[The following transcript has been edited for clarity.]

The folks at Mighty Networks believe that people pay attention to what they pay for. They assert that members of paid Mighty Networks are more engaged, more excited, and get better results. The purpose of this model is to explore the cases under which that might be true and why and the implications it has for us as community hosts.

What this model says is straightforward, it says the rate at which you receive membership fees and dollars per month is a function of your price (dollars per member per month) times the number of members in your community at a point in time. So, the level of members in turn is a function of the rate at which new members join relative to the rate at which members leave per month.

Just think of the level of water in a sink. The level of that water is going to be a function of how much water is coming into the sink relative to how wide open the drain is. If you've got a very high inflow but an equally high outflow, your level of members is not going to grow. To increase the level of membership, you can increase the rate at which members join and/or decrease the rate at which they leave—that is, reduce their churn or extend their average membership duration—something we neglect a lot of times.

In turn, the rate at which new members join can be expressed as the sum of new members from advertising and new members from referrals. By advertising, I mean the result of one-to-many messaging that's initiated by you, the host. So, it can be blogs, content, marketing, email outreach—anything that you initiate as a host. On the other hand, new members from referrals are a function of messaging that's initiated by existing members themselves—one-to-one messaging versus one-to-many.

In this scenario, there is a referral rate of 0.2 new members per existing member per year. That means, on average, an existing member will make an effective referral that results in a new member joining on average about once every five years.

I've made some key assumptions that I think are reasonable. One is (this is the one that I think we recognize) that a higher price makes it more difficult to recruit new members through advertising. For a given level of expenditure of time and money, it's just harder to sell a higher-priced membership.

Mighty Networks suggests a higher price is correlated with higher engagement. I've taken this further. Well, so what? What does engagement do? Well, I suspect that higher engagement translates into higher rates of member-initiated referrals. Engaged, happy, members (on balance) are going to be more likely to make enthusiastic, effective referrals to prospective members.

I also think, for similar reasons, that higher engagement translates into a longer membership duration. If relative engagement number goes up, so does membership duration.

What do I mean by relative engagement? It's a tough thing to quantify, but we can. I just created an index from zero to 100. Zero is minimally engaged. A hundred is maximally engaged. We can observe that qualitatively. So even though it's tough to measure, it doesn't mean it's not measurable. It certainly doesn't mean it's not important.

I've translated this into some mathematical relationships here, which I won't go through in-depth. They just map out the directional effects I have asserted in these assumptions.

Now, I created this model as part of a conversation I had a couple of weeks ago with a membership community host who had been charging $20 per month. He was going to restructure his membership offering and raise his price to $100 per month. I developed this little model to explain to him why I thought he was making the right move.

This is a timeline from month 0 to month 60. So, it’s a five-year model. When we roll forward with this base set of assumptions, membership grows slowly to about, within 18-24 months, something like 100 members. At $20 a month per member, not very surprisingly, that translates into $2,000 per month in average aggregate fees.

Furthermore, in this set of assumptions, it really doesn't get that much better over time, because while the rate at which members join grows as new members from referrals sort of kicks in, the rate at which members leave also grows. For a fixed average membership duration, the leaving rate approaches the joining rate, and the level of members flattens out. That’s a powerful truth that we sometimes neglect.

So even though I was spitballing these relationships, it turns out this curve and this rate were consistent with this host's experience. He'd been at it for a while. He'd given the $20 a month community a lot of his effort and time. This model seems to be reasonably well-calibrated to reality. The point is, while your mileage may vary, this set of assumptions doesn't seem crazy at first blush.

The next thing we wanted to do is to explore what happens when there's a price increase? So, let's turn to this view.

This is the cumulative revenue graph, just sort of blown up. Here's the members graph. What this [control] allows me to do is just move the pricing slider back and forth.

I want you to look at a couple of things. As I change the price, watch this cumulative revenue, and watch the level of members over time. If I double the price from 20 to 40, cumulative revenue goes from $122,000 to $424,000. In other words, a doubling of the price doesn't double [cumulative revenue], it increases revenue by 3.5 times. If we move the price from $20 [per member per month] to $80 (a 4x increase), cumulative revenue goes from $122,000 to $1.2 million over the five-year period—a 10x increase in cumulative revenue. If these assumptions bear some semblance to reality, which I believe they do, then the price has a non-linear effect on revenue over time.

Why might that be? This is what I draw out of it. One is that the real cost of membership to your members is not so much the fee that they pay, but the time and attention that they give toward engaging in the community in substantive ways and investing their social capital in referrals.

One of the truths that I have drawn from Priya Parker's work and her terrific book, *The Art of Gathering*, is that people who aren't fulfilling the purpose of your gathering are detracting from it, even if they're doing nothing. Membership communities are nothing more than a sequence of social gatherings.

In my experience, price is a signal to prospective and current members that there aren't going to be any hangers-on. There's not going to be dead weight in the community. There isn't going to be a situation where 5% of your members are contributing 80% to the conversation. Price indicates that it's going to be more balanced. Consequently, it makes sense for people to invest their time and attention [in the community].

Furthermore, that positive relationship between price and engagement translates into higher levels of referrals and retention, which over some range, offsets the negative relationship between price and advertising effectiveness. When we go back to this price [slider] and you watch cumulative revenue, [revenue] goes up and up and up, and then it starts going down (in this scenario) when you get above about $90 [per member per month]. At that point, you start seeing the advertising effect come into play: you can have too much of a good thing in terms of [raising] price.

Where those inflection points are, I'm not sure. My sense is that the sweet spot of pricing, at least for the kinds of communities in which I'm involved, is somewhere between $49 and $99 a month. That's a rule of thumb, a starting point. It's not zero. I believe I'm in full agreement with Mighty Networks [on that point]. I think [the pricing sweet spot] is more like $49 to $99 per month.

Even if this is true, it takes patience and some courage to increase your price, to go with a high-price strategy. Let me compare the base case, which is the $20 a month scenario, versus a higher price, $80 a month, scenario. If you look at the first year and a half, even two years, of cumulative revenue, there's just not that much difference.

Furthermore, over that same period, the higher price scenario translates into lower levels of membership. It takes something like a year and a half to get up to about 50 members. I'm not sure exactly what the timeframe is, but what matters is that it takes a while before the reinforcing cycle of higher rates of referral and the effect of higher retention to really kick in. It's a matter of years before you really see a divergence in membership and cumulative revenue.

So, in the early days, it isn't at all clear whether a high revenue strategy is going to work. It takes a fair amount of conviction and commitment to make a high membership fee strategy work. It's not for the faint of heart.

This model raises some questions for me. One is that a high-quality community, like a party, is an experience good. It really benefits from referral. Unless you know the host, personally, and have experienced going to their "parties," it's difficult to commit to being a part of their community.

However, referrals require members. If you've got five members, even if they're out there referring like crazy, that just doesn't translate into that many numbers early on. It takes a while.

That's why trial periods are often very helpful in the early months of a community. A trial period is like a sample. You get to experience the community before you make a commitment of, not only your membership fee, but your time and attention.

The problem with trial periods is they can represent a fairly narrow window of opportunity. If it is one month, two months, three months, it's kind of a shot in the dark as to whether you'll make that connection with another member, you'll engage in a small group conversation that is really enlightening and potentially transformative.

Trial periods are a challenge. Extend them too long, and it starts to look a lot like a free community. You risk attracting too many people who are tire-kicking. That brings you back to Priya Parker’s point that if members aren’t fulfilling the purpose of your gathering, they're detracting from it.

So, one of the questions that's very much on my mind is the extent to which two-tier pricing can be beneficial. I'd love to hear your thoughts on that.