Using Free-nomics to Avoid Pipe-ification

Going Beyond Free to Monetize Mobile Cloud Apps & Services

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I. INTRODUCTION

More mobile companies are jumping on the freemium bandwagon. They are offering mobile apps and services for free in an effort to attract large numbers of users. Their use of freemium is intended to eliminate a major obstacle -- cost -- that prevents people from trying something new.

The freemium model is typically viewed by companies that use it as a loss leader or a stepping stone to some other method to monetize users, either direct or indirect. This paper examines several examples of freemium models in use today. It reviews their monetization approaches and discusses what happens when freemium by itself is insufficient to make money. The paper also discusses a major dilemma facing mobile operators, who are battling deep-pocketed competitors who deploy freemium-based mobile services. Should carriers also employ freemium to fight back and if so, how can they make money?

This topic is relevant for mobile marketers, executives and industry participants who are introducing new mobile apps or services and who are considering a freemium approach. It will help them better understand the possibilities for making money by using a freemium model.

Let's start by highlighting some online and mobile companies that employ popular freemium services, such as:

- Google, with free online and mobile search
- Facebook, with free online and mobile social networking
- Zynga, the social gaming company, with free (and paid) virtual goods and currency
- Nokia and Microsoft, with free mobile cloud sync services (Ovi and My Phone, respectively)

What do these services have in common? They are expensive to provide, yet free is core to their appeal. How many of their users would search, post, play social games or sync if they had to pay even a nominal amount, for example, five or ten cents, each time they searched or posted a message? Not nearly as many who do something that is free. Some studies have shown that there can be 10 to 30 times the number of people who are willing to use a free service versus a paid version.

Note that some might argue that many people are willing to pay a nominal fee for some mobile services, such as SMS (text) messages, which means that freemium is not that important. However, SMS should be viewed a special case because it used to cost more than it does now. When SMS became cheaper, its usage pattern followed a typical demand curve where many people increased usage because it cost less. One tenet of free-nomics is that if people are used to paying for something and it becomes cheaper or free, that is usually perceived as a good value and leads to more usage. On the flip side, when people are used to getting something for free, or someone else offers the same thing for free, it is very difficult if not impossible to charge for it. This is one reason to not initially offer something for free, because it can lower the perception that people have of it, as many people believe that 'you get what you pay for'.

Furthermore, if a mobile app or service is introduced as a paid offering, there is additional room to maneuver in terms of being able to lower or temporarily discount the price, but it is virtually impossible to raise the price of a free app or service, unless a premium or ancillary version is introduced.

The use of a freemium model raises several important business questions , such as:

- What happens when users become so accustomed and conditioned to free that they resist paying for things altogether -- how are companies left to make money? Are companies that use a freemium model cutting off their nose to spite their face, or are they employing a necessary-evil survival tactic?

- Companies that employ freemium models often attempt to make money by 'nickel-and-diming' users. A familiar example in the offline world today are airlines, where it seems that for virtually anything beyond a seat, there is an extra charge, for checked bags, seat selection and meals. Are people ultimately going to grow tired and rebel against nickeling-and-diming, or is unbundling a harbinger of the future for the pricing and packaging of mobile apps and services?

- When is the use of a freemium model considered to be predatory pricing such that it becomes anti-competitive and worthy of government intervention? For example, one might argue that many Google services, such as Gmail, which have a reputation as a loss leader, are subsidized by Google advertising. Given Google's deep pockets, is it right that they continue to offer Gmail at a loss, which stifles competition ("thins the herd") until most other providers are driven out of the market, whereby Google could then have its way with users (despite their corporate credo of 'do no evil')?

  As a point of reference, it was not too long ago when Microsoft was forced to unbundle Internet Explorer from Windows because they were presumably suppressing browser competition. Is Google's subsidy of its non-search services really that different? Should Google (and others with quasi-monopoly share and deep pockets) be able to wield freemium pricing to unfairly dominate markets, especially markets that are still developing (such as many "micro-markets" for mobile apps and services)?

Regardless of one's beliefs concerning these questions and free market economics, freemium has become entrenched as a popular mobile business tactic. If you are interested in learning more about freemium, the book, "Free: The Future of a Radical Price", offers many useful and interesting insights.

II. PIPE-IFICATION OF MOBILE OPERATORS

Recently, one of the world's largest mobile operators was considering deploying a mobile email service. They were trying to determine how to price the service as well as how much they were willing to pay to provide it. They asked, "Why should we even offer mobile email? Any user with a smartphone can get it for free." They were referring to the situation that on most smartphones today, users can get email from many systems without paying extra. Phone manufacturers have embraced a freemium model for mobile email to level the playing field against other email providers.

From a user's point of view, the carrier has a valid point. Why should users pay for something they can get for free? Unless there is significant added value, there is no reason to pay for something that people perceive as free and can get for free (assuming they can figure out how to get it without paying).

From a carrier's point of view, however, what are they to do? Should carriers passively sit back and watch companies such as Nokia, Google, Microsoft and others offer free mobile services to their users? Carriers might think that this is only mobile email, but email is just the proverbial tip of the iceberg. These mobile companies are 'upping the ante' by offering additional free services such as mobile cloud sync, social networking, maps, apps, VoIP and more. They are even starting to encourage users to go around carriers e.g. by using VoIP services such as Skype on their cell phones over wifi.

Will carriers like this? Although this may reduce their costs and offload their mobile networks in the short term, it also reduces their relevance and starts people down a slippery slope of thinking, "hmm, do I even need my carrier that much anymore? Not so much." Look at people who are cutting the cords to their landlines. What happens if and when wifi and other broadband networks become so pervasive, or subsidized, that people start wondering if they really need a $40 or $100 monthly mobile bill.

By not offering comparable free mobile services, it starts to marginalize carriers' relevance and role in the value chain to that of dumb pipe-ification. Imagine if you were a carrier today and did not offer voicemail, or you tried to charge extra for it, would subscribers go for that? Of course not. The same will be true of many other mobile services in the not-too-distant future.

Carriers can stick their heads in the sand and hope that free mobile services won't affect them much. But forward-looking people see the writing on the wall -- the spoils will go to companies like Google that experiment with and determine how to monetize users via a freemium approach. If carriers do not become proficient with a freemium approach, they will lag further behind and maybe never catch up.

Put another way, do carriers really just want to become a dumb pipe, which means they had better be the most efficient and lowest cost provider, or do they want to be more than that e.g. a provider of value-added mobile services and content? Either strategy is fine as long as you have the right company culture and cost infrastructure behind you. Is your company poised to succeed as the low cost leader?

To sum up, the carrier was right, it is very tough to compete with free. But in most cases, the alternative, of not competing, is worse. Here are some things that carriers can do about this.

III. MOBILE CLOUD FREE-NOMICS

Over the past two years, several large companies in mobile have used a freemium model to offer mobile cloud sync and push email services. For example, Apple MobileMe is free for 60 days, then charges $99 a year. Some industry observers believe that because Apple charges for MobileMe after the trial period, and because users think they can get comparable services otherwise for free, MobileMe's number of users has plateaued and MobileMe is not on a high growth trajectory. (At the same time, there is a rumor that Apple is securing additional data center resources and may be planning to reduce MobileMe pricing or even make it free to compete with similar services).

Google Sync provides a free way to sync contacts and calendars with some smart and feature phones. Power users of Gmail with a supported phone and data plan are likely to use Google Sync because it is free. Nokia Ovi syncs a wide range of mobile data and content for free for many Nokia phones, as does Palm Synergy for Palm Pres and Microsoft My Phone for Windows (Mobile) Phones. A recent market entrant is Vodafone, one of the world's largest mobile operators, with their free 360 service that syncs six phones, with more phones coming soon. These freemium mobile cloud sync services are compared in Table 1.

Service	Freemium Model	Storage Limit	Monetization Strategy
Apple MobileMe	Syncs contacts, calendar, photos and email for free for the first 60 days.	- Individual subscription: 20 GB file storage and 200 GB monthly data transfer - Family subscription: individual 20 GB storage + 5GB for each family member (max. 4) - Additional extra storage: up to 40 GB	- Individual subscription: $99/year - Family subscription: $149/year - You can also buy up to 40 GB of extra storage
Google Sync	Syncs contacts, calendar and email completely for free	Unlimited storage	Makes money from advertising on other Google services
Nokia Ovi	Syncs contacts, calendar, email, photos, social network info and other content completely for free	Unlimited storage	- Customer retention (more likely to buy another Nokia phone) - Nokia Ovi store has premium/paid content

Table 1 (continued on next page): Comparison of freemium mobile cloud sync services

Service	Freemium Model	Storage Limit	Monetization Strategy
Vodafone 360	Syncs contacts, calendar, email, photos, social network info, and other content completely for free	7 GB storage available	- Customer retention (Vodafone 360 branded phones offer the best Vodafone 360 experience) - Vodafone 360 store offers premium/paid content
Microsoft My Phone	Syncs contacts, calendar, email, photos and other content completely for free	200 MG storage available	After your phone is misplaced or stolen you can activate My Phone Premium Features that help you to locate, lock and erase your phone. It is free the first time that you use it. Then the cost is $4.99 per use.

Table 1 (continued from previous page): Comparison of freemium mobile cloud sync services

Let's review the ways that these companies strive to make money using a freemium model.

Apple -- after a free 60 day trial, they charge $99 a year. Apple also has the iTunes store and makes money from selling premium content (and mobile devices, of course).

Google -- free with no stated method to charge. The implication is that if people use Google Sync to sync their contacts and calendar, they will be more likely to use Google services and increase traffic for Google advertising.

Nokia -- free with no stated method to charge. The implication is that if people use Ovi to store their mobile data and content in the Nokia cloud, this greatly raises the switching cost for users because it is virtually impossible to sync Nokia cloud data with a non-Nokia device. Also, Nokia is following Apple's lead with the iTunes store by offering premium content in the Nokia Ovi store. And of course, Nokia sells mobile phones so Ovi is subsidized by their revenue.

Palm (not included in table) -- Palm, like Nokia, does not charge for their Palm Pre Synergy solution. Instead, they monetize it by providing a value added service that attempts to lock users in. For example, when a user loses a Pre or considers upgrading to a new model, it is seamless to get all of their cloud data and content back on their new device.

Vodafone -- no charge for the service but offers premium content and apps in the Vodafone 360 store.

Microsoft -- when users lose their phone, they can pay $4.99 for an optional service that helps them locate it and erase their old phone's data (which is similar to a free service offered by a recent version of iPhone).

To sum up, these companies employ multiple loss leader methods to monetize freemium mobile cloud services, as follows:

- try-then-buy (Apple)
- premium content (Apple, Nokia, Vodafone)
- premium and ancillary services (Microsoft)
- advertising (Google)
- selling hardware/mobile phones (Apple, Nokia, Palm)
- lowered cost of customer retention (Nokia, Palm)

IV. FUNAMBOL EXPERIENCE

The evolution of the mobile cloud sync market has been a boon for Funambol as it has forced companies who provide mobile services or who are considering providing them to decide if they should offer mobile cloud sync. Many have decided that they need to, to be innovative or competitive.

Once these companies decide to offer mobile cloud services, their next decision is whether they should build a solution or if not, which one should they buy. Given that Funambol and our open source community has spent the equivalent of about $50 million developing our mobile cloud sync solution, it makes much more sense for companies to buy a solution than build one, especially as time to market is critical. Many of these companies come to understand the value and advantages of an open source approach, such as its broadest mobile device compatibility and flexibility.

The result is that many companies are racing to offer a mobile cloud sync solution to avoid being dumb pipe-ified and competitively disadvantaged. However, when it comes to deploying the service, these companies face the same question as the aforementioned carrier -- how do they compete with free?

Funambol has begun suggesting to customers that they employ a hybrid approach that combines the best of freemium -- for widespread, viral user adoption -- with an approach that generates a solid revenue stream to monetize freemium users. Here's how it works.

Funambol can host our solution for customers so that it can be quickly deployed to their users (with the customer's branding and look-and-feel). There is no cost for users to sync their mobile phones with the customer's cloud, or to sync their other online information such as PIM data, email or social network content with their phones. By making all of this free, this removes cost as a barrier for users and encourages people to try and use the service. This greatly increases the relevance of the customer to their user base.

How does this freemium approach make money? The only time people pay is when they lose their phone or get a new phone and they want to sync their data and content back to their new device. In this scenario, they can pay an optional, nominal fee. Although advanced users may be able to figure out a way to avoid paying, our research has shown that many people are willing to pay a convenience fee to quickly get their information back on their new phone. In many cases, when people lose their phone, they are relieved to find out that their old information is available and they are more than happy to pay. In some cases, for high value subscribers, our customers may opt to hide the convenience fee and pay it on their behalf of their subscriber as part of their retention cost.

From the user's viewpoint, they gain a valuable free service. The only time they optionally pay is once in awhile and many people do not mind paying because they recognize the value they receive, even if they could possibly use an alternative free service.

Consider the revenue and costs of this approach for a mobile provider with five million users, as displayed in the financial model of Figure 1. The model makes conservative consumptions for the percentage of people with a data plan (and hence are potential sync users), that would sync (versus not sync for whatever reason), that would have cause to sync their data and content back to a new device (because they lost their phone or got a new one, based on industry averages) and that would "convert" i.e. that would pay a convenience fee to sync back to a new device. The model also makes conservative assumptions about the cost of hosting the solution in a cloud and performing related support activities.

The model shows that once a breakeven number of users is reached, which happens in the first 60 days, this can be a profitable service. It is relatively risk-free, as the service can be hosted and startup costs can be shared. There is little upfront cost and high revenue potential. The model projects net revenue (exclusive of operating expenses) of about $5 million, or $1 per user, by the end of three years. It projects several $million of net revenue every year afterwards due to the critical mass of syncing users.

In addition to the financial aspects, this freemium approach is a defensive move that prevents users from experimenting with and getting hooked onto someone else's service. It lays the foundation for additional revenue bearing services. For example, Funambol is working to generate additional revenue for our customers by leveraging a mobile ad-funded approach that offers incremental revenue. Additional revenue such as that from mobile advertising or premium content are additional ways to monetize freemium users and is a "bonus".

Premium transaction price	$10		SUMMARY		Year 1	Year 2	Year 3	3 Year Total				
			Gross revenue		$272,178	$1,377,705	$4,133,976	$5,783,859				
			Cost		$77,344	$148,393	$226,862	$452,599				
			Net revenue		$194,834	$1,229,312	$3,907,114	$5,331,260				
YEAR 1												
Month	1	2	3	4	5	6	7	8	9	10	11	12
Total Subscribers	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
% with data plan	20%	21%	22%	23%	24%	25%	26%	27%	28%	29%	30%	31%
Potential syncing subscribers	1,000,000	1,050,000	1,100,000	1,150,000	1,200,000	1,250,000	1,300,000	1,350,000	1,400,000	1,450,000	1,500,000	1,550,000
% of above that are 'free syncers'	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%
Actual # of free syncing users	50,000	63,000	77,000	92,000	108,000	125,000	143,000	162,000	182,000	203,000	225,000	248,000
% potential paid transactions	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%
# of potential paid transactions	3,000	3,780	4,620	5,520	6,480	7,500	8,580	9,720	10,920	12,180	13,500	14,880
Conversion rate	20%	21%	22%	23%	24%	25%	26%	27%	28%	29%	30%	31%
Conversion # of transactions	600	794	1,016	1,270	1,555	1,875	2,231	2,624	3,058	3,532	4,050	4,613
Gross revenue generated per month	$6,000	$7,938	$10,164	$12,696	$15,552	$18,750	$22,308	$26,244	$30,576	$35,322	$40,500	$46,128
Cost	$6,017	$6,079	$6,146	$6,217	$6,294	$6,375	$6,460	$6,551	$6,646	$6,747	$6,852	$6,961
Net monthly revenue	-$17	$1,859	$4,018	$6,479	$9,258	$12,375	$15,848	$19,693	$23,930	$28,575	$33,648	$39,167
YEAR 2												
Month	13	14	15	16	17	18	19	20	21	22	23	24
Total Subscribers	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
% with data plan	32%	33%	34%	35%	36%	37%	38%	39%	40%	41%	42%	43%
Potential syncing subscribers	1,600,000	1,650,000	1,700,000	1,750,000	1,800,000	1,850,000	1,900,000	1,950,000	2,000,000	2,050,000	2,100,000	2,150,000
% of above that are 'free syncers'	17%	18%	19%	20%	21%	22%	23%	24%	25%	26%	27%	28%
Actual # of free syncing users	272,000	297,000	323,000	350,000	378,000	407,000	437,000	468,000	500,000	533,000	567,000	602,000
% potential paid transactions	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%
# of potential paid transactions	19,040	20,790	22,610	24,500	26,460	28,490	30,590	32,760	35,000	37,310	39,690	42,140
Conversion rate	32%	33%	34%	35%	36%	37%	38%	39%	40%	41%	42%	43%
Conversion # of transactions	6,093	6,861	7,687	8,575	9,526	10,541	11,624	12,776	14,000	15,297	16,670	18,120
Gross revenue generated per month	$60,928	$68,607	$76,874	$85,750	$95,256	$105,413	$116,242	$127,764	$140,000	$152,971	$166,698	$181,202
Cost	$11,076	$11,195	$11,319	$11,448	$12,402	$12,540	$12,683	$12,831	$12,984	$13,141	$13,303	$13,470
Net monthly revenue	$49,852	$57,412	$65,555	$74,302	$82,854	$92,873	$103,559	$114,933	$127,016	$139,830	$153,395	$167,732
YEAR 3												
Month	25	26	27	28	29	30	31	32	33	34	35	36
Total Subscribers	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
% with data plan	44%	45%	46%	47%	48%	49%	50%	51%	52%	53%	54%	55%
Potential syncing subscribers	2,200,000	2,250,000	2,300,000	2,350,000	2,400,000	2,450,000	2,500,000	2,550,000	2,600,000	2,650,000	2,700,000	2,750,000
% of above that are 'free syncers'	29%	30%	31%	32%	33%	34%	35%	36%	37%	38%	39%	40%
Actual # of free syncing users	638,000	675,000	713,000	752,000	792,000	833,000	875,000	918,000	962,000	1,007,000	1,053,000	1,100,000
% potential paid transactions	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%
# of potential paid transactions	51,040	54,000	57,040	60,160	63,360	66,640	70,000	73,440	76,960	80,560	84,240	88,000
Conversion rate	44%	45%	46%	47%	48%	49%	50%	51%	52%	53%	54%	55%
Conversion # of transactions	22,458	24,300	26,238	28,275	30,413	32,654	35,000	37,454	40,019	42,697	45,490	48,400
Gross revenue generated per month	$224,576	$243,000	$262,384	$282,752	$304,128	$326,536	$350,000	$374,544	$400,192	$426,968	$454,896	$484,000
Cost	$17,642	$17,818	$18,000	$18,186	$18,376	$18,572	$18,772	$18,977	$19,187	$20,223	$20,442	$20,666
Net monthly revenue	$206,934	$225,182	$244,384	$264,566	$285,752	$307,964	$331,228	$355,567	$381,005	$406,745	$434,454	$463,334

Figure 1: Financial model of service provider with five million subscribers

Of course, for your mobile apps and services, "your mileage may vary", depending on several factors. The point is that this approach appears to be a viable way to monetize freemium users. If you are interested in how this model would apply for your situation, contact Funambol for a customized model based on your circumstances.

The Funambol and other examples illustrate that there are many ways to monetize freemium users. Even though people may be conditioned to view and use a service for free, there are several ways to provide a basic free service and make money in the process.

The Funambol example may also appear to be another example of 'nickel-and-diming' people. However, viewed another way, many people do not mind paying for something when it improves their life and they perceive that they receive good value in exchange, which is another tenet of free-nomics. Although many people believe that "you get what you pay for", many also understand that there is "no free lunch" and that if they are using a valuable, free service and they are presented with a compelling offer, such as getting back their lost or stolen mobile information for a nominal cost, it is worth it.

V. SUMMARY

Freemium pricing has become a mainstay of mobile apps and services. When competing against a "free" alternative, rather than believe there is no way to make money, this paper provides several examples of freemium approaches that generate revenue. It also shows that while a pure freemium model may be unsustainable, there are numerous options to make money.

An important insight of this paper is that when planning your next mobile app or service, you should ensure that you have the flexibility to package and price it according to the conditions of your market. For example, maybe you want to allow users to get part of an app or service for free but then charge for the rest, or to monetize them some other way. Whatever monetization approach you choose, you should make sure that your underlying technology platform can support it.

VI. ABOUT FUNAMBOL

Funambol is the leading provider of open source mobile cloud sync and push email for billions of devices. Funambol open source software has been downloaded over three million times by 50,000 developers in 200 countries. This helps Funambol provide the broadest mobile device compatibility. The commercial version of Funambol has been deployed by many of the largest device manufacturers, mobile operators, portals, service providers and ISVs in the world, including AOL, 1&1, EarthLink and CA. Funambol is headquartered in Redwood City, California with R&D in Europe. For more information, please visit http://www.funambol.com. You can also follow Funambol on Twitter at http://twitter.com/funambol.

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