



Freemium 101

A brief introduction to the
freemium business model



What is freemium ?

The word freemium is made up from the words **free** and **premium**.

It describes a business model where you give a core product away for free and sell premium products; like the way Skype gives away free computer calls and sells voicemail, calls to landlines and other products.



Why use freemium ?



*To make more money !!!
While making your users happy.*

Contrary to what some people may think freemium is not a form of socialism. Freemium is a business model, employed with the main objective of making money. Adopting this new business model is a way of adapting to the changing market and the conditions of production.

The term freemium has its origin in the IT world. Here, software companies and Internet service providers have used the model for quite some time. Against the background of the recent financial crisis, the model seems to have become even more popular within this industry.

During the last few years, companies within several other industries are gradually implementing freemium. This is particularly true for the music and publishing industry. A great example of this is the rock band Nine Inch Nails. Fans could download their latest album *Ghost I-IV* for free. Simultaneously, the rock band generated revenue from a number of other sources, including concerts, deluxe CD box sets and paid downloads.

Use of computers

Since the invention of the computer, we have continuously been able to use it for an ever increasing amount of tasks. If someone in the mid 80's had told me that today I would be using my computer to listen to music, watch movies, read books and connect to people in the whole world, I would have thought that they were crazy.

Nonetheless, today the computer is used for both initial creation and distribution of most media products. The download sales of "Vive la Vida" by Coldplay topped 617,000, making it the best selling digital album of 2008. Not only was a computer used to produce this album, it was also a computer that created the 617.000 mp3 files of this number that has been sold so far.

Cost of computers

As the possible uses of computers are becoming increasingly pervasive, the cost is declining. Moore's law is a term used to describe the exponentially decreasing cost of computing. It observes that the amount of computer power you get for a certain cost doubles every 18 months. Similar tendencies are true for Internet connection, memory and a range of other related factors. In other words, the cost of computing has been falling exponentially since the end of the 50' and will most probably continue to do so.

The effect of these tendencies is that computer production is very inexpensive. You can duplicate digital products at almost no cost. So after producing the initial mp.3 file, the production of either 100 or 100 million files costs practically the same.

Compared with traditional physical production, this is a very disruptive. These changes in circumstances create a situation with a lot of new dangers like piracy.

More importantly, it also creates a lot of new possibilities, for those willing to rethink their business model.

Effect

In a traditional economy, it would not make sense to distribute 100 free CDs in order to sell 2 concert tickets, 3 T-shirts or 4 paid CDs. The cost of producing and distributing the actual records will simply be too high compared to the revenue.

Once you are able to produce and distribute the music with computers, this changes. The marginal cost of distributing each album is close to zero. This means that only a small percentage of users need to buy something, for this model to be profitable.

Skype



As most readers will probably know, Skype is a VoIP service that provides audio and video calls through the computer. Since the first version in 2003 there have been over 1 Billion downloads of the free software. In the third quarter of 2008, the service had 16 billion of call minutes on Skype-to-Skype calls. During the same time, there were under 2.2 billion paid Skype-out minutes used. Or in other words, of the total 18.2 billion minutes, only 12% were paid for.

While there is a debate going on whether Skype was worth the 2.6 billion price tag, it remains a fact that it is highly profitable. In third quarter of 2008 the company declared a profit of \$45 million.

The reason Skype can make so much money while only 12% are paying, is that the free product is so cheap for them to duplicate and distribute.

Flat World Knowledge

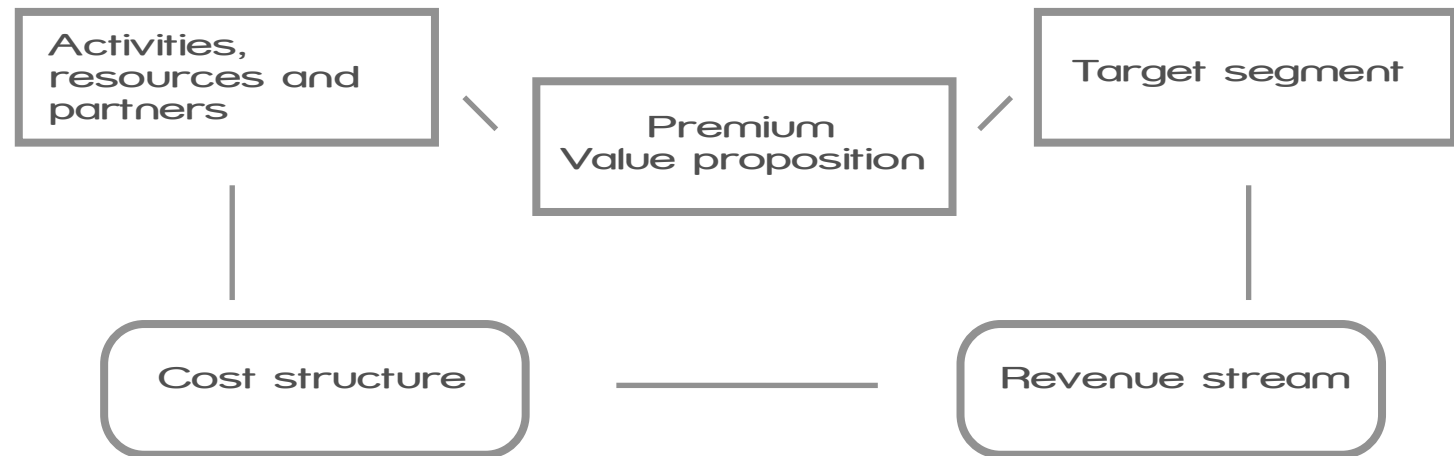


The company publishes college textbooks. Like other textbooks publishers they use recognised experts and complement this with reviews and editors.

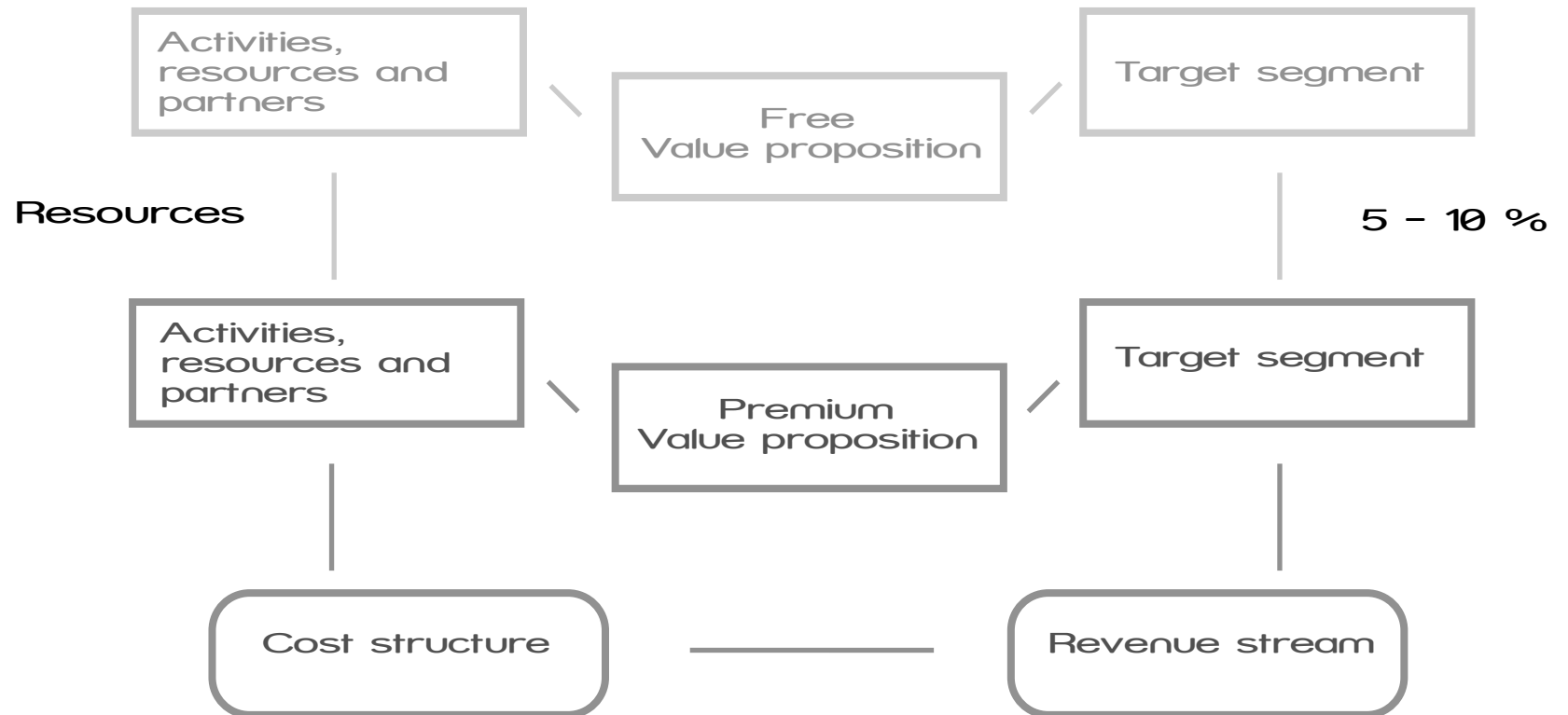
Where they differ from their competitors, is in their business model. Instead of only selling extensive paper versions that change every two years, they release the books online for free download. Students and professors have access to quality textbooks at no cost. The publisher makes money from selling a range of other products.

While Flat World Knowledge is still a young company, this business model looks to be profitable for them.

Traditional Business model



Freemium Business model



Not Gillette



Businesses have been using free as a strategy for a long time. Gillette is famous for giving away the razor and selling the blades. Similarly you can buy a cell phone for \$1 IF you sign up for subscription. This is fake free – you are just paying in another way.

For a model to be freemium, the free has to be something that can be used in and of itself, without necessarily buying something else. Like the way you can use the free version of Skype as a valuable tool, without necessarily buying something.

Not advertising

Free newspaper and Google are two great examples of products that are free to the customer, and are financed by advertising. This is not freemium.

While Google also relies on the ever decreasing cost of computer power, the business model is based on advertising and not premium product.

Yet it is not totally clear cut. Within IT, freemium is often combined with advertising.

LinkedIn makes 75% of its revenue from premium offerings and 25% from advertising.

Not Wikipedia

Lately, there has been a rise in what is often referred to as gift economy, wherein people gift their efforts with no monetary reward in sight. This happens in places like Wikipedia, where thousands of volunteers write and edit the enormous encyclopedia. The motivation behind this is often attention and reputation within the community

Note that as with advertising, there is not a clear cut division between gift economy and freemium. Most people contribute in the gift without any financial goal or return. Some might contribute in order to establish themselves as experts in a field, and then to use this status for making money from consulting or speaking.

Who should use freemium?



From working with freemium and looking into best practice examples, I have isolated a few characteristics of companies prone to freemium success.

1 Quality free product that people want

The most important condition for creating a successful freemium model is that you have a great product that people want. It will be the engine that drives your freemium based business. If this free product does not have inherent value your freemium will not get off the ground.

So instead of giving away a sample track of the music, let people download the whole album. Instead of letting people take a look at your worksheets, let them have all your tools for free.

2 The free product can be duplicated digitally

Only a small percentage of the free users will usually buy something. In order for this to make financial sense, the expense of distributing the free product should be very minimal. Digital duplication ensures virtually no cost for copying and distribution.

If you want to distribute 1 million pieces of something, \$1 as unit price is quite a substantial amount.

3 Large reach

Freemium depends on generating attention with the free product; then to sell premium products or services to some of the free users. In most cases only a small % of the free users will buy something. This is no problem, as long as it is a small percentage of a large number.

How to create a successful freemium

There are generally two methods that should be incorporated in order to ensure freemium success.

- ✦ Adapting the business model
- ✦ Ensuring a wide distribution of the free product

Ensuring a wide distribution

The economic logic behind freemium is

“When the supply of a product increases, the demand for its complementary products also increases.”

The free product is the driver of the revenue creating products and more free users means more paying users.

Since additional distribution of a free product costs close to nothing, the success of a freemium business will increase with the number of people using it.

There are two main ways of helping this along

Actively promoting this

By actively promoting your product, you make sure that more people get to know about it – which will lead to more users.

The generous nature of freemium fits very well with the emerging field of social media, and social media marketing has proved to be a good way of promoting a freemium product.

Removing barriers for people to access it

If it is hard to access your free product some people will stop before they get to it. Not only will these people not be exposed to your thoughts, they will also have wasted time on you.

Or as Corey Smiths manager puts it: “My job is basically to remove barriers between the fans and Corey’s music”.

Adapting the business model

If your free product is indeed a quality product that people want, it will generate a lot of attention. In order to make the overall model profitable, you need the right complementary products to generate revenue from this attention.

The Rock group Nine Inch Nails is a great example of adaption product. In conjunction with the free album “Ghost I-IV”, fans could buy a range of other products – ranging from the extended \$5 download, to a \$ 300 limited edition super deluxe box edition.

Isn't this just a marketing stunt?

In modern society based on broadcast media, most people associate marketing with a narrow definition. You probably don't want the aggressive advertising and PR involved in selling products. From this perspective freemium is not marketing. You give people a product of value and they are free to stop there.

In a broad definition, this is about creating, communicating and delivering offerings. From this perspective, freemium is marketing. It is a way of spreading your ideas to a large group of people.

When Google launched Gmail, half the people I know had a Gmail address within one year. The service spreads viral, without advertising. While Gmail is not based on the freemium model, it is a great example of how a great free product that people want will spread.

Using freemium, the free product has the possibility of spreading viral. As the use of the free product increases, the demand for the revenue generating products increases.

The business model recognises the value of a free user, even if they don't end up generating revenue.

Instead of calling freemium a marketing stunt, I would define it as a business model with integrated viral potential.

A better world



While freemium is mainly adopted as way of making money, it also has effects on the surrounding society.

It can be a small step towards a better world. It puts knowledge and tools in the hands of people who could not otherwise afford it. A great example of this is the way open source software companies have made money while making free software available to everybody.

Info



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