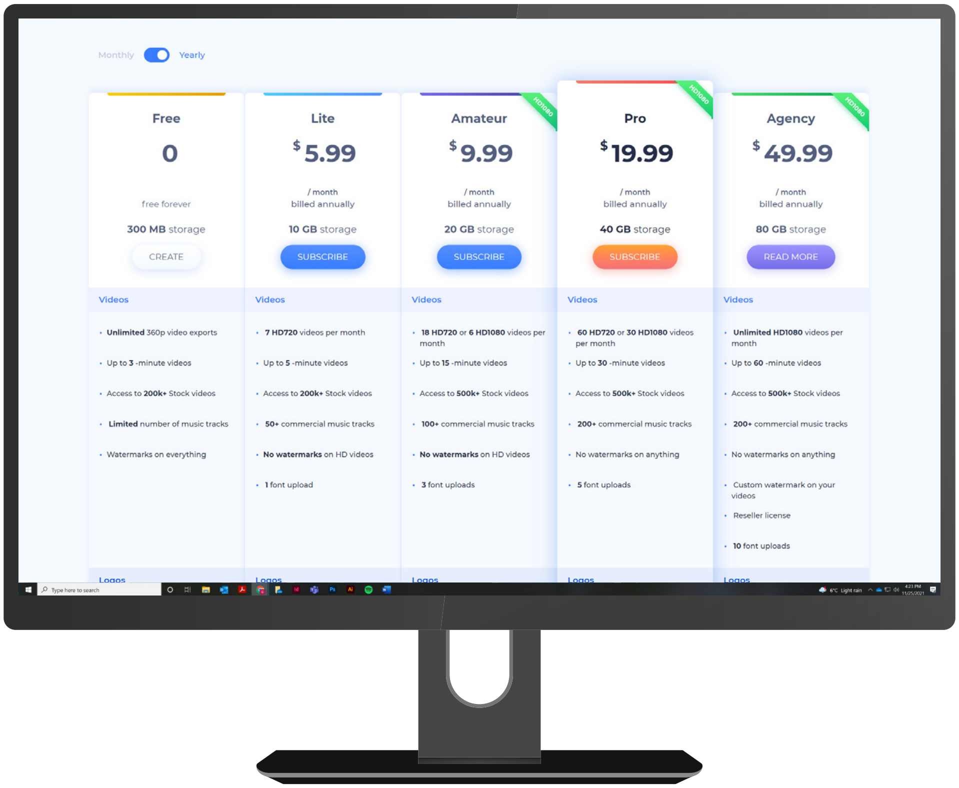


Tiered pricing | Explanation and example

The use of tiered pricing for usage-based billing requires companies to package their product or service in tiers. Often this is done by assessing the volume of units used and dividing it into tiers. Price increases with each level but so too should perceived value. Often SaaS companies will combine different usage metrics in each tier, placing volume limits on each one.

It's common to see this sort of pricing used by tech companies, but it has its uses elsewhere. Companies need to consider the psychology of the tiers they choose, as knowing which features or usage matters most to your customers will be critical.

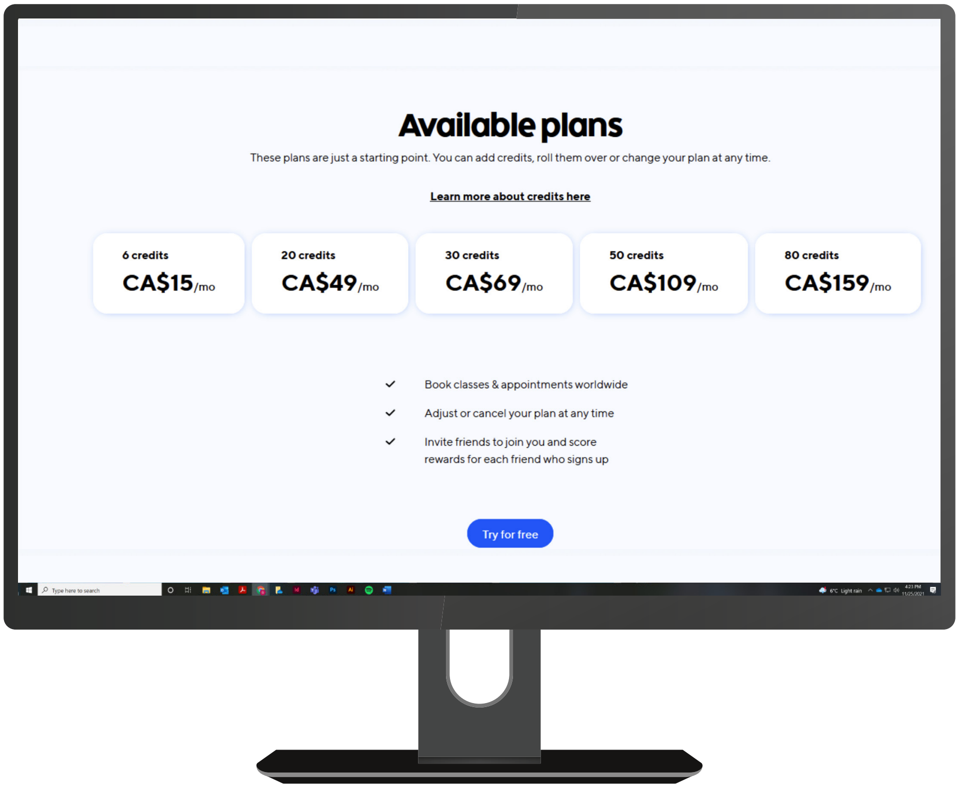
Renderforest is an example of a company that uses different tiers to sell usage (they're also an example of a company using almost every trick in the subscription pricing book). If you look at the breakdown of their tiers in the image below, you can see that the top four features in each level are usage-based and use volume limits to establish the cost. It's easy for customers to understand why Pro is an attractive option in comparison to Lite. However, it's also possible for smaller companies to trial the service for free before committing.



Tiered pricing with overage | Explanation and example

Often companies will make the premium or final tier level unlimited, but this can be problematic when it comes to heavy usage of your services. For example, if a company takes advantage of “unlimited” storage and exhausts resources, it may be hard to support usage over time. That’s why many are now introducing overage pricing on the final tier level. Overage gives users an attractive usage allowance in the top tiers while charging extra when users max out their usage allowance.

For example, classpass implements this by giving each tier a pre-defined number of credits for fitness classes per month. In every single tier, you have the option to go over your allowance for the month and buy more credits, effectively charging you for heavy usage. This method also helps upsell their higher tiers as customers who regularly purchase bonus credits can upgrade once they understand their usage habits. In addition, classpass does not fall into the trap of heavy users taking advantage of an “unlimited” tier which might cost more to manage over time.



A short guide to revenue recognition for usage-based billing

When it comes to recognizing revenue, usage-based billing is one of the most straightforward billing models to manage. In most cases, users pay for the service as they consume it, and therefore the revenue can be recognized immediately with no need to defer until a later date.

When billing for project-based work like building a website, you might bill a lump sum upfront but set the deferral schedule to account for a set completion percentage per month.

One exception to this rule is when customers only use part of a set package in increments or billing is based on the percentage completion of a particular project.

For example, a customer signs up for 10 courses and pays a total of $1,000 in advance. Perhaps they take the courses over 10 months. In this situation, revenue would be deferred and recognized as they complete each course. If the customer completes one course a month, you would only recognize one course worth of income for that period, deferring the rest of the revenue until the service is delivered.

Similarly, when billing for project-based work like building a website, you might bill a lump sum upfront but set the deferral schedule to account for a set completion percentage per month. This approach allows you to account for slower months and recognize revenue more accurately and is vital for remaining compliant with accounting standards.

Managing the complexity of usage-based billing

It perhaps comes as no surprise that companies will not implement usage-based billing effectively if they rush it. Here are the three critical elements of the billing model that you can't afford to get wrong.

The 3 critical elements of your usage-based billing strategy

1. The value metric

Market research and a firm understanding of the value your customers perceive in your product or service are both critical. It may take time to decide on your value metric or figure out how to combine various value metrics. The most important is aligning the perceived value with the chosen value metric. Standard value metrics include data, users, and the number of events.

2. Decide on your pricing strategy

Earlier in this article, you will find several examples of pricing strategies to help you implement an effective usage-based billing model. Once you've decided on your value metric, you will need to understand each of these to make an informed decision. Will you need to include overages? What kind of tiers would work best? Get creative with your strategy and look beyond your own industry's examples. You may be surprised what you could borrow from successful SaaS companies.

3. A robust billing solution

Without a powerful recurring billing solution that allows you to bill for usage accurately, you may find that even the most exciting pricing strategies will fail. High customer churn rates result from poorly managed subscription services where it's hard to understand invoices and customers do not have clear insight into their usage. Implementing a solution that allows you to accurately invoice customers without errors that might result in a bad customer experience is critical. As you scale, it will also be important that this solution can handle compliance for ASC 606 and IFRS 15.

Introducing Subscription Billing Suite

A comprehensive solution for billing, deferrals, and recognition that streamlines the entire quote to cash process at every step from billing and invoicing to reporting and forecasting. It provides consistent and reliable invoicing for a wide range of pricing models and allows you to take control of your pricing and billing schedules at the line-item level within Microsoft Dynamics 365 for Finance and Operations, Microsoft Dynamics 365 Business Central, and Microsoft Dynamics GP.

What our customers say

"Wonderful, wonderful, wonderful. A joy to work with Binary Stream. Everyone was super helpful and positive, which had a big impact on the success of the implementation.

MoxiWorks

"What makes Binary Stream different from other software companies we have worked with is their ability to truly listen to customer input and enhance their subscription solution to meet those needs.

ibexa

"Since I have come on board, Subscription Billing Suite has paid for itself more than once over. Having this solution to help us manage over 10,000 deferred contracts is an essential part of our financial processing.

BT

"I've long been a fan of Dynamics, and Subscription Billing Suite met and exceeded every feature of our previous solution. However, the factor that made this project a success is having a partner who augmented our internal integration efforts.

OTC Markets

Binary Stream

Start your financial transformation journey today

Learn more by reading our complete guide to subscription management, offering insights into billing models, pricing page psychology, and plenty more.

Discover more