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[Essentials of Software-as-a-Service \(SaaS\) Business.](#)

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## 3.7 Usage-Based Subscription Model

In this lecture, we will learn about the next subscription model called usage-based. It is often referred to as the "pay-as-you-go" model.

- customers pay based on **actual service usage**
- applicable for various services like **cloud resources, API calls, and media consumption**
- charges are calculated based on **real-time usage metrics**
- can be **cost-effective** for users who have lower usage levels
- allows **scaling up or down** without fixed costs, ideal for fluctuating needs

Here the customers are charged based on their actual services or resources usage. In practice, this model can apply to a variety of services such as cloud computing resources, API calls, or even digital media consumption. In a usage-based subscription model, charges are calculated based on real-time usage metrics. This means that customers are billed precisely for the amount of service they consume during a billing period. Charges can vary depending on the type of service used and the extent of usage. For instance, this could include billing for every hour a virtual server is operational, every gigabyte of data stored per month, or for each thousand emails sent through a service. An example could be cloud provider Amazon Web Services. They measure a customer's usage across multiple dimensions such as computing power, storage space, and data transfer. They then charge the customer based on the exact resources used during the billing cycle. This method ensures that customers pay only for what they use, making it a flexible and often cost-effective option for various types of users. Next, this subscription model is particularly beneficial in industries where consumption can fluctuate significantly. Customers are able to scale services up or down according to demand without committing to a fixed cost which can lead to cost savings.

Let's take a look at the concrete example of Amazon's product called Simple Storage Service.

Storage pricing	
<b>S3 Standard</b> - General purpose storage for any type of data, typically used for frequently accessed data	
First 50 TB / Month	\$0.023 per GB
Next 450 TB / Month	\$0.022 per GB
Over 500 TB / Month	\$0.021 per GB

Customers are charged based on the amount of storage they use, and the pricing structure is designed to be progressively cost-efficient at higher volumes of data.

For the initial 50 terabytes (TB) of data stored per month, customers are charged at a rate of \$0.023 per gigabyte (GB). If the customer's storage needs exceed 50 TB and go up to 500 TB within a month, the storage price drops slightly. For heavy users who need over 500 TB of storage in a month, the rate decreases further to \$0.021 per GB. This tier caters to enterprise-level customers who require extensive storage capacity, offering them the most economical rate.

In essence, the more data you store, the less you pay per GB. This model ensures customers are not overpaying for unused space and can manage their expenses in line with their actual storage utilization.

It is also common to blend the tiered and usage-based subscription models which creates a hybrid approach that offers both predictability of tiers and flexibility of usage-based pricing. For instance, Communications platform Twilio Sendgrid offers a flexible pricing structure that allows customers to choose the number of contacts and emails per month that fit their needs.

The image displays three pricing tiers for Twilio Sendgrid:

- Free:** Try it out! Store up to 2,000 contacts and send up to 6,000 emails/mo. Price: \$0/mo. Includes a paper airplane icon and a "Start for free" button. Note: No credit card, no commitment.
- Basic 5K:** Send up to 5,000 contacts and 15,000 emails/mo before overages apply. Price: \$15/mo estimated\*. Includes sliders for contacts (0 to 100,000+) and emails (0 to 300,000+). "Start for free" button. Note: \* Taxes and overages may apply.
- Advanced 10K:** Send up to 10,000 contacts and 50,000 emails/mo before overages apply. Price: \$60/mo estimated\*. Includes sliders for contacts (0 to 200,000+) and emails (0 to 1 million+). "Start for free" button. Note: \* Taxes and overages may apply.

The first tier called “Free” is targeted at new or low-volume users. It allows you to store up to 2,000 contacts and send up to 6,000 emails per month without any cost. In a higher tier, customers can slide scales to select the desired number of contacts they wish to store and the number of emails they plan to send each month.

### ***Disadvantages of the Usage-Based Model***

Now let's explore the challenges associated with the usage-based pricing model. While it offers flexibility and can align costs directly with consumption, this model introduces complexities in budgeting, requires sophisticated billing systems, and can lead to unexpectedly high costs for heavy users. Let's discuss these disadvantages:

- Costs can be unpredictable
- Billing systems must accurately track usage
- Costs can escalate quickly for heavy users

- *Costs can be unpredictable*

In a usage-based model, customers pay for what they use, which means costs can vary widely from month to month. This can make it difficult for businesses to forecast expenses and set budgets. For instance, a company using cloud computing services like AWS or Azure may experience a surge in website traffic due to a successful marketing campaign, resulting in a higher bill for the increased server usage. To mitigate this issue, many cloud providers offer cost management tools that help businesses monitor and forecast their spending, setting alerts to avoid unexpected costs.

- *Billing systems must accurately track usage*

Next, to support a usage-based model, a complex billing system must be in place that can track usage with high accuracy. This can require significant investment in billing software. Telecommunication companies, for example, need to track call minutes, text messages, and data usage for billing purposes. Solutions to this challenge include investing in advanced billing platforms that automate tracking and billing processes.

- *Costs can escalate quickly for heavy users*

Finally, the potential for escalating costs under a usage-based model can pose a challenge, particularly for customers who consume services heavily. As usage climbs, so too can expenses, sometimes exceeding the cost of alternative subscription models. For example, in the realm of cloud services where usage can be difficult to predict, customers might face surprisingly high charges during periods of peak demand. To counter this, SaaS providers offer plans with usage caps or thresholds where, after a certain point, the pricing model switches to a more predictable flat fee, or the additional usage is charged at a significantly reduced rate.

In the last lecture, we will transition from the structural tactics of pricing to the psychological tactics that can enhance these strategies further. We will explore behavioral economics, which merges psychology with economic decision-making, to uncover how emotional factors and cognitive biases influence customer choices.