Masters of Scale Episode Transcript: Payal Kadakia

> **PAYAL KADAKIA:** Every weekend I was, I felt like I was a like mini roadshow. Where my parents would come with me and I'd have my costume and my cassette and I'd have to walk in and make sure that the music played all right.

REID HOFFMAN: That's Payal Kadakia. She's been on stage since she was three years old.

> **KADAKIA:** My earliest memories would be waking up on Saturday morning and going to one of my friends' basements and we would dance together with a group of 10 girls and learn Indian folk dances, which really connected me to my culture, it connected me to my ancestors.

HOFFMAN: Her talent for what we'd now call "Bollywood-style" dance was a combination of technical skills with empathy.

> **KADAKIA:** Indian dance has a lot of obviously skills associated with it from just regular technical skills but it also has this beautiful expression associated with it, too, which taught me like, wow, you can actually help someone feel something when you express yourself.

HOFFMAN: Dance gave Payal a form of expression. But what she cared about most had less to do with what she expressed, and more to do with how the audience experienced it.

> **KADAKIA:** I'm always performing for other people. I even think about rehearsals and even when I think about music, I'm like, how is someone else going to feel when they hear this and when they see this and when they see these costumes or they see us in this formation?

HOFFMAN: Payal kept paying attention. She danced her way through her childhood. She danced through college at MIT. She danced through her first job as a management consultant. In 2008, she founded the Sa Dance Company to realize her own vision for Indian Classical performance. And her eyes never left the audience.

> **KADAKIA**: Whenever I am practicing or rehearsing, I'm always thinking about my audience. It's very similar to always thinking about your customer.

HOFFMAN: Payal is constantly asking herself: How is my audience going to react to this move? How is this beat going to make them feel? How are they going to be transported by these costumes, or this music, or that twirl? When you're in the spotlight, you *have* to ask those questions.

And company founders are also in a kind of spotlight, with customers tracking their every move. Payal knows this first-hand. Because when she's not dancing, she's also the founder and chair of ClassPass, the fitness subscription service. Her years watching the audience would serve her well, in this different kind of spotlight. Change the rhythm, and suddenly everyone's murmuring and fidgeting in their seats. One step in the wrong direction, and you can lose the whole crowd.

There was nothing quite like ClassPass when Payal launched it - there was no preset choreography, no rhythm to riff on. And that meant she had to make up some of the moves as she went — improvising in public on many of the things her customers cared about most.

For example and especially: pricing. How do you know what price to put on a first-of-its-kind product? How do you gauge what's low enough to entice crowds of new users, but high enough to keep you in business? You probably won't know — for a while. And in your company's early days, I'd argue it's more important to get users in the door, even when you're taking a very steep loss.

But when you ultimately need to change the price? They'll grumble for sure. A few might storm out. But if you brought enough of them in — and if you've created something really compelling — many of them will stick around.

That's why I believe that the price that bleeds your business, may save your business.

[Theme Music]

I'm Reid Hoffman, co-founder of LinkedIn, partner at Greylock and your host, and I believe that the price that bleeds your business may save your business.

Nearly all startup founders essentially start out deep in the red. It's why I call startups the walking dead. The cost of serving your first few customers is astronomical — and you're in a race to bring those costs down and revenue up as quickly as possible.

Depending on the price point you set, each new customer may dig you deeper into the grave — or lift you out of it. That all depends on what we here in Silicon Valley call your "unit economics." How much do you spend on that customer? And how much do you make in return?

The MBAs will tell you to work out those numbers as soon as possible. In their view, the prudent entrepreneur first proves that the unit economics are sustainable. Once you can say, "Yes, here's what customers will pay for my service. I'll break a profit by X date," then you're free to scale. And not a moment sooner.

But Silicon Valley, as regular listeners may have noticed, tends to operate by a different set of rules. Frequently you have to scale first and figure out your unit economics later.

In fact, putting off this question is the prudent route for anyone playing in a winner-takes-all market. Your competition won't wait for you to figure out your unit economics. They'll take all your customers while you're still in the middle of your MBA calculations. And then your unit economics are really, irretrievably bad.

So you have to be prepared to lower prices to unsustainable levels — give your work away for free, if you must. And even as you hemorrhage cash, keep telling yourself what many of Silicon Valley's iconic entrepreneurs have told themselves, "I'll figure out a way to break a profit later."

I want to give you a sense of how an entrepreneur starts flirting with fatal prices in the first place. It has nothing to do with gutsiness or heedless risk-taking. In fact, the best entrepreneurs I know are highly risk-intelligent — and they would absolutely love to figure out what their unit economics are before they scale.

So why don't they? Because the most scalable ideas require a leap into the unknown. They don't begin with a business plan. They begin with an observation of human nature driving a crazy hypothesis — a nagging thought that might sound a little something like this...

> **KADAKIA:** So, I've danced my entire life. It's such a big core part of who I am. I danced through MIT, I danced through Bain. It was something I just never let go of. And I wanted people to have something like that that they could run to and go to and feel sort of refreshed in their life.

HOFFMAN: Payal Kadakia has danced her entire life. It's essential to who she is. And she wanted other people to have something like that. That was the inspiration for ClassPass, her fitness subscription service. For a flat monthly fee, users can sign up for a staggering variety of fitness classes. They can dance if they want to – or do hot yoga or spin classes. The sheer variety of classes is precisely what makes ClassPass such a hit. Since it launched in 2013, ClassPass has scaled to more than 40 cities worldwide.

But the variety is also what makes ClassPass such a fiendishly difficult thing to price. How do you set a fee for a grab bag of different classes that people use in different amounts? How do you get the whole range of customers and fitness studios to all agree that the price is right? Payal couldn't answer any of these questions at the outset of her entrepreneurial journey. In fact, she originally tried to sidestep those questions entirely.

Before ClassPass, she had a much less complicated business plan. In 2011, she founded a startup called Classtivity.

The idea behind Classtivity was quite simple — she would create an online hub where users could sign up for all types of classes — not just fitness, but painting classes, pottery classes. Any activity you could hope to master, you could find on Classtivity. In short, it would be a search engine for classes.

> **KADAKIA:** I was online, I was searching for a ballet class. I obviously had used things like ZocDoc, OpenTable, SeamlessWeb, and it made sense. I was like, okay. Let's build an OpenTable model for classes.

HOFFMAN: OpenTable lets you search restaurants near you and find, well, an open table at the right time. With Classtivity, Payal aspired to the same model — offer comprehensive listings and a passthrough service for reservations.

> **KADAKIA:** It made sense to investors. I raised capital. I hired a team that bet on the idea.

HOFFMAN: So how would Classtivity break even? Simple — like OpenTable or Seamless — she would charge a small transaction fee.

And like that, she'd be in business. In fact, Payal was so convinced she'd be in business — big business — that her team invested a year and a half in web development.

> **KADAKIA:** And we just wanted it to be perfect, 'cause we just thought it would work.

HOFFMAN: It was gorgeously designed — a fully realized vision, ready for launch day.

Frequent listeners of this show may recall my theory that you never want to release a fully realized vision in the software world — because it's most likely flawed. In fact, if you're not embarrassed by your first release, you've released it too late.

Many successful entrepreneurs have discovered this counterintuitive theory the hard way. They perfect their product, as Payal did, and then on launch day, well...I'll let her tell the rest.

> **KADAKIA:** And so, June of 2012, we launched Classtivity, finally open to the public. We had thousands of classes listed, a beautiful design. And I would say we did about ten reservations a month. It was terrible.

HOFFMAN: Yes, she said 10 reservations a month.

> **KADAKIA:** I mean, our whole entire business was obviously based on the revenue share we would get off of every transaction. And the business model was built on getting millions of transactions through the platform, and we weren't doing that.
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> **HOFFMAN:** So, you launched with this notion of being the Yelp or the review site, and the ability to choose good classes and be informative.
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> **KADAKIA:** Right.
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> **HOFFMAN:** And then what you found was people used you as a search engine, but didn't actually book.
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> **KADAKIA:** Right.

HOFFMAN: I hear this story all the time — from entrepreneurs who failed and those who succeeded. The difference? The successful ones keep trying. Not by digging in and assuming they were right, but by asking themselves, over and over, “Where did we go wrong?”

Payal’s team started with the problems they could see on the website itself…which created another problem.

> **KADAKIA:** So, in the middle of the summer, we started playing with buttons. I always remember, I call it “the summer of buttons,” ‘cause we were contemplating—well, maybe it’s cause the color’s wrong, or the shape is wrong. We were thinking it might be a UI problem, and it wasn’t.

HOFFMAN: The “summer of buttons.” I know a lot of entrepreneurs who have lived through that sorry season.

And I sympathize with Payal. When your service is under-performing, it’s incredibly tempting to hyper-focus on the user interface — because that’s under your control. You can swap out colors and move buttons around the page for months. Sometimes it creates a breakthrough. More often, it’s a dead end. Interface changes are really useful for improving a user interaction that’s fundamentally working. What design can’t do is solve a fundamental problem in your business model.

All those other entrepreneurs who survived a “summer of buttons?” They all came to a similar crucial insight, which Payal has carried with her throughout her career:

> **KADAKIA:** I think the other thing I realized over time is that technology actually wasn’t going to solve everything for me. And I think of a lot of times, and you’re like, oh, I have an engineer to build the site, and I don’t need to do anything, or I don’t need to get any other information. And that was actually wrong. It was really, just see if I can actually get someone to class in any mechanism possible, even if it was manually making reservations, which we did a lot of once we figured it out. Because it wasn’t important yet to get to a place where we were building scalable technology, because we didn’t actually even have one customer.

HOFFMAN: But ultimately, if you’re a visionary like Payal, you’re not just trying to change the way a user interacts with a button. You’re trying to change the way they interact with the real world. And she was not about to change the world at a rate of 10 reservations a month.

I want to bring out something Payal didn’t do at this critical juncture in her career: She didn’t go on autopilot. And believe me, after pouring a year-and-a-half of work into a website, you’d want to go on autopilot. Instead, Payal had a moment of reckoning.

> **KADAKIA:** And I remember there was this clear day. It was about two months after we had launched. And I think I just had to have that honest moment with myself. I was

talking to an advisor. We had money in the bank, so I wasn't actually worried. But the worst thing you could do in that moment was actually just coast and let it fail.

HOFFMAN: You can't rebuild from a bank balance of zero. You need money in the bank. And the hard truth is that you can't even begin to test your theories on pricing until your customers reach some level of critical mass. You can either go the conventional route and get your "unit economics" to work before you scale. Or you can do it the Silicon Valley way, by "bleeding your business" with super-low prices that massively build your customer base.

But the hard truth is that you can't do either of these with 10 reservations a month. Payal would have to built a new runway after that failure to launch.

But this is one of my favorite things about entrepreneurship — you have to refine your theory of human nature.

Every consumer Internet entrepreneur — and arguably every entrepreneur, period — needs to have a theory of human nature. Your product should be based on your theory about how humans behave, both as individuals and as groups. That theory should underlie your strategy, your product design, your incentive program — every decision you make.

Many of the founders who have joined me on this show have shared these fundamental theories — even if they didn't announce them as such. Mark Zuckerberg has a theory underlying Facebook, which he shared with us on the show:

> **MARK ZUCKERBERG:** People just have such a thirst for understanding what's going on with the people around them in their community. Much more than you'd think.

HOFFMAN: Brian Chesky, CEO and co-founder of Airbnb, also has an underlying theory he shared with us — about what travel means to people:

> **BRIAN CHESKY:** If you can belong out of your comfort zone and something new happens to you, then there's going to be a moment of transformation, where the person you were, in a small way dies, and a new better version of yourself is reborn.

HOFFMAN: And Linda Rottenberg has a theory underlying Endeavor, which creates startup ecosystems around the world:

> **LINDA ROTTENBERG:** The best ideas don't die in the marketplace or in the laboratory, they die in the shower, because people don't even give themselves permission to walk out of the shower and write it on a napkin and take it into the world because they're afraid of what others are going to think about them. And they're afraid that people are going to say well this is just a crazy idea.

HOFFMAN: For Payal, she kept returning to that founding theory that everyone should discover a fitness routine that doesn't feel like a chore, but rather a calling or an escape. You shouldn't force yourself to go to class. You should feel compelled by the class itself. It should be for them, like dance was for her: A source of inspiration.

But there was a fundamental flaw in her theory — one that she wouldn't discover — and never could have known — until she started really asking her users, "What do I have to do to get you off of your couch and into a class?"

> **KADAKIA:** To me, the hunt was to get someone to go to class. And I think all ideas were on the table. But I just was like, let's go build something new.
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> We were sitting behind the screen here, right? For a year-and-a-half, we were building API integrations. We were building scrapers to get the schedule data. We weren't talking to our partners or our customers. And that was also something that we started doing.

HOFFMAN: Payal started interviewing fitness studio owners. She asked one after the next, how do you get people to sign up for a class? And immediately she spotted a pattern of responses.

> **KADAKIA:** Many of them were offering a first class for free. Till this day, most studios do that.

HOFFMAN: A free class — that might not sound innovative — but "free" is actually the force multiplier that countless Silicon Valley companies have used to achieve scale. It's like the dynamite that they use to blast through mountains of indifference. And like dynamite, freebies are also pretty dangerous. You better know what you're doing and set off a controlled detonation.

Freebies are an extreme example of the "fatal pricing" that will bleed your business. There's no faster way to get a lot of people in the door than with a give-away. But if those freebie-seekers don't convert to paying customers, then you're just left with hemorrhaging. For the price that bleeds your business to save your business, you need a conversion path.

Payal devised the perfect experiment. She had already partnered with studio owners across the city. She had a central view of all their freebies. And it occurred to her that she could bundle all of those free classes together into one package deal. A user could then hop from class to class — and perhaps discover their true fitness calling. And Passport would benefit by bringing them in the door of all these varied studios.

> **KADAKIA:** We had this idea of packaging it together into one product called a passport. I said, what if we could offer a 30-day period where people could go and try ten classes, and on the other side of it, we would do retargeting and remarketing to get you to go back to these studios. This was a new idea. It was great that we had built a lot of, like,

the scheduling software. And what was nice is people did like this idea, so we started finally seeing reservations. We had people buying this product.

HOFFMAN: The Passport was an immediate success. User enthusiasm ran so high, that when their 30-day grand tour expired, some users tried to cheat the system. They signed up for a new passport, under a new email address. Basically, they started forging passports. Payal was delighted.

KADAKIA: So, we started thinking about this, and I was like, okay, everything is really actually pointing towards a subscription, because people were signing up with multiple email addresses.

So, we did a survey, and 95 percent of our users said they would buy the product again if they could go back to their favorite studios.

HOFFMAN: Through the power of free — Payal had discovered a whole new market. You might call it the market for fitness dabblers. To Payal's surprise, they never discovered their fitness calling through one class alone. They found their fitness calling through a variety of classes. Her vision had come into focus, and it revealed a picture that she could have never foreseen.

KADAKIA: They wanted to do a spin class on Monday, a dance class on Thursday, a yoga class on Saturday. And I think the other really beautiful thing here was that people realized their potential. And I think for me, as a founder with the vision we always had, I wanted people to find what I had had in dance.

In a strange way, this passport product, that was the magic to it. And that was, still is, the core of what made ClassPass everything it is. People loved variety. And no one realized that. There was this market out there for dabblers, when everything was trying to push everyone to be like complete loyalists. And there are definitely both sides, and I think people go in and out of those cycles in their life. But there was only sort of the gym for the dabbler.

HOFFMAN: She could see it, a confederation of gyms for the fitness dabbler. One class pass to rule them all. And 95 percent of her users wanted it. Now she's onto a truly scalable idea. And she's about to take an extraordinary leap into her theory of human nature.

Scale entrepreneurs don't just posit a theory. They go one step further, and ask, "So how can I use this theory to change human behavior?" In Payal's case, she was asking, "If my mission is to get everybody to lead a more fit lifestyle — how do I facilitate that?"

Now most entrepreneurs take the easier path to scale. They play to our vices, because vices are actually much stronger than the virtues. So, for example, convincing someone to floss or convincing somebody to go exercise is actually much, much harder than to convince them to watch something scandalous — you know, the equivalent of the people who slow down to look at the burning car at the side of the road.

One thing I've been saying for the past 13 years is that I tend to invest in companies that play into one or more of the seven deadly sins. Facebook plays into our vanity. LinkedIn? Greed, naturally.

I could go on, but the point is, you don't just want a trigger for user behavior — you want a hair-trigger. Now Payal might not be able to tap that hair-trigger response to exercise — because that's just human nature. She's trying to rev up virtuous behavior, which is much harder to get started.

But the hardest ideas are often the most scalable, and it's one reason I admire Payal's relentless pursuit of this business model. She'll have to fight to get users into the habit of exercise. And their habits will shift unpredictably — which means her prices will be highly unstable as well.

And even if she compels users to try out a few classes — that will only solve half her problem.

> **KADAKIA:** There was another problem, which was that people weren't going back to these studios.

HOFFMAN: That's right, the other half of her user base, the studio owners, were essentially asking, "What's in it for us? Would any of those users taking advantage of our first free class ever return as paying customers?"

> **KADAKIA:** And that was ultimately the promise we had made. And these studio owners were giving us these classes for free. So, long-term, it wasn't great for our partnership with them. But the good side of this product was we realized people loved variety.

HOFFMAN: So Payal had to make a decision — would she continue selling a 30-day passport? Or would she remove that expiration date, and enable users to take a variety of classes, indefinitely? In essence, should she rebuild her business model?

This wasn't an easy decision — because Classtivity was finally generating real revenue. They were making money. It was a simple business model based on a small transaction fee for each booking.

> **KADAKIA:** We actually were 100 percent profitable 'cause we weren't paying the studios. But at the end of the day, I was fast-forwarding in my head, and I'm like, this just feels like a bad deal site and a bad program.

And I didn't want to change people's lives for a month. I wanted to change people's lives constantly, and the only way to really do that was through a product that was gonna have more retention. And so, we decided to move into the subscription.

And I think my team was like. I think they were tired. I think people—you have to remember, this was three years in. And I mean, at this time, we were also making every reservation manually. We all stayed up till 2, 3 in the morning every night. A reservation would come in. We didn't build the technology early on. It would literally send one of us an email. We would go onto the site, make the reservation, and send a confirmation back to the customer. And so, all of us were doing that. We were all doing customer service. So, there was a little bit of that, of people just being like, well, we finally are there. Like, why do we need to change? And what we ended up agreeing on, which was fine, 'cause I didn't know, is we actually didn't know if the passport would become lead gen for the subscription.

So, we decided to not completely let go of the passport at the time. And then when we launched ClassPass, we realized it was just tweaks to it, right? So, from an engineering perspective, it was the passport, it was just with—you could go back to a studio. Okay, great, and it was a monthly subscription.

HOFFMAN: And so, in 2013, one year after the launch of Classtivity, Payal launched a service that would become her second startup. She called it "ClassPass." For a $99 monthly membership fee, users could sign up for 10 classes a month — They could dabble away, indefinitely.

If that doesn't sound like a radical departure from the Passport, then consider the user response.

KADAKIA: Three months into the subscription, the revenues of ClassPass overtook the revenue from the passport. And I think the other part was I started getting these letters from our members that were just about their lives changing, and that they never enjoyed working out, and they look forward to working out, and they felt more confident, they got a promotion, they found love. Like, it was this interesting thing where I realized I had changed people with the product, and that was really what I had set out to do.

HOFFMAN: It was as if her users had said, "Forget Classtivity, forget the Passport — forget all of the work you've done over the past year. We now dub you: ClassPass."

When your users send a clear signal to scale a product, you have to jettison any other products that might steal your team's attention. We talked about this in detail on the episode called "The Big Pivot" with Stewart Butterfield from Slack. Because shuttering a legacy product is never easy. But it's easier when it's failing. It's much harder when you've seen modest success, like Payal did with Passport. That's when you'll really struggle to throw away your hard work and that modest stream of revenue. Sometimes, a blunt talking mentor can help you rip off the band aid.

> **KADAKIA:** I remember talking to another advisor, and he told me to get rid of the Passport. He was like, "It's crack to you guys." I mean, it was kind of funding our business in a way, right? I mean, because we were making cash from it. It took me about probably three months to kind of come to terms with that. I felt like I had given them what I wanted, right? Like, that mission inside, it was like it literally was realized in the subscription product.
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> And so, decided to shut down the passport and Classtivity. And I remember him saying to me, "The passport will be a chapter in your book." And in the halls of ClassPass today, I mean, the passport is like a data field, right? My engineers are like, "What was that?" And I'm like, right. He was totally, absolutely right.

HOFFMAN: So with Classtivity vanishing down the memory hole, Payal could give her undivided attention to her newest venture, ClassPass. She had hopeful investors. She had wildly enthusiastic users — and the thank you letters to prove it. She was poised for a rapid expansion into new cities. She would get to test her theory of human nature on a global scale.

Only one piece of the puzzle remained: The price. At what price could she enroll enough subscribers to this new model of fitness. She had an inkling of what users might pay.

> **KADAKIA:** So, we have this product out on the market, $99 for ten.

HOFFMAN: So for $99, her users could take up to 10 classes each month. Why 10? It seemed generous enough. The average user took five classes. So the average user probably wouldn't even notice the cap. Or so she thought...

> **KADAKIA:** And one of the things that was interesting is, ten classes is actually—to some people, was impossible. And to some people, it wasn't enough. And we also started getting people who were sometimes churning, saying, "Oh, I only went to eight." And I'm like, this is so interesting that people were like tying themselves to this number.

HOFFMAN: Notice how she didn't expect users to "tie themselves to this number." In fact, they tend to tie themselves up in knots when you try to change that number. This is the gordian knot of user expectations…and there's no easy way to untangle their demands.

Almost any move you make after you've slapped an initial price on your product comes with the risk of sending your customers scattering.

When users sign up for that price - the one you probably used in marketing, the one that your earliest fans decided was worth it - you've sort of made a promise. At the very least, you've solidified a key part of your company's brand. Think about Subway Sandwich shop and their inescapable earworm. "Seven-dollar footlong" just doesn't have the same ring to it.

So when you hike your prices, even by a negligible amount, some of your users will feel like you broken your promise. At that point, it's personal. And it can drive even your most passionate fans to come at you with pitchforks.

So why risk it at all? One word: competition. Payal noticed them closing in. It started with the successful experiment that ClassPass ran, to test their users' appetite for classes.

> **KADAKIA:** We kind of wanted to once again experiment with this idea of what if we didn't put a number on it, to see what would actually happen. And so, we launched this summer promotion called Unlimited Summer, where people could go to as many classes as they wanted to.
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> And we saw people love it.

HOFFMAN: This flat monthly fee offering unlimited access is another classic pricing model to bring customers in the door. There's no faster way to get them to commit than to create a subscription, especially one that auto-renews. In some cases, monthly fees create a cash cow: They *feel* like a bargain to customers, while actually creating profits. In other cases, monthly fees with "unlimited" access bleed your business in the short-term, but save it in the long-term — after a crucial price hike.

Payal doesn't know yet what her unlimited pricing will do for her bottom line. But she knows it will give her the critical insight she needs into customer behavior. And from that, she can make sure her price was right.

For now, though, it was working. Demand had surged. Customers loved the offering. It seemed like the right time to start a round of funding.

> **KADAKIA:** And then we announced our series A, our $12 million dollar round, and it was a great moment. And always in hindsight, I'm like, I don't know if I would have done that. Because what it did is it spurred competition in every market.

HOFFMAN: Payal's Series A financing round brought in real money - but it also brought in the wolves. ClassPass competitors started popping up all across the U.S., and they each had the benefit not only of Payal's idea, but also of a fresh start. They weren't beholden to those promises - of pricing, of number of classes - that ClassPass had made.

> **KADAKIA:** Everyone was copying the unlimited model, right? And so, it became a little bit hard to go back on that.

HOFFMAN: Imitation is the sincerest form of flattery, right? If you pilot an idea and everyone copies it, it's a good indication that you're onto something. But it also means two things: one, if you don't lean all the way into that idea, your users might drop you for the five, ten, twenty similar products that have popped up. And two: You better start sprinting.

With all those competitors fielding the unlimited model, Payal found herself locked into it. Not only that - she had to both perfect that model and get it up and running before any of her competitors did.

> **KADAKIA:** So, we went to the ground, and we had to fight our own battle, too.

> **HOFFMAN:** Said, let's hit the pedal to the metal. Let's go as fast as possible.

> **KADAKIA:** We completely did. Yup, absolutely.

HOFFMAN: For ClassPass, that meant staking flags in the national fitness landscape. City by city, they decided: Which could they not afford to lose.

> **KADAKIA:** Me and my cofounder sat down, and we were like, let's just go. And we decided it was called Operation 2015. It was 20 cities by January 1 of 2015. So, in two-and-a-half months, we decided to launch 12 additional cities on top of what we were going to.

HOFFMAN: They were definitely going to need a bigger team.

> **KADAKIA:** I remember that whole weekend, we just spent interviewing sales folks. We sent them out into the markets, and we did it. And so, by January 1, we were in 20 markets.

HOFFMAN: Twenty new cities. Twelve of them in two and a half months. Make no mistake: Payal and her team sprinted.

> **KADAKIA:** We needed to make sure the studios we were getting on board were right, so we had someone go and try them.

HOFFMAN: Payal basically air-dropped employees into new cities like soldiers.

> **KADAKIA:** We'd always just send people in.

HOFFMAN: Soldiers who could reach her personal line around the clock**.**

> **KADAKIA:** You have a problem? Like, you know, call my cell phone.

HOFFMAN: Everyone at ClassPass sprinted for those grueling two-and-a-half months. And when they looked up - they'd done it. They were in twenty cities, and their competitors? Mostly left behind.

But the problem with being that far ahead in uncharted territory? There aren't any footpaths you can follow, or markers you can orient yourself with. Payal had latched onto the unlimited model, but she hadn't yet figured out the unit cost of each bundle of fitness classes. She'd made a big promise to her users, but they hadn't made any promises in return.

Some took the "unlimited" offer seriously, attending so many classes that they did more than "bleed" Payal's business, they caused a hemorrhage. For them, ClassPass was a bargain! Others barely took a class. For them, it was absurdly expensive.

And this split in behavior is one that many businesses grapple with. How do you set a single price when usage patterns vary so wildly? How do you know who your loyal users are? How do you know just much they'll pay? What are their breaking points? You cannot answer these questions by running limited-time-only experiments with your pricing — you have to go all in to really understand how users will respond.

And Payal had just grabbed this bull by the horns. ClassPass was a rollicking success. Now she had to figure out how to sustain that subscription model, indefinitely. The price that bled their business could save their business — if she gets the numbers right.

> **KADAKIA:** So, this is when we went through a series of price changes. And we spent, you know, the next year-and-a-half doing it. And look, there's no blueprint. But I also didn't want to be a gym membership in the sense of like making someone sign a year-long contract to really be able to benefit from people not going, right? That was something that was like—it was a little bit hard, because we were kind of flirting with two different models and trying to change people's behavior.

HOFFMAN: Payal was torn: Smaller bundles of classes for lower fees, or unlimited classes for a higher one. They just didn't have enough data to decide what was going to be the most sustainable. ClassPass tried to run both models simultaneously.

> **KADAKIA:** So, we ended up launching a five-pack and a ten-pack. But what that meant, because we knew the lower usage users would go on the five and the ten, the unlimited plan had to up even higher.

HOFFMAN: And this process of fine-tuning prices rarely goes off perfectly the first time.

> **KADAKIA:** It was hard. We couldn't predict where usage would fall. We did a small price increase, and it wasn't enough, which is really hard to do, right? When you know you put it out there, it's a hard moment, and then it didn't work, because we were churning out a

lot of the users who weren't going to enough classes because the price was higher. And we were trying to find this price point where maybe it was low enough where the lower usage users would stick with us. It just—it wasn't happening. So, after the first price increase, I think I started realizing, I'm like, this is gonna—we're just gonna keep having to increase price.

HOFFMAN: So the way Payal sees it, the price changes were a difficult, but necessary part of keeping ClassPass available to more users - keeping it running, for that matter. Her customers felt differently.

After the unlimited subscription price went up for the second time — one user tweeted "Raise your hand if you've been personally victimized by ClassPass." "No no. Cancelling my membership NOW," tweeted another.

To be clear: ClassPass was not the first company to experience that particular kind of customer riot. And they definitely won't be the last. When Netflix raised its subscription prices, customers were outraged - not necessarily about the new price tag, but about how it made them *feel*. "I can definitely afford it," one angry ex-customer said, "but I dropped them on principle."

When LastPass, the popular password-storing app, raised its premium prices by just one dollar a month, a customer tweeted that it was like a "slap in the face."

Some amount of backlash is inevitable. It's just human nature. No one ever wishes they could pay *more* for a service, no matter how much they love it. And what happens frequently in growth cases like ClassPass is that you start with a business model that's unsustainable. It's the only way to hook that vital set of early users. But if you stay with that business model, you die.

This was also true of PayPal. Our burn rate was tens of millions of dollars each month. That was considered crazy at the time. Now, it's a bit more common. For example, Uber's burn rate is considerably higher. Eventually they'll have to change their pricing, either how they pay drivers or charge customers some years down the road. It's hard to predict, and I bet Uber's executive team couldn't tell you right now either. It's the nature of working in fields where the rules are still being written.

At PayPal, one of our early promises was simple: Add a friend to the platform, and you'll each get ten dollars. It was an easy, effective way to build out our early user base. But eventually, it got so expensive that PayPal's co-founder, Peter Thiel, wanted to scrap the entire idea - and break that early promise in order to keep costs down.

But from my point of view, there was a way to keep that sparkly, eye-catching promise intact. We just had to dim the sparkles a bit. We still gave users and their friends that gift of 10 dollars each, but to get it — you had to give us a little more: You would have to enter your credit card, validate your bank account, and load fifty bucks into your new PayPal account. We kept that promise of 10 dollars. You just had to work a little harder for it.

And this brings me to my next point: When you're making the critical transition from bleeding your business to saving your business, you have to be hyper-aware of avoiding a mob reaction. And mobs rally behind very simple statements.

They're going to get fired up if they read "PayPal stops giving new users the money that they promised them!" But they're probably not going to linger for too long on "PayPal asks for slightly more information from new users but continues to give them the money they promised them."

You have to know what it is about your service that your customers find invaluable. Protect that - that's the only promise that really matters. Pricing riots die down, and if you have a service that customers *really* love, they are eventually going to let you out of the doghouse.

Take it from Payal. Yes, the uproar about ClassPass pricing got very loud, and pretty mean. But at the end of the day...

> **KADAKIA:** We lost very little of our members. Some of them, I think, supplemented their ClassPass membership. So, they stayed on the ten-pack and they ended up getting a gym membership.

HOFFMAN: So Payal inadvertently catalyzed a reaction that was ultimately at the heart of her company's mission: Get people exercising, exactly as often as they wanted. Some of her users were sticking with ten classes a month - maybe so they could try out taekwondo, or spin, or dance every once in a while - but taking the money they might have spent on an unlimited pass and spending it at their local gym, instead.

And the entire process - the price-tweaking, the different models, the customer reactions - taught Payal a lot about the alignment of mission and money.

> **KADAKIA:** I think I've learned this lesson—whatever your vision is and your business model need to align. When you're realizing that the business is hurting at the expense of your mission actually working, that's not a great setup.

HOFFMAN: And chances are, if your vision and your business model are truly aligned, you've created something you love. Meaning there's a good probability that other people out there are going to love it too. And if they really do love it, and you've built something both innovative and invaluable - like a Netflix, or a LastPass, or a ClassPass - your users will put down their pitchforks. And they'll plan their next workout — while binge-watching an entire TV season. Because for Payal, it's something about the *feeling* that ClassPass offers that's important. It's a feeling she's ready to chase alongside her users.

KADAKIA: It's a feeling of being limitless, right? It's a feeling of, I can work out and I can go to class. It's not just about the prices, and if the product is unlimited. And we're still on that journey of making sure that the product feels that way. And I think that's on us to figure out, because that is what our core mission is.

HOFFMAN: I'm Reid Hoffman. Thank you for listening.