

The Business of Free

An Analysis of Business Models Based on Chris Anderson's Book, *Free: The Future of a Radical Price*

We are accustomed to the price of things going up

Remember when a cup of coffee cost....?

However, the price of computer processing power keeps going **down**

- In 1961 a transistor cost \$10
- In 1968 it cost \$1
- In 1975 it cost 10 cts
- Today it costs 0.000015 cts....which is pretty close to Free

Also, the cost to Distribute and Store Digital information is **falling even faster** ...and approaching Free

Digital goods can cost so little that they can be priced very very low...what if they can be given away free?

How can giving away your product for free be a good business model?

Free works - Three of the most successful web based products that transform how we work, think and socialize, are free to the user



1.65 Billion users



2.3 million searches per day
\$74.54B in revenues



Survives on donations

The essence of “Free” product is the cross subsidy – an old idea that is being reinvented with digital goods

a cross subsidy is a way to **shift money** (and profits and losses) from one thing to another, or from one period of time to another



The phrase, “There’s no such thing as a free lunch” originated in the 1870’s. U.S. Saloons would offer a free meal with the purchase of a drink. While the cost of the meal was more than the price of a drink, the saloon was betting on customers having more than just one drink.

There are 4 classes of cross subsidy

New economy ideas

Really Free: Supplier does not expect to be paid. Ever

Get someone else to pay:
three-party markets

Get the Basic version Free ...
Freemium models hope you pay for cool upgrades

Strings attached: Get something Free – but only if you pay for something else

Old economy ideas

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Strings attached: Get something Free or below cost – but only if you pay for something else

- Free services, sell products (apple store tech support)
- Free products, sell services (free gift to open bank account)
- Free software, sell hardware (IBM, HP Linux products)
- Subsidized hardware, sell software (videogame console)
- Subsidized hardware, sell add-ons (printer, coffee)
- Free shipping for orders over \$x (online retail)

Old economy ideas

Examples



Open Source
Software



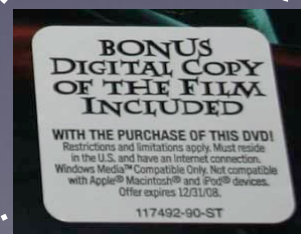
ANDROID

Linux

EXAMPLES

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DRM





When a customer orders a DVR from Comcast, the unit is delivered at a much lower price than Comcast bought it for. According to the pricing structure, Comcast won't break even on the device until the 6th month the customer has it. Profits are made every month afterward.

This analogy is a blueprint for designing business model innovations for brands that make hardware that runs on software.

The logo for Gillette Fusion, featuring the word "Gillette" in white and "Fusion" in blue with a stylized orange and blue circular graphic behind the letter 'o'.

In 1903, Gillette (working as a Salesman) started giving away razor blade handles to people who bought gum, spices, and even marshmallows. What he accomplished was to generate demand for disposable razorblades, since the razors themselves are useless without replacement blades.

After selling billions of blades, the business model is emulated by many industries. (Cell phones, Inkjet printers, Coffee makers, etc.)

This analogy is a blueprint for designing business model innovations for brands that make durable things with proprietary parts.



Open Source Software



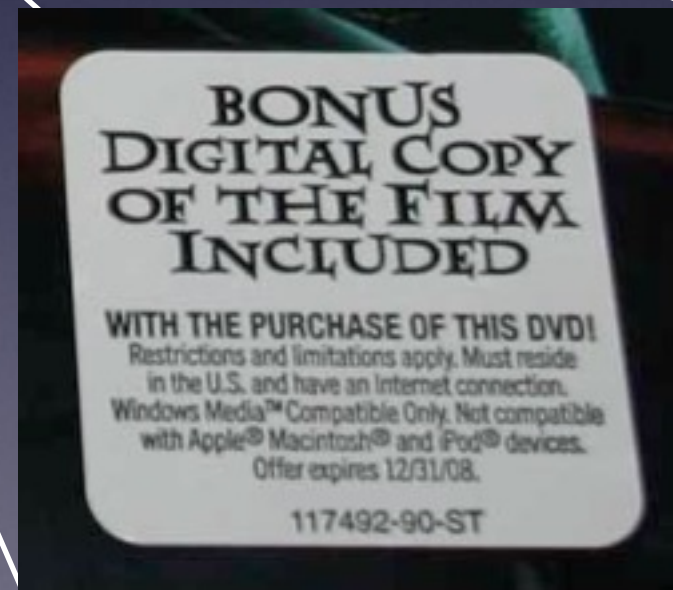
Linux

Open source software started life as “freeware”, and ranged from Operating Systems to word processors. It is built on a license that requires anybody who changes the software to make those changes available to everyone for free. Anyone can distribute the software, but they can’t own it. Android has a 53% share of the mobile device market. most web servers and almost all Supercomputers use some form of Linux.

This analogy is a blueprint for designing business model innovations for brands that Need network effects to grow sales.



In an attempt to cut down digital piracy of movies, many DVDs now come with a code to download a digital copy of the movie. This digital version can be viewed on computers, iPods, and other video devices and reduces incentive to illegally download the film.



This analogy is a blueprint for designing business model innovations for brands that choose to manage digital content with DRM.



In 1906, Upton Sinclair wrote *The Jungle*, exposing the poor conditions of the meat industry. As a result, people had a very poor opinion of hot dogs. Nathan's used to offer medical doctors a **free meal** if the doctors would eat at the restaurant in their white coats and stethoscopes. (The campaign worked on the principle of "If doctors eat our hotdogs, then you know they're good!")

This analogy is a blueprint for designing business model innovations for pharmaceutical and medtech brands

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The difference between the digital economy and the atoms economy is profound: Free samples cost real money in the atoms economy – and are therefore limited. But with zero product & distribution costs for digital goods, the economic model rule is reversed – give away lots! Build cost structure so You can make money with just one paid upgrade per 19 basic give-aways

4 ways to deliver & contain the “Free”mium:

- Time limited: 30 days free, then pay. Salesforce.com
- Feature limited: Wordpress
- Seat limited: Intuit
- Customer Type limited: Microsoft BizSpark is free for companies less than 3 yrs old

5 ways to get the Free”mium”:

- Sell virtual items: Nexon’s Maple Story
- Subscriptions: Disney’s Club Penguin, newspapers/silverware
- Advertising: e.g. in casual gaming
- Sell Virtual Real Estate: Linden Labs
- Sell Merchandise: Webkinz plush toy + game code

Radiohead



Radiohead, an alt-rock band from England, made headlines when they decided to release their seventh album, In Rainbows, for download over the internet at a price that could be set by the user. Some chose to pay nothing, while others chose to pay over \$20. The average price was \$6.

Rather than potentially free pricing hurting sales, the album went on to become the band's most successful, selling over 3 million copies, the box set (retailing for \$80) sold 100,000 copies, and 1.2 million tickets were sold for the following concert tour. Monty Python had a similar experience with online sales.



This analogy is a blueprint for designing business model innovations for brands that want to break traditional distributions and pricing methods.

How Can Healthcare Software Be Free?

Since Nov. 2007, thousands of physicians have signed up to receive free electronic health record and practice management software from San Francisco-based startup Practice Fusion. Enterprise software for medical practices can cost \$50,000. How can one company give away its e-record system at no charge?



-Freemium and Advertising: Tapping the Freemium Model, Practice Fusion offers two versions of his software: a free version with ads (a la Google AdSense) and an add-free version that costs \$100/mo. Only 10% of the first 2,000 doctors opted to pay, but the real revenue lies elsewhere.

-Sell Access to your data: Using free software, Practice Forum attracts a critical mass of physician-users who, in turn, create a growing database of patients. Medical associations conducting research on specific conditions require longitudinal health records for a large set of patients. Each patient's anonymized chart could fetch anywhere from \$50 to \$500.

This analogy is a blueprint for designing business model innovations for brands that make software that will become an integral part of a business.

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3-party markets: someone else will pay for your free stuff

- Usually, an advertiser pays for/subsidizes the cost of your free goods, in the hope that you will buy their advertised product

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How Can Everything in a Store be Free?

- Charge for entry. Only “members” who pay registration and/or annual fees are admitted.
- Charge a “rental” fee for shelf space. Companies can give away products to the store for free and can even pay to keep an item on the shelves.
- Charge for feedback. By offering extra free goods, members can become a focus group.
- Utilize a trade system that bypasses currency.

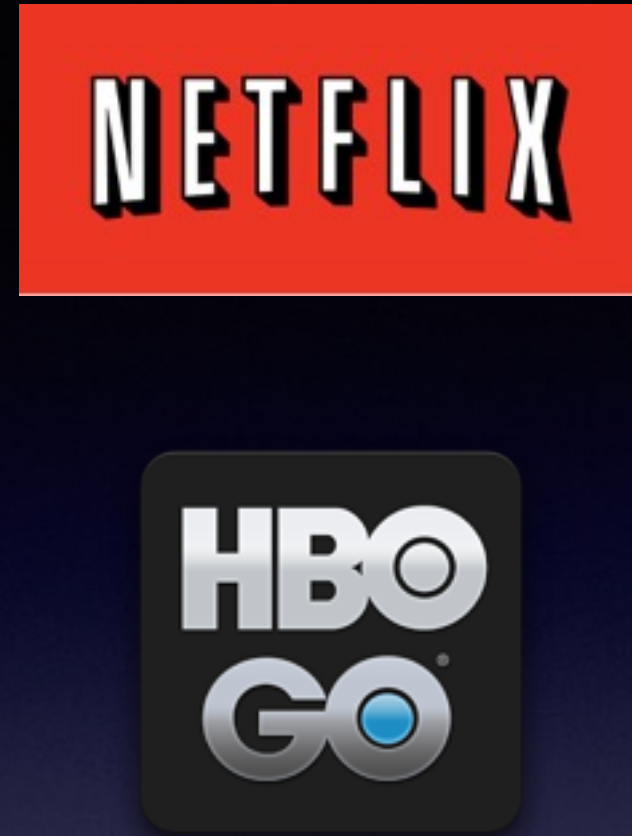
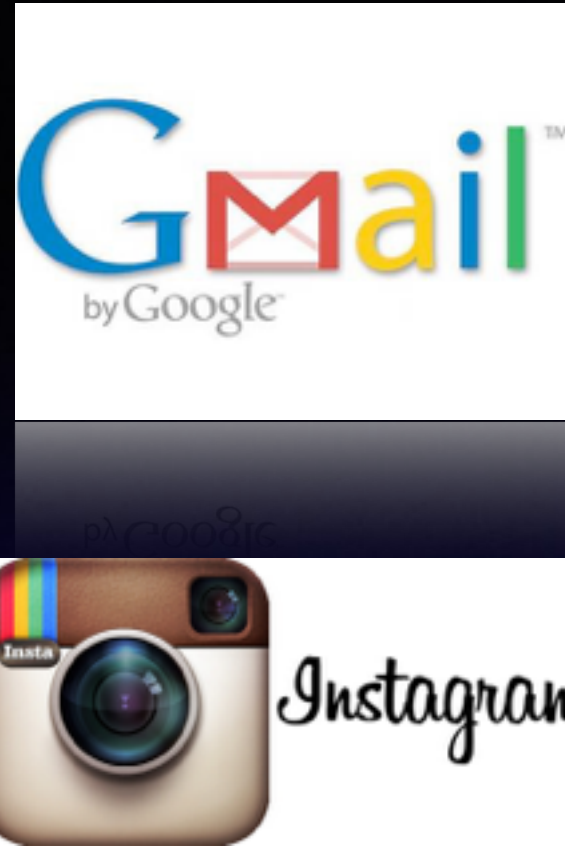
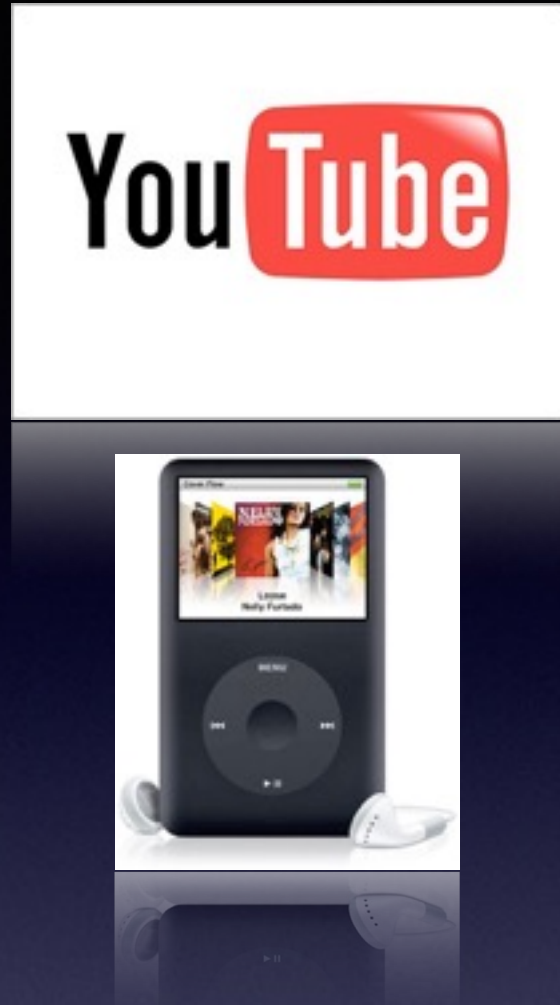


The Yahoo! logo is displayed in a red, stylized, serif font with a registered trademark symbol.The Google logo is displayed in its multi-colored, sans-serif font.

When Google launched its free Gmail service in 2004, Yahoo was charging \$30 a year for a fraction of the storage. (Gmail offered 1 GB of storage vs. Yahoo's 25MB.) By 2007, Yahoo was forced to offer free unlimited email storage as well. However, their revenue per user had fallen to around \$12, while Google was enjoying nearly \$90. Yahoo never recovered their market position.

This analogy is a blueprint for designing business model innovations for brands that can take advantage of the shrinking costs of digital services. (ie- Cloud-based companies)

Abundance



Bandwidth that's so cheap it's not worth metering has brought us many products and services. By “listening to technology” Apple launched the iPod, allowing users to carry an entire music library, thus creating new demand. Similar stories for YouTube, Google, TiVo, and Flickr.

This analogy is a blueprint for designing business model innovations for brands that offer streaming content or social media sharing.

Radio



The dawn of the radio industry started around 1925, and has always been a free service. Since radio commanded such a large audience, advertising seemed to work very well in the medium once national radio networks were created.



This analogy is a blueprint for designing business model innovations for brands that want to offer free content/service to the consumer and make money on advertising or a cross-subsidy

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Gift that gives me a non-money benefit: reputation, feel good factor
Unintentional gift: we are all workers for Google

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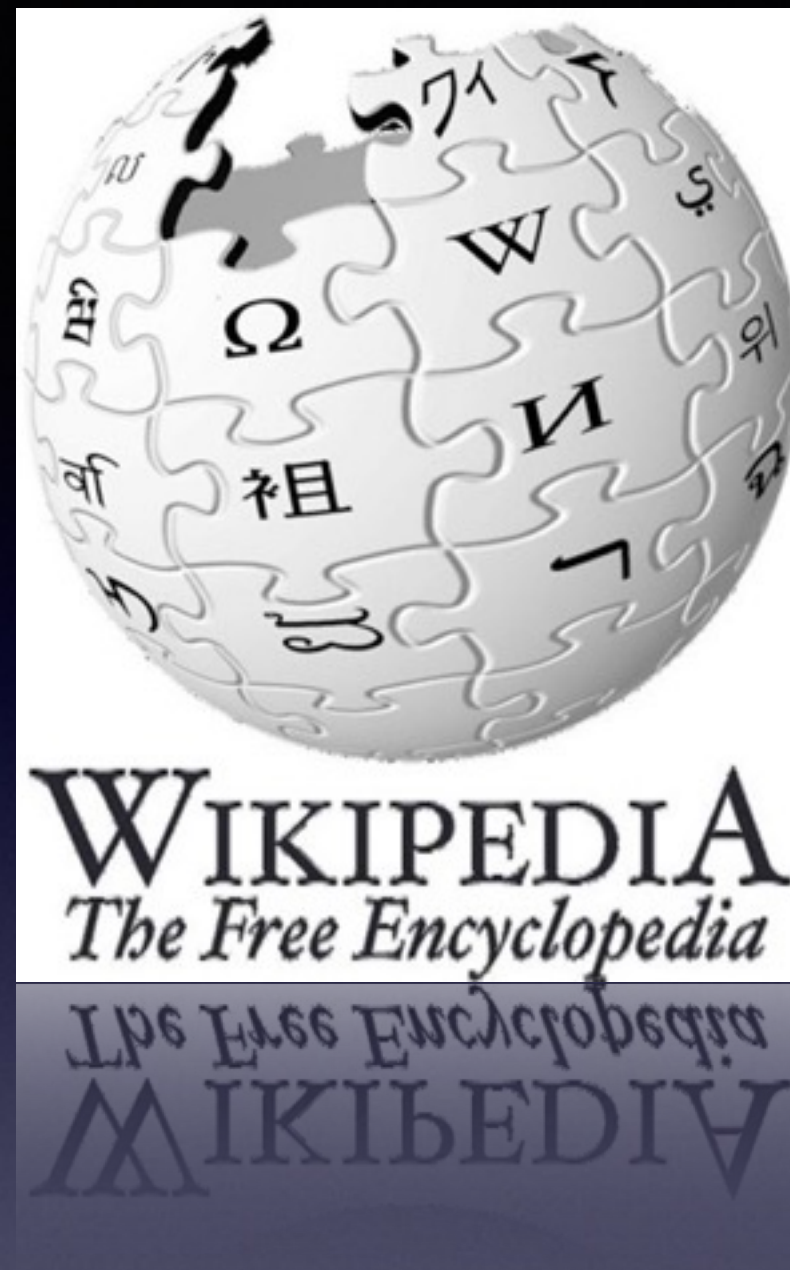
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Wiki



Wikipedia has decimated the printed and disc-based encyclopedia market. (Microsoft killed off Encarta because of it). Wikipedia makes no money, but because it arms us with more knowledge there is a great benefit (and reason to donate) to this massive information resource.

Piracy



Piracy is an *imposed* form of free. It isn't intended by the producer of the product, and is a special form of theft, like downloading media illegally.

Piracy doesn't take anything tangible away from the the rightful owner. This doesn't result in a loss, but *less gain*.



Free as a business concept has created many transformative businesses and will continue to be a driving force for new innovation in the future. By grafting aspects onto existing businesses, new areas of growth can be explored.

Analogy Partners has the experience and knowledge to enable companies to incorporate these aspects into their business models.