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Succeeding with freemium: strategies for implementation¹

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Purpose: The freemium business model has recently become one of the most dominant business models in online markets. However, entrepreneurs and managers still have a limited understanding of why some companies using freemium business models become successful and sustainable while others do not. The purpose of this article is to highlight the key points for succeeding with the freemium business model in online digital business from a strategic point of view.

Design/methodology/approach: The findings and recommendations derive from the study of online digital companies and applications, which either succeeded or failed to develop a sustainable freemium model. These are LinkedIn, Spotify, Box, Eventbrite, Chargify, Gasketball, and TravelCrony.

Findings: The article describes the generic strategy and the key strategic choices that enable and support successful freemium business model execution in an online digital business.

Research limitations/implications: The research is limited to digital companies applying a freemium business model and offering their products and services online.

Practical implications: The findings and recommendations can help new and existing companies first, to evaluate if the freemium business model is feasible for them, and second, to adjust strategies to develop a successful freemium business model and scale it up.

Originality/value: The article extends the current understanding of the freemium business model logic.

Keywords: business model, business model innovation, freemium business model, freemium

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Introduction

The development and spread of various online technologies has led to the emergence of innovative online consumption patterns, markets and business types, including 'freemium' products and business models (Niculescu and Wu, 2014). In a nutshell, the freemium business model involves providing a basic version of a product or service for free, with the intention of persuading sufficient numbers of customers to pay for a more advanced version. Industry data indicates that 98% of Google's Play Store revenue and 95% of Apple's App Store revenue come from freemium applications, making freemium a robust business model of the digital age (Anderson, 2010).

There are several prominent examples of online digital companies that successfully employ the freemium business model, such as the professional network service provider LinkedIn, the music streaming service Spotify, the cloud computing company Box.com, the online event management service provider Eventbrite. To find out how they succeeded, we followed the companies for three years, reviewed their business models' configurations, and analysed their strategies and tactics for every year of operation since their foundation. We aspired to unveil the strategy and strategic choices, which led to their success with the freemium business models.

However, while these companies were able to make their freemium business model a success, a large number of other online digital companies have experienced freemium as a costly trap. We studied a number of failed freemium cases and selected three of them for illustration and comparison in this article. We chose the provider of online billing-management services for SMEs Chargify, the iPad game Gasketball and the start-up behind a travelling app for iOS devices TravelCrony. The three freemium-troubled companies offered products that were well-received by the target audience and expert reviewers but failed to build a sustainable freemium business model.

While comparing successful and failing companies, it became apparent that the successful companies employed similar approaches to the development and execution of their freemium business models. More importantly, unlike the failed cases, they achieved a clear alignment between the competitive strategy, the business model elements, and the strategic choices in that process.

In the following, we present the most important findings and suggest what entrepreneurs and managers should take into account when they are building an online digital company based on the freemium business model. We also discuss the business model configurations of the successful companies using the 4V business model framework described briefly below.

The 4V business model framework

Scholars, industry experts and consultants employ a wide repertoire of definitions and graphic representations when explaining what a business model is, ranging from simple narratives of how a firm does business to complex system charts. To summarise our findings

across the four successful cases, we use the 4V framework presented in Figure 1. The 4V framework suggests that a company's business model consists of four basic interconnected elements: *value proposition*, *value creation*, *value delivery* and *value capture* (Holm *et al.*, 2013). The 4V framework is closely related to the business model framework put forward by Baden-Fuller and Haefliger (2013), and is derived from the work of other business model scholars (Teece, 2010, Gassmann *et al.*, 2015, Baden-Fuller and Mangematin, 2013). The main advantage of the 4V framework is that it facilitates a discussion on the strategic level of a company.

Figure 1. The 4V framework

<i>Value proposition</i>	<i>Value creation</i>
Value offering – a firm's bundle of products and their characteristics (e.g., product or service, brand, novelty, etc.)	Arrangements of resources, competencies, activities, processes and partnerships with other firms to create and deliver the value offering
<i>Value delivery</i>	<i>Value capture</i>
Segments of customers to whom the firm offers the value offering, the various means and channels to reach the segments, and the firm establishes relationships with the segments.	Monetisation – the way the company makes money from the value offering through a variety of revenue flows and their overall profitability (i.e., revenue model and cost structure)

The freemium business model

The principle of the freemium business model is that there are at least two groups of consumers who benefit from a value offering: non-paying users (often referred to as free users), who receive a limited value proposition for free, and paying customers, who get a more enhanced value proposition for a premium (Gassmann *et al.*, 2015). Free users can later become paying customers and vice versa. In an online digital business, the value proposition as defined in the 4V framework is typically a digital product distributed through the company's own and its partners' digital channels. Engagement with the product and its consumption takes place mostly online and sometimes offline through a digital device. To deliver its value offering, the online digital company builds a suitable infrastructure and platforms, and often integrates its products with various media. The company communicates and interacts with its consumers electronically. It captures value by collecting revenues from paying customers, who may represent various groups of the mass market and/or specific segments of the B2B market. The successful online digital firms we studied have comparable freemium business model configurations, which we summarise using the 4V framework in Figure 2.

Figure 2. Freemium business models of LinkedIn, Box, Spotify and Eventbrite

Company Business Model Block	LinkedIn	Box	Spotify	Eventbrite
Value proposition	Fully functional and technically advanced offer for non-paying users, though with some limitations			
	Advanced and targeted offers for paying customers	Advanced and customized offers for business customers	Enhanced products and features for paying customers	Additional features for paying customers
Value creation	Platform development and maintenance Continuous innovation and new product development Partnerships and integration with other products			
Value delivery	To mass market Delivery through own channels (web and applications) and multiple partner channels			
	To specific premium segments	To specific B2B customers		
Value capture	Costs from non-paying users and paying customers			
	Revenues from specific segments, mostly from recruiting organisations	Revenues from designated partners and business customers	Costs from content providers. Revenues from premium customers	Revenues from for-profit customers

LinkedIn Inc. was founded in 2002. It runs a professional networking site allowing the members to create business connections, and search for jobs and potential clients. As of 2015 the network had more than 380 million members in over 200 countries and territories. LinkedIn was valued at approximately US\$2 billion as of 2015.

Box Inc. was founded in 2005. It is a cloud storage and integration service provider which enables sharing, accessing and managing digital content. In 2015 Box had 30 million users and 44,000 paying customers including most of the Fortune 500 companies. By 2015, Box had a market valuation of US\$2 billion.

Spotify AB was founded in 2006. It is a digital music service providing the users with access to millions of songs. Spotify is available on computers, smartphones, and other devices. The company delivers its music streaming service to 15 million paying customers and some 45 million free users. As of 2015, it was valued at US\$8.5 billion.

Eventbrite Inc. was founded in 2006. It runs a self-service ticketing platform. The technology allows anyone to create, share, find and attend new events. The online service is used in 187 countries for 1.2 million events per year and the platform processes 4 million tickets each month. According to Crunchbase, Eventbrite was valued at US\$ 1billion as of 2015.

The freemium strategy

Our analysis reveals that the successful freemium companies built their business model on the execution of a strategy characterised by continuous innovation and growth imperatives. They grew through new products and market development, and strived for excellence in free offerings and constant growth in number of users. Whether the growth was initially sporadic or planned, the growth factor played a fundamental role in the survival and further development of the freemium companies' business.

Thus, when choosing to compete on freemium in online digital space, managers, in addition to offering an excellent free product, swiftly need to secure a large user base. They should in particular strive for the following:

- 1) **To attract vast number of users:** The online digital industry's experience is that the conversion rate of free users to paying ones is somewhere between 2-5%. Therefore, having a solid user base is the number one priority as even 100,000 free users may not provide enough premium signups and hence revenues to run a sustainable business.
- 2) **To aim at a high company valuation:** Free users are very valuable for attracting venture capital. The larger the number of active product users, the higher the valuation of the company and hence its attractiveness for the market and investors. Although a business model without adequate revenue streams to cover costs is not viable in the longer term, LinkedIn, Box and Spotify chose a growth-before-profitability strategy and operated with a revenue-deficient business model for many years.

LinkedIn demonstrates the success of a growth-before-profitability strategy as they built their user base very quickly. Within two years, their network grew to over 500,000 members, and a year after – in 2004 – it had a membership of over 4 million individuals. This success helped LinkedIn not only to secure the initial pool of users but also a significant venture funding: US\$4.7 million in Series A funding in 2003 and US\$10 million in Series B funding only one year later.

In contrast, our failure case, TravelCrony, entered the market with an innovative and excellently designed app for iPads. The app had extensive features for travel planning, network sharing, communication and navigation. However, the creators failed to attract enough users to survive in the marketplace. They initially assumed that having an excellent free product is enough to acquire a substantial number of users for further application development and monetisation. They made little effort to attract users and stimulate app downloads, and a few years after the app launch, they had to stop its further development.

The key strategic choices

Despite some industry-specific peculiarities, LinkedIn, Box, Spotify and Eventbrite realize their freemium strategies through a robust set of strategic choices geared to their

explorative growth strategy. In contrast, Chargify, Gasketball and TravelCrony did not follow the same path and consequently failed to develop a sustainable freemium business model. To help managers avoid the fate of these failure cases, we provide a set of concrete recommendations for making strategic choices.

1. Sustain the high value of free and premium offerings

To succeed with freemium, online digital companies need to achieve and sustain the excellent value of their offerings to free and premium users by continuous development and improvement of their value propositions e.g. a better user interface, additional new features, further compatibility with other systems and solutions, more free space, etc. This approach leads to increased customer loyalty, better customer retention and higher switching costs. This is especially important for freemium companies since switching costs might be perceived as being low because their offer is for free. This strategic choice requires continuous innovation and investments in research and development activities as well as new product development. For example, LinkedIn spends approximately one fifth of its revenues on R&D.

2. Maintain an optimal balance between free and premium offerings

Reaching the right balance between free and the premium offerings is crucial for a freemium business. There is always a danger that too much will be given away for free, thus eliminating the incentive for users to upgrade to the paid version (O'Malley, 2015). For example, Chargify started out with a freemium business model in 2009. It provided a free service for users who invoiced fewer than 50 customers a month. To invoice more customers, a merchant was required to pay a monthly fee of just US\$49. Most Chargify users never became paying customers, and in 2011 the company was on the path to bankruptcy. Therefore, it removed the free option, and it took another 1 ½ years for Chargify to recover financially from its freemium adventure (Needleman and Loten, 2012). Similar to Chargify, the iPad game Gasketball was very well received by its target market and had been downloaded more than 420,000 times within a month of its launch. Nevertheless, the start-up behind the game, Mikengreg Games LLC, managed to get only 1% of users to pay US\$2.99 for the full version of the game (Needleman and Loten, 2012).

3. Extract maximum value from free users

Free users should be treated as a valuable resource and as a marketing tool rather than as operational costs (O'Malley, 2015). They are helpful in testing and ideating the freemium portfolio and provide invaluable feedback when it comes to product usability and features. They can also serve as a gateway to a potentially lucrative cooperation in a B2B market as they can suggest the product they liked to their employers, as well as peers and co-workers. One of Box's executives explained how this works in practice: "A lot of times we use prosumers who sign up for free on the web for Box service and then, over time they like it so much they will bring it to work and they will say 'hey, would you use this for team, for project, for our company', and then it starts spreading throughout the organization." In contrast, failing freemium companies do not perceive free users as a valuable resource beyond seeing them as potential paying customers in the future.

4. Learn continuously from user and consumer behaviour

Understanding the users' online behaviour is a key competitive advantage for a freemium business. The successful companies spend a great deal of resources in building their data analytics capacity. They find this knowledge to be particularly important for optimizing user-management and tailoring their premium offers. Having members from 120 different industries and from various parts of the globe, LinkedIn found that the most meaningful way of segmentation was based on their members' platform behaviour (Piskorski, 2007). Analysts at LinkedIn derived three major categories of users: relationship managers, networkers and contactors. Relationship managers are generally interested in maintaining their first-degree relationships and contact information. Networkers represent approximately 5% of the members and build their network for the network's sake in the expectation that at some point in time their relationships will pay off. The final 5% of the members, referred to by the company as contactors, represent a group of recruiters, salespersons, analysts, investors and other types of professionals whose job requires them to find and contact people who match certain criteria. Based on the user analytics, LinkedIn launched a number of premium services for all three categories of members (ibid.).

5. Harness social networks

Social network sites allow quick and practically free product distribution, access and penetration in new markets and sharp increases in product awareness. Unlike LinkedIn, neither Spotify nor Eventbrite possessed extensive social network capabilities. Nevertheless, they made a tremendous effort to add a social network aspect to their offering. With the integration of social media such as Twitter and Facebook, both companies enable users to share music and events with friends. For example, each Facebook share of an Eventbrite event drove 11 visits back to Eventbrite.com according to company's estimates from 2009. It also resulted in US\$2.52 worth of ticket sales. A Twitter share was only worth US\$0.43, and a LinkedIn share was worth US\$0.90 (Schonfeld, 2010). Eventbrite has also long collaborated with BiddingForGood (BFG) – an online fundraising auction community of 450,000+ contributors and bidders. The collaboration allows an integrated solution that combines Eventbrite's event services. Eventbrite's users can easily add an online fundraising auction to their event while BFG customers can easily integrate Eventbrite ticketing data into bidder registrations.

6. Target potential users through product bundling and integration

To reach a broader scope of potential users it is worth considering product bundling and integration with the offerings of strong and well-established market players. To enhance the distribution of its service and mobile app, Spotify signed partnership agreements with mobile operators. For instance, on entry to the UK market in 2010, the mobile operator "3" offered Spotify's music app preloaded on its handsets. Box's success is also strongly related to the company's focus on integrating its service into its customers' products, platforms and applications. In 2015, the company entered into a strategic partnership with IBM to combine the technologies and resources of both companies to transform work in cloud-based solutions. For another example, Eventbrite's iPhone app allows event organizers to check-in attendees by scanning a 2D barcode on Eventbrite tickets directly from their iPhones. Eventbrite's iPad credit card reader helps event organizers to collect ticket payments at the door and generates a comprehensive list of their sales data captured through the Eventbrite platform.

7. Minimize costs of free-user management

Costs are an important aspect for any company, yet are an especially important aspect for freemium companies since free users generate costs related to service and maintenance, data usage and cloud computing, but no direct income is earned from them. Therefore, successful freemium businesses work hard on reducing user-servicing costs by implementing automated and mass-customized customer relationship platforms. Furthermore, successful freemium companies often use free users as a means to reduce marketing costs. For example, Eventbrite reached 10 million users without a big budget for advertising, based only on the word-of-mouth of free users. In contrast, we did not observe any of these cost reduction efforts in the failure cases.

8. Consider aggressive internationalization

Once the freemium company is established in the local market, it should consider internationalization. This is a highly logical consideration for a successful freemium online digital business since its strategic orientation is focused on constantly expanding its user base. For instance, LinkedIn focused on growing its presence in China, which in 2015 became the company's second largest market for new signups behind the US. Box also spends a considerable amount of cash on marketing and international market development, which was the main reason for its annual operating losses of \$166.7m in 2015. As Box's co-founder and CEO Aaron Levie explained in his interview to The Telegraph: "So for us a focus on profit versus just trying to achieve as much market share as possible would be the wrong decision for the company and our investors" (Williams, 2015). As mentioned earlier, the company stays faithful to its growth-before-profitability strategy.

9. Access new technologies and users through mergers and acquisitions

Freemium managers should consider mergers and acquisitions to add new technologies or to reach new users and customers. The successful freemium companies are constantly in search for complementary and supplementary capabilities that are aligned with their strategic orientation. This allows them to leapfrog the competitors and swiftly enhance their value offerings and user base. In 2009, three years after its inception, Box acquired IT company Inereo Solutions, which offered tools for teams to collaborate. The technology allowed the integration of the collaboration and annotation functionalities in the Box' cloud services, as well as displaying documents on websites. In 2015, LinkedIn acquired Lynda.com, an online learning company that helps anyone learn business, technology and creative skills to achieve personal and professional goals. The deal was valued at US\$1.5 billion.

Conclusions and implications

Choosing the freemium business model for an online digital business in fact means choosing to compete in a particular way. Our research suggests that this approach is based on a logical chain of innovation and growth strategies, the freemium-relevant business model elements and the strategic choices, which we present in the article.

Below we summarise the key takeaway points for competing successfully with the freemium business model.

- Offering a service for free does not guarantee a business success, even if the offering is of excellent value. First, from the very launch, the new free product must be tremendously appealing to and desired by the mass market, and it must satisfy an existing or a latent need of potential users. More importantly, this mass market may not only consist of individual users but also of potentially more attractive business customers with higher buying potential.
- Before choosing to compete on a freemium business model basis, it is necessary to evaluate whether your business can pursue the innovation and growth strategies needed. If this strategy is not an option in the long run, then it is worth considering other business model types and configurations.
- The logic of the freemium business model requires not only a constant new user acquisition, but also persistent user retention. The perceived customer value should inherently increase to keep users loyal and increase their switching costs.
- Running the freemium business model in online markets requires a deeper knowledge of users and consumers that goes beyond traditional market research. The knowledge of the consumer behaviour while using the product is crucial for the company's survival. Big data and web analytics are relevant and necessary activities to be performed continuously. They are also highly applicable for identifying and refining the most effective cut-off between free and premium offerings.
- Various forms of product and platform integration allow companies to reach existing and potential users, promote the product, enhance user experience and add value to the offering. To keep the business going, mergers and acquisitions can add additional "bricks" and customers to the business.
- All things considered, the business strategy, the business model configuration and the strategic choices need to be well aligned and continuously reviewed, modified and optimised to build a sustainable business.

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