How to assess whether usage-based pricing is right for your business

Foreword

In a recent survey of 1,500 business leaders, 40% said they are planning to change their pricing model in 2024. Usage-based pricing (UBP)—where customers pay based on their consumption or usage of a product or service—has emerged as a compelling strategy for companies seeking to align their revenue streams with customer value. This pricing approach has gained traction across various industries, particularly software-as-a-service (SaaS) and AI.

However, usage-based pricing is not a one-size-fits-all solution, and companies need to carefully weigh a number of variables to determine its suitability for their unique offerings.

Usage-based pricing models are everywhere. In tech, they're most commonly used by infrastructure, middleware, and SaaS businesses. It's a familiar pricing model—it's how people pay for utilities, such as mobile data plans and electricity.

Infrastructure

snowflake, DigitalOcean, DATADOG, Google Cloud, Azure, mongoDB.

Middleware

stripe, twilio, SendGrid, zapier, PLAID, algolia

SaaS

Webflow, TripActions, momentive, mailchimp, INTERCOM, copy.ai, Jasper

But how do you know whether a usage-based pricing model is right for your business, product, and users? And what impact could it have on your operations?

We've built this guide to help answer those questions.

Usage-based pricing vs. flat-rate subscriptions

Usage-based pricing is an effective way to align customer and business incentives. A charge is only triggered when a desirable outcome is met, enabling you to deliver uncapped revenue with scaled usage, and retain more customers because they're only paying for something they actively use.
In contrast, flat-rate subscriptions charge for access to a product regardless of usage (e.g., a flat fee of $100 a month). Public software companies such as Zapier and Snowflake have deployed effective usage-based pricing models, and they've benefited from higher growth and retention rates than their peers.

Pros and cons

UBP

PROS	CONS
• **Low barrier to entry:** Customers can get started right away, without having to pay up front. This might accelerate sign-ups and initial usage. • **Scalability:** Customers can scale up their usage with demand, and your revenue scales accordingly. You don't need to upsell customers on a new package or tier to extract more revenue. • **Retention:** Because customers are only paying when they use the product, they're less likely to churn.	• **Unpredictable revenue:** Finance teams aren't fans of unpredictable costs. You also likely prefer your revenue to be somewhat predictable. Early on when using a new product, it's hard to predict just how much it'll be used, and therefore, how much it'll cost. • **Seasonality:** Are your customers going to be using your product evenly throughout the year? If not, how does this impact your cash flow? Travel and event-focused software are often affected here. • **More resources spent on communication and tracking:** You'll need to build out tracking and reporting capabilities, and present these to customers in order to avoid any awkward billing discussions. Failing to do so can result in billing errors, disputes, and strained relationships with customers.

Flat-rate subscriptions

PROS	CONS
• **Simplicity:** They're easy for businesses to implement and straightforward for customers to understand how much they'll pay. • **Predictability:** Businesses can forecast revenue more accurately due to fixed subscriptions, and customers can forecast their costs.	• **Potential for underutilization:** Customers who don't use the product to its full potential might feel like they're not getting their money's worth. • **Higher barrier of entry:** Unless you have a free tier, an up-front subscription fee could discourage product adoption.

These two pricing models have very different value profiles. However, they can be blended to create a hybrid usage-based model (e.g., $100 a month + $0.01 per API call). Early-stage companies might start out using a simple flat-rate subscription, and gradually work toward a more sophisticated hybrid pricing model as their understanding of customers and their product usage increases. This hybrid approach allows them to continuously improve the user experience while maximizing revenue.

Common usage-based pricing models

There are a variety of usage-based pricing models, including:

- Fixed-fee with usage entitlements
- Pay-as-you-go
- Fixed fee and overages
- Credit burndown

In a **fixed-fee model with usage entitlements**, you charge your user a monthly fixed fee that includes a predetermined usage amount. This is the simplest usage-based pricing model, which combines the predictability of subscriptions with the scalability of usage-based pricing. Once consumed, the user needs to top up or purchase an alternative plan.

In a **pay-as-you-go (also known as "in arrears billing")** model, you track usage incurred over a determined period and charge the customer at the end of the period.

In the **fixed-fee and overage** model, you charge a flat fee per month for the service, which has some included usage entitlement, and any additional usage (overage) is charged at the end of the period. Combines the predictability of subscriptions with the scalability of usage-based pricing.

In a **credit burndown** model, a user pays up front for usage of a particular product and uses up credits over time.

For additional information on how to choose the pricing model that works best for your startup, read our SaaS pricing guide, which is based on interviews with leading software founders, investors, and Stripe experts.

Components of a usage-based billing system

It's helpful to define the various components you need in any usage-based billing system.

- **Billing metric:** This is the type of usage metric you track in order to charge customers—for example, the number of API calls (e.g., Photoroom) or gigabytes of storage used (e.g., Amazon Web Services, or AWS).
- **Usage record:** This is the record of instances of customer usage, either as raw data or aggregated over a certain period, accurately linked to a specific customer and timestamped for billing precision.
- **Pricing model:** This is how you calculate each customer's usage cost. You apply this model to your usage data, which could be flat, pay as you go, or some combination of the two.
- **Invoicing and payments:** Your system generates an invoice detailing the usage costs, total due, applicable taxes, and payment due date. This is usually an automated step in a properly orchestrated usage-based billing system.
- **User interface:** It's helpful to provide real-time usage data to the customer instead of making them wait until the end of the billing period to see how much they've used. The interface could provide raw usage or a snapshot of the upcoming invoice, and can help users monitor and control their usage.
- **Thresholds and alerts:** To manage risk, implementing usage or cost thresholds can be beneficial. If a customer's usage or costs breach these thresholds, systems can alert them or even restrict further usage to prevent unexpected billing or payment issues.
- **Analytics:** Storing usage data in a data warehouse and using analytics tools improve operational efficiency, customer service, and forecasting. Real-time monitoring of usage data provides better control over thresholds for customers, instead of making them wait for billing provider alerts.

The **billing metric** is the most important variable to get right—it's the anchor for your entire pricing model. It should be:

1. Easily tracked and intuitive for customers to understand
2. Aligned with your cost structure
3. Aligned with the value your product ultimately delivers

Is usage-based pricing right for your business?

When assessing whether this pricing model is right for your business, there are three core variables to measure.

Your customers

UBP only really works when you have an intimate understanding of how your customers take value from your product. Your revenue is linked to the delivery of that value—your company succeeds or fails based on how well you understand that exchange.

If your product or service is not absolutely central to the day-to-day delivery of value within your user's operation, UBP is likely a nonstarter. For example, many companies build their entire marketing function on top of HubSpot. Every day, marketers are extracting value by exporting contacts and running campaigns. This activity is easily tracked and intuitive for users to understand, making it a natural metric to center pricing on.

Subscription pricing typically works better for companies that are disconnected from the day-to-day delivery of value, but still play a small role in the overall value creation process.

Who you're selling to is also important. Developer audiences are more familiar and comfortable with usage-based pricing, so if you have a developer as an end user, you're better positioned to deploy usage-based pricing.

Your product type

Products that are self-provisioned, allowing customers to easily control their usage and costs, are more conducive to a usage-based pricing strategy. Conversely, products with complex deployment or usage patterns may not be suitable.

The companies that typically adopt usage-based pricing have products that are low in the technology stack, have high costs of goods sold (COGS) or operating costs, are linked to revenue, and are capable of usage intensity growth. For instance, infrastructure-as-a-service (IaaS), platform-as-a-service (PaaS), and AI companies that rely on scalable cloud computing resources, such as AWS, often find usage-based pricing to be a natural fit.

If you generally have a very sticky product that can scale from a small team to the entire company, you might want to consider usage-based pricing. Otherwise, you'll need to keep waiting for the renewal window in order to upsell on flat fees, which could take years for larger customers.

Your competitive dynamics

You'll need to consider whether you're releasing your product into a market that already has comparable products, and whether those products have widely accepted pricing standards. Would adopting UBP be a radical step change to the industry standard, or conform to it?

There's no correct answer here. If UBP would be too much of a change from the norm for users and adoption would suffer, it's best to stick to established pricing standards and focus your differentiation efforts on building a best-in-class product experience.

However, sometimes deploying UBP in a competitive market that‘s unfamiliar with this pricing model can serve as a differentiating tactic, particularly when customers are price-sensitive or the average cost of existing products is high.

For example, deploying a pay-as-you-go pricing model offers an entry level tier for users, effectively serving as a low-friction way to get customers to trial your product and begin recognizing its value. You would be using UBP as an acquisition strategy, with the intention of delivering value and upselling customers on new products or pricing plans at a later stage.

Key takeaway

Adopting UBP should be an intentional strategic decision that you make in order to acquire new customers, earn more revenue, or differentiate yourself from the legacy pricing structures offered by competitors.

Importantly, UBP can enable you to reach customers who simply don't have the willingness to pay for large up-front licenses or fixed subscriptions. It offers a low-friction way to introduce a new customer to your product, expand your opted-in database, and ultimately better understand their usage before upselling them.

How Stripe can help

Stripe Billing helps companies accelerate growth by offering flexible billing logic for everything from simple per-seat subscription plans to usage-based billing. Stripe Billing powers all your recurring revenue—from metering to billing and reconciliation—all in one place.

More than 250,000 companies, including OpenAI and Anthropic, use Billing to:

- **Launch new products, and offer alternative pricing models:** Stripe Billing offers flexible billing logic for everything from per-seat pricing to metered billing out of the box. In addition, support for discounts, free trials, prorations, and installments is built in.
- **Optimize their pricing strategy:** We offer real-time analytics capabilities and advanced reporting so users can experiment, iterate, and optimize their pricing strategies to find what works best for their business.
- **Streamline accounting and minimize reporting oversights:** Reduce costs with a single platform for unified reporting and accounting, revenue recognition, and reconciliation.
- **Automate tax collection on your recurring transactions:** You can seamlessly integrate Stripe Tax into Stripe billing to facilitate Tax calculation and collection. Know where to register, automatically collect the right amount of tax, and access the reports you need to file returns.

To learn how you can accelerate your growth by capturing recurring revenue, contact our sales team or sign up for an account.