9 “Free” is Not a Business Model: Business Models Behind Free

Who can boast of not having any free applications on their phone, looking for and testing new web services, especially if they are free, and appreciate being able to do a lot of research on the Internet for free? We are all free riders and digital businesses have understood this. Free access is an integral part of our digital experience, but what are the business models and their characteristics behind this free access? Often used to attract new users rapidly, what are the business challenges behind free-based business models? And can “free” work as a long-term strategy?

9.1 Free as a “Hot Button”

All the top 10 most downloaded apps in the world in 2021 are free to download and free to use. Equally and excluding e-commerce websites, the top 20 most popular websites in the world are also accessible at least partly for free. These illustrate the prominence of ‘free’ in the digital economy. Most digital users consult their emails, connect with friends, read the news, watch videos, and listen to music for free. And yet, there is another ranking that is worth considering. The ranking of the apps is according to the level of revenue they generate. Here, the app that tops the list is also free to download and partially free to use. This app–the dating app Tinder–offers free and premium subscriptions. This is called a “freemium” model: consumers can download the app and get access to a certain range of features for free, but if they want to use the app’s full range of features, they need to pay. These rankings illustrate the counter-intuitive and paradoxical nature of ‘free’ as a business model. It can be seen as a marketing tool to achieve scale but can also be the foundation of a powerful business model. In this section, we review the marketing function of ‘free’ and then turn our attention to the diverse types of free-based business models.

The popular adage *There is no such thing as a free lunch* conveys the idea that it is impossible to get something for nothing. The “free lunch” in the saying refers to the formerly common practice in American bars of offering a “free lunch” to entice drinking customers. So, “free” is very rarely free. In this case, users will pay for something else – for example, the drink. If a group of users does not pay for anything, then they probably have their own intrinsic value. For example, nightclubs may offer free entrance to women. Women who tend to drink less may not be the ultimate target. Instead, through such a promotion, clubs expect to attract the more profitable “men segment”. However, men want to meet women; hence the need to offer women a free pass. In other words, men will pay for admission and drinks to meet women. “Meeting women” constitutes an element of the value proposition

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offered to men by the nightclub. It is the real "job-to-be-done", for which the value proposition of the nightclub captures the value.

Digital companies use similar tricks. For instance, when users access Google's search engine for free, they essentially become part of the value proposition to attract paying advertisers. Many digital companies provide a free basic offer. The dating app Tinder lets users "swipe to date" but gives them only a limited number of opportunities to do so. If users want unlimited swipes, they must pay a monthly subscription fee for the premium service. Likewise, Dropbox offers a small amount of free cloud storage in the hope that users upgrade to its premium plans. Finally, Netflix offers a free month of their service to new users hoping that they would continue after this expires. By asking customers to enter their credit card details before receiving their free month, they still can be automatically billed, should they forget to cancel before the trial ends.

9.2 Who/What Subsidises the Value?

The previous examples range from short-term marketing tactics to potentially long-term sustainable marketing strategies. They illustrate the idea that "free is not really for free". Users will pay later or for something else; otherwise, someone else will pay instead of them or literally for them. Google, Tinder, Dropbox, and Netflix do not have the same digital business model. Instead, 'free' is used differently from one business model to the other.

A Constellation of Free-Based Business Models

Because there is no associated value capture with the "free" offers, there is no business model if the company's plan does not go further than the free offer. Business models, defined as a company's plan for making a profit, imply revenue models. Hence, 'free' can be a business model only if a subsidy process is involved. This subsidy may be provided by a diverse set of stakeholders and can serve different strategies behind free-based business models. Based on the seminal work of Anderson (2009) in the book *Free: The Future of a Radical Price*, four distinct subsidy mechanisms can be identified (Figure 9-A). The subsidy technique enables companies to still capture value while operating a "free-based" business model.

Cross subsidy: In this configuration, a product is offered for free with the expectation of making money from another related product (often requiring repeated purchases of consumables). This technique can also be called "razor and blades" or "hook and bait". The basic product (bait/razor) is offered cheaply or for free; the complementary product or refill (hook/blades) is sold expensively. The basic product cannot be used without the complementary product. A similar mechanism exists in the

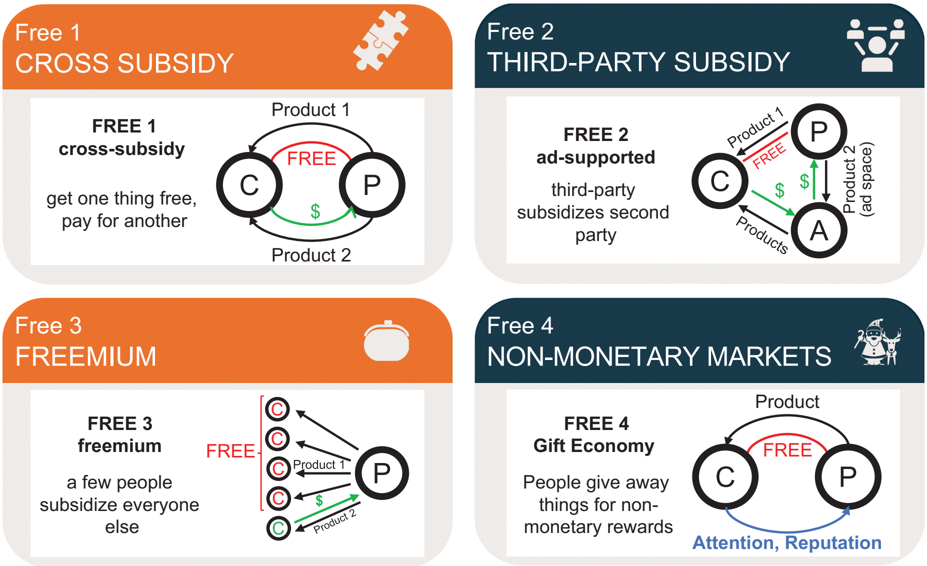

Figure 9-A: Subsidy Mechanisms Behind Free-Based Business Models.
(Adapted from Anderson, 2009)

traditional economy. Printer companies sell printers at a low price and make money on cartridge purchases; even Nespresso machines are available for an affordable compensation of 1 euro in exchange for the subscription to monthly billing of credits for Nespresso Pods.

Some apps use this strategy to entice and connect with users and sell in-app tools to extend the user experience. The most downloaded mobile app video games include “Clash of Clans”, “Angry Birds”, “Candy Crush”, “Hill Climb Racing”, and “Subway Surfers”. They are all free but all of them also practise in-app purchases. The average spending of Clash of Clans users, for example, is $112. In-app purchases may include full game unlock, bonus game levels, game currency, such as coins or gems, or simply removing painful ads.

Third-party subsidy: This category epitomises the adage “if it’s free, you are the product”. The product or service is free for the end-users, subsidised by a third party. In many cases, the third party is a business side, often advertisers who wish to reach a targeted user base. Google’s search engine and Facebook (Meta) are such examples where third-party advertisers pay the company to access users. Advertisers pay the platform when users click on their advertisements and watch their promotional videos so that ultimately, they visit their website and buy their services. We (as users) passively accept and appreciate this mechanism: how many times do we go on page 2 of results on Google?

Freemium: In this scenario, a basic service is provided to the users free of charge. The service is subsidised by a small number of users (*people subsidy*)–as few as 1% – who subscribe to the premium offer. Music streaming service Spotify, for example, offers a free version and a premium one with additional features. The next section discusses the freemium model in detail.

Non-monetary markets (the gift economy): The company provides a free product/service/content *in exchange for attention or brand reputation*. Google offered a free Wi-Fi service to the millions of users of the Indian railway, as part of a corporate social responsibility initiative but also to promote Internet usage – which ultimately led to the usage of their product and services. Wikipedia is another example of a non-monetary market. Here, experts contribute articles on specialist subjects to the site, which acts as a platform they can use to build their reputation. *The Guardian* newspaper in the UK also proposes to its readers to "support our journalism with a contribution of any size". The same is the case with influencers on YouTube or other social platforms who create tutorials, reviews, and so on, in the hope of gaining followers. Ultimately, these influencers can develop a third-party subsidy business model. This happens when brands provide free products or pay social media influencers to mention them in sponsored blogs or posts to reach the influencers' followers.

Offering something free in the short run may appear unsustainable. However, as we will discuss now, it can also lay the economic foundation to develop a scalable digital business model.

The Underlying Rationale for a "Free" Strategy

As seen earlier, a traditional business model implies a value exchange. Companies provide something of value to consumers, who in return offer money. "Free" is, therefore, a very risky strategy/tactic, as businesses need to develop an offering without receiving the normal necessary monetary exchange for the value they have created. Hence, before initiating such strategies, it is necessary to review the conditions under which they make sense. Those conditions depend on the characteristics of the offering or the market.

Offering's Rationale for Free

'Free' is the proverbial carrot dangled before the users to give them the sense that they have "nothing-to-lose" in the absence of a monetary recompense, besides the time spent and data provided as investments. For the entrepreneurs, this free experience good/service should remain financially sustainable.

The financial attributes of the service/product are important to consider. Free offerings are easier to deploy when they do not imply variable costs or only marginal ones for the cost per unit. It is not surprising in this sense to see several players across different industries adopting a free offering in their business model: software as a service (SaaS) (Dropbox, Slack), media portals (Facebook, Newsfeeds websites, YouTube), bit vendors (App Editors), search agents (TripAdvisor), and so on. Accordingly, instead of developing new features, entrepreneurs can present their minimum feature set to a large audience for free, as a way for experiencing their basic services and gaining traction in their markets.

In the world of digital business and network economies, the law of marginal cost is an important economic motivator. When deploying its network, a business must cover its start-up costs while investing in supporting infrastructure. However, once the infrastructure is in place, the cost of each new user is close to zero – what we call the law of marginal costs adapted to network economies: *If the cost to serve a customer (support aside) is close to zero, the long-term price of the product in the market will be zero (because of competitive pressure).*[1] That remains the case until a point is reached where no more users can be accommodated without adversely affecting the service and the cost to serve.

Their enormous capacity is the reason mobile phone service providers can incrementally increase the amount of data offered with their monthly plans. Just a few years ago, an average plan might have offered 5 GB of data. Now, 20 or 40 GB data plans are standard, with some plans even offering unlimited data. Most customers signup for the large data plan because they want the comfort of knowing they can use their phones without running the risk of incurring unexpected charges. However, if they were to check, they might find that they are using only 10 GB of data per month on average – that is, nowhere near their data limit. Hence, offering 40 GB per month is a useful marketing strategy for mobile phone carriers, as it costs them nothing. Even if a few users come close to or even exceed their data plan limit, the carrier has the capacity to accommodate them at virtually no cost.

For start-ups, this means the flow of marginal costs is reversed, as they know the long-term cost will be zero. As Anderson put it: "when something halves in price each year, zero is inevitable" (Anderson, 2010, 163). By starting with a cost of zero to the customer, they can lock in long-term users in the hope they will subscribe to a paid-for plan, or the advertisers will flock to the platform seeking access to a wide user base. Accordingly, they anticipate the lifetime value of their customers at the price of negative cash flow in the short run. Thus, free is not essentially free of financial consequences for digital ventures. It needs to be subsidised by other stakeholders (shareholders by raising money in this case).

1 The Complete Guide to Freemium Business Models, blog article on TechCrunch (September 5, 2011) – accessed on April 14, 2022.

9.3 Mind the Paywall

The Critical Mass Imperative

Digital ventures sometimes bring radically new value propositions, implying that the user experience does not compare to any known customer journey. In those cases, companies need to find ways to give a taste of the new experience and entice initial users.

In this context, *free is undoubtedly a huge accelerator of the adoption of novelty*. On streaming platforms' highly competitive battlefield, "free" is a way to lock in the user. It allows to quickly reach a critical mass of users to validate the minimum viable product, convince investors to back up the scaling phase, and reach a dominant position before the competitors.

Whatever the configuration, somewhere and/or at some time, someone must pay to ensure the sustainability of the business. The risk is that free users become reluctant to become long-term paying customers. *When people get used to "not paying" for a service, it becomes more difficult to get even a penny from them*. This is called the "penny gap". This expression means that there is a market for a "free" offering and no market at all for a paid solution, no matter how cheap it is.

Playing on the emotional hot button of "free" has radically changed since the beginning of the Internet. People are now used to free and expect free digital offerings. Mobile phone users download dozens of free apps and are equally used to free social media platforms. Those behaviours may also affect SaaS providers or streaming platforms. Further, many consumers have developed a "multi-homing strategy" for their cloud storage by creating profiles on different cloud storage services before reaching the size limit of the free service.

Free can rapidly become a market entry necessity. If this is the case, then companies have to offer a free taste of the service at least for a limited period and/or limited features. But *companies need to pay attention to their customers, not only users*. In that sense, companies do not have to engage specific financial resources to attract "free users". This psychological price should be by itself a marketing tactic to attract users, *a viral lift*. The more users are satisfied with the service, the more they become ambassadors and promoters to their connections: *spreading the word of mouth* at no marketing costs for the company to attract new users. If the viral lift works perfectly, the marketing activities will be focused on the conversion of free users into customers and the lock-in of users by enhancing features and encouraging them to connect often to the service.

Then, Is "Free" Part of a Long-term Strategy or a Short-term Tactic?

The answer depends on the company's vision and how they integrate the scaling ambition into this vision. Reid Hoffman, the founder of LinkedIn, named this strategy Blitzscaling in a reference to the blitzkrieg performed by the German Army during

World War II: *Blitzscaling is what you do when you need to grow really, really quickly. It's the science and art of rapidly building out a company to serve a large and usually global market, with the goal of becoming the first mover at scale. [. . .] If a start-up determines that it needs to move very fast, it will take on far more risk than a company going through the normal, rational process of scaling up.* (Interview with Reid Hoffman in Harvard Business Review, May 2016, 46)

Accordingly, "free" can be seen as a short-term tactic to grow quickly and scale faster than competitors, even if it implies cumulative losses to subsidise the adoption curve and learn during this period on which customer segments to focus on, to quickly balance the cumulative losses during ignition and scale phases and starting to compensate costs by a worldwide base revenue stream.

As we will see now, with freemium, the question of keeping the offer free in the long run remains open, as the novelty of the service wears off and the penny gap makes it difficult to convert users into customers.

Free + Premium = Freemium

As described previously, intuitively, when we figure out some free-based business models, we refer easily to freemium, where a few customers subsidise a large base of free riders. Let us introduce some key characteristics and challenges faced by businesses in this context.

The key idea behind freemium can be summarised thus:

> Give your service away for free, possibly ad supported but maybe not, acquire a lot of ~~customers~~ [users] very efficiently through word-of-mouth, referral networks, organic search marketing, etc., then offer premium priced value-added services or an enhanced version of your service to your customer base. (Quoted from Fred Wilson on his blog, in March 2006)

This is how Fred Wilson, a personality in the US landscape of venture capitalists, described a common pattern of business plans he received at the time. As he was asking in his blog post for a name for this business model, one of his followers suggested "freemium".

Beyond the catchy story of wording concepts with the crowd, we have here the foundations of a generic pattern to create, deliver, and capture value – viz., a business model.

In a "freemium" business model, a product or service is offered free alongside a premium subscription version. The free version is the hot button that encourages users to try the service in the hope that they will adopt it and some of them will pay for it and subsidise the free riders. If the "people subsidy" mechanism is a systemic understanding of this archetype business model, Fred Wilson also sought a way to describe how these businesses, particularly the cash-strapped ones, were using innovative and viral marketing strategies and tactics like word-of-mouth, referrals, and organic search to cut the cost of gaining traction and acquiring new users – which became known as *growth hacking*.

Freemium: Blitzscaling or Long-term Strategy?

Strategists at companies using freemium business models must really understand their markets if they are to attract sufficient new users through outbound marketing activities, as well as enhance and promote service quality to premium customers so they continue to subscribe. By employing growth hacking tactics to attract free users, more of the marketing budget can be aimed at premium customers. By treating them well, the business can increase the potential for referrals and cut its churn rate by converting more free users to premium plans.

Besides using freemium as a short-term marketing tactic to capture many individual users, some businesses use it as a long-term strategy to penetrate business markets. Dropbox encourages the uptake of its service by rewarding everyone with free storage. It employs free offers to full advantage by creating a viral lift through three service tiers – a free Dropbox Basic, Dropbox Pro, and Dropbox Business. Since those who want to share and receive files through Dropbox must both have accounts, the service makes it extremely easy to invite others on board. In fact, it incentivises them to do so. For example, if a university lecturer uses Dropbox to share files with students, they get additional storage for "recruiting" them, as will those students when they, in turn, recruit new Dropbox users. The higher number of new users someone recruits, the more free storage they receive. Dropbox does this in the hope that when these students graduate and some of them start their own companies, they will convert to the subscription service because they see the benefits of using Dropbox in business. Thus, the real revenue for Dropbox comes from B2B subscription plans based on user numbers, storage amounts and other services.

In freemium business models, revenue can also be generated by monetising the data gathered by the service. If data can be valued for a third-party stakeholder, then gathering data can be a long-term strategy, as it enables better profiling. This means ads and information can be more effectively targeted at users based on the way they use the service, such as the type of music they listen to.

The app economy has also reinvented freemium business models through in-app payments. While the TV show South Park may have satirised free gaming apps as *just barely fun*, many have proven addictive, hooking players by offering a limited number of free games but then requiring in-app payment to keep playing or advance to the next level. The payments, though small, sometimes less than a dollar or Euro, add up when millions of users make them. Some paid applications also offer in-app purchases. A photo-editing application, for instance, might include a limited range of filters as part of the original purchase, with the option to buy additional filters later. Invesp reports that as of 2017, while just over 5% of the users spent money on in-app purchases, global sales from the in-app purchases were pegged at $37 billion.

Candy Crush Saga is a mobile gaming app that lets users make in-app purchases to acquire “extra lives” or access additional features. Its growth strategy revolves around creating a game that is sufficiently addictive to go viral. In 2013, it did just that, with over 300 million playing the game by the end of the fourth quarter. Of these, 12.2 million made in-app purchases, a conversion rate of 4%. It is estimated that the app earned around $693 million in 2018 through in-app purchases across Google Play and the App Store.

Candy Crush Saga illustrates just how a free offer can act as a hot button that attracts users. If a company’s ambition is to go global and its service costs the same whether it has 10 million or 300 million users, even a relatively small percentage of paying users is enough to create a lucrative business when the service goes viral.

Though less visible than premium subscription offers, *in-app payments are the new freemium*, relying on the “barely fun” aspect of games to create an addictive quality that expands the user database through the social value derived from word-of-mouth recommendations and user referrals. Conversions to paid use are encouraged through micropayments that are so small they seem inconsequential, but which may add up to more than the cost of a subscription plan. Such micropayments are also a source of controversy, with children clicking payment buttons to continue playing a game on their parents’ phones or tablets, without realising they are accumulating charges on mum or dad’s credit cards.

When determining whether to adopt a freemium business model, a company must consider three questions:

1. *How big does the company want to become?* If the goal is to create a dominant worldwide platform within a specific industry, a free offer should be a short-term tactic and possibly even a long-term strategy.
2. *What will be the value of free users?* Will the free offer be a downgraded version of the premium offer, or will it include only basic features? In other words, when explaining the value of being a free user, the company also must explain the value of being a premium customer.
3. *How much will it cost to serve free users?* Before embarking on a freemium strategy, a company must be sure the cost of free users is close to zero and that they can count on a viral lift from word-of-mouth, referrals, and incentives to rapidly reach a critical mass of users. Once this is achieved, marketing activities should be focused on converting free users into premium ones, while retaining those already acquired. This aspect is detailed in the last section.

The key to determining whether a business model is truly freemium is revenue generation. *If most of the revenue stream does not come from the premium offer, then the company is not a freemium company.*

For instance, though LinkedIn began with a freemium business model, its premium offer no longer generates most of its revenue. By 2018, premium subscriptions represented just a small portion (17%) of LinkedIn's revenue, the majority of which was from its talent solution (65%) and marketing solutions (18%). In the long run, instead of premium account payments, data generated by free users have proven valuable for LinkedIn, as this can be used for marketing and to generate brand awareness. User profile data is also valuable to recruitment companies and HR departments wanting to identify suitable job candidates. Thus, it has not remained a freemium company, as the real value proposition now no longer revolves around individuals but businesses, making revenue generation B2B-oriented.

Key Performance Indicators behind "People Subsidy" Mechanisms

As a starting point, *critical mass* refers to the minimum number of users required to get the business model operational. *Critical mass should not be confused with the breakeven point*, which relates to the number of customers required to balance service costs. For an online game, the critical mass would be the number of players needed at any given time. For a communication tool, *the critical mass refers to the minimum number of users required to spark the initial liquidity to find value in the service*. This metric is not associated specifically with the freemium business model, as it is mostly dependent and required for any network-based service – for example, a service for which the value is dependent on the participation of at least two sides. But in the context of freemium, the critical mass will depend on the viral lift which can enhance the outbound marketing and limit inbound marketing to develop and sustain the initial adoption of free users.

As mentioned previously, the freemium business model involves a "people subsidy", as premium users' payments support the free users of the service.

> The easiest way to get 1 million people paying is to get 1 billion people using (Phil Libin, Founder of Evernote)

In a freemium business, the critical mass must be known to calculate the percentage of users the business must attempt to convert to premium users. To be sustainable, freemium relies on the big numbers required to support a consistent revenue stream. So, one of the key performance indicators (KPIs) for the freemium business model is the *conversion rate*, which refers to the percentage of users who decide to adopt the premium version of the service. By monitoring this metric, a business can gauge how successful they are at bridging the penny gap. By experience, this ratio is often low: 4% conversion rate for Dropbox, 0.5% for Google Drive, and 4.1% for

Evernote. In other words, out of every 100 users, there are just 2 to 4 who become paying customers. When Phil Libin mentions a far lower conversion rate (1/1,000 instead of 1/100), it is a prudential way to design the costs of the service and not overestimate the adoption rate necessary to support an expected conversion rate. Because a freemium business model requires such large numbers of users, it is of the greatest applicability to companies with ambitions to reach millions, if not billions, of users, and function as global services and companies.

Before being acquired by Facebook (Meta), messaging app WhatsApp employed an interesting revenue generation strategy by making the first year of usage free but charging an annual fee of $0.99 thereafter. This gave users time to establish chat groups on the app and to experience the convenience of communicating with friends anywhere in the world at a low cost. After enjoying these benefits, users were more than happy to pay the virtually insignificant follow-on fee. This locked them in and overcame the penny gap. Considering that the platform had 500 million users and was growing at a rate of 1 million users per day, even such a small annual fee had the potential to generate over $500 million in annual revenue. This, of course, changed once the application was acquired by Facebook which decided to subsidise the service and maintain it free for its users after the year test.

Then comes an important metric for the sustainability of the freemium model: the *freemium ratio*, which is the number of premium users required to subsidise free users. For instance, a ratio of 1/10 would mean that one premium user is needed to support nine free users.

To Have a Sustainable Freemium Business Model, the Conversion Rate Should be Greater than the Freemium Ratio.

Let us understand these ratios using some examples (see box below). For simplicity of calculation, assume that each user costs the business €1 to serve and a single premium user is charged €10 – that is, covers 10 users (including him(her) self). A freemium ratio of 10% means that out of every 100 users, 10 would convert to premium. Thus, there would be no profit or loss. If the conversion rate is 1/5, 2 out of every 10 users would convert to premium and the business is profitable with a €5 margin for each premium user. If the conversion rate is below 1/10, say 1/15 – less than the freemium ratio – the business loses money, and the freemium business model would not be sustainable.

A Simulation of Freemium KPIs
Conversion rate of 1/10 (10 free users are required to get a premium user)
Cost of acquisition and service: €1*10 = €10 (*cost structure*)
Premium VP: €10*1 = €10 (*revenue stream*)
Margin = €0 (*break-even*)
Conversion rate of 1/5 (five free users are required to get a premium user)
Cost of acquisition and service: €1*5 = €5 (*cost structure*)
Premium VP: €10*1 = €10 (revenue stream)
Margin = €5 (*profit*)
Conversion rate of 1/15 (15 free users are required to get a premium user)
Cost of acquisition and service: €1*15 = €15 (*cost structure*)
Premium VP: €10*1 = €10 (*revenue stream*)
Margin = €5 (loss)

Similarly, to any subscription-based business model (as we will explore in the next chapter), the sustainability of a freemium business model depends on paying customer loyalty. This can be described by two KPIs:

The *customer lifetime value* (CLV) refers to the revenue stream generated by a customer as long as he/she remains a customer of the service. Understanding the lifetime value of diverse types of premium users can help determine how best to direct marketing activities. For instance, LinkedIn Premium marketing would be better off targeting salespeople searching for leads as well as professional users, who are likely to have a greater CLV, than targeting a job seeker. According to your subscription plan structure for the premium service, CLV is dependent on the pricing plan adopted and the duration a customer remains a customer.

The duration will be impacted by the *churn rate*, which is the proportion of customers or subscribers who leave the service during a given period (yearly or monthly). The reasons can vary from low quality of service or a better service offered by a competitor.

Evernote was another successful freemium business model. This famous app for note taking, organising, and task management was very efficient in the design of their service and the monitoring of KPIs to be sustainable. In a founder’s interview in 2010, Phil Libin shared their books and emphasised the key elements to pave the freemium performance:

Two conditions of value proposition design are:

1. *The way the product/service is designed* should influence a significant portion of free users to cross the paywall.
2. *The more a user spends time on the service*, the more he/she values it, and the more this user is closer to hitting the free service limit.

And three steps to pave the freemium success:
1. *Win millions of free users*: Freemium sustainability is primarily dependent on a large adoption base, which should be acquired at a low cost (no customer acquisition cost for the free users) by extensive outbound marketing strategies and a viral lift.
2. *Convert more active users to premium status over time*: The path of conversion should improve over time to demonstrate the sustainability of the freemium model and also on an organic basis, as the free riders spend time on the service.
3. *Keep costs down,* whether they are associated with customer acquisition or the cost of the service. Again, those costs should be mainly fixed not to be dependent on the volume of service and explode with the number of users and customers on board.

In 2013, Evernote was considered a unicorn – a start-up with a valuation above 1 billion dollars:
- 41 million users were active in 2013 versus 34 million in 2010.
- 1.5 million premium users in 2013 (3.7% conversion rate) versus 1.4 million in 2010 (4.1% as conversion rate in 2010).
- Gross revenue was estimated at $0.25 per premium customer ($0.09 towards costs and $0.16 as net profit).
- These metrics supported an expanding product range over time to sustain continuous growth.

9.4 Key Takeaways and Further Considerations

1. To be a business model, 'free' needs a revenue mechanism. Free-based business models rely on subsidy mechanisms, whether they are features, people, third parties, or a non-monetary counterpart of free riders.
2. The Freemium model works by offering basic services free and premium/business services for a payment.
3. The freemium strategy works only with many users.
4. In the absence of other revenue sources, freemium may not be a sustainable business model in the long run.

A Value Proposition Canvas for Freemium?

As noted earlier, in the freemium model, the free offers are used to introduce a new service or product that consumers could use at no cost. The free service is used as a hot button to entice would-be buyers to try out the novelty aspect of a value proposition. Freemium business models require a value proposition canvas (Figure 9-B) different from the traditional business model or that of the two-sided platform because, with freemium, the canvas must present separate value propositions for free and premium customers.

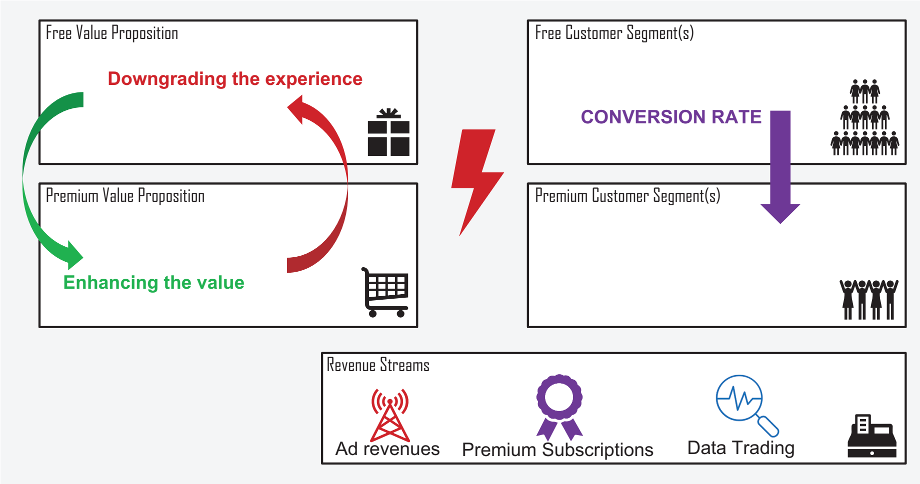

Figure 9-B: Proposition of an Adapted Value Proposition Canvas for Freemium.

Moreover, the business must also define a limit, or paywall, at which value is either enhanced for premium customers or downgraded for free users. There is a difference between the two approaches. In some business models, the premium offer extends the number of features available to users. LinkedIn Premium is an example. Here, premium users get access to InMail and can see who has viewed their profile. In contrast, Spotify keeps the value of its free offer low by exposing free users to ads. This is done in the hope that the users would jump to the premium plan to avoid being annoyed by promotional messages when listening to music.