ProfitWell™

THE FREEMIUM MANIFESTO

Free Premium

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2018

Chapter 01

THE BIRTH OF FREEMIUM

PRICING MODELS NEVER MADE HEADLINES UNTIL FREEMIUM CAME ALONG.

Praised as the fuel for rapid growth of companies such as Dropbox, Spotify, and Evernote, and lambasted as the reason smaller companies went bankrupt, freemium has piqued the interest of developers and CEOs who hope to get as many people possible hooked on their products.

Freemium is Free + Premium: a good or service that can be offered for free, but ramps up to include premium features that cost money. The concept is basic and widespread: entice enough curious people, accept some early losses, and win over a few remunerative customers for life. An ice cream truck offers free samples; some people stop by to try a flavor, some just take a bite and leave, and others buy large cones for the whole family every summer for generations. Often the path to buying software is not as direct as ordering soft-serve. We want to clear the air about freemium and its place in the SaaS landscape.

We'll look at why it works, what happens when it breaks down, how profitable companies have made it fit into their longterm goals, and what the future holds.

This is our Freemium Manifesto—what we consider the right way to do freemium.

Ad for Ben & Jerry's annual free cone day. [source]

Consider this guide the final word on how to make freemium work in SaaS from the people that have seen inside more SaaS companies than anyone else. Freemium does have its pitfalls, but done right it can work beautifully to get users into your ecosystem and on the path to upsell. To start us off in this first chapter we want to see where it all started. Let's look at why companies started offering products and services for free.

FREEMIUM IN ITS INFANCY: 1982-2000

The freemium model as we know it now can be traced back to the early eighties, gaming culture, and a few press-savvy developers.

FREEWARE AND SHAREWARE

In 1982, an editor at PC Magazine, Andrew Fluegelman, wrote a communications program called PC-Talk. It was a great little program. PC Magazine, perhaps unsurprisingly given its editor, said PC-talk "is elegantly written and performs beautifully. It is easy to use and has all the features I would expect from a communications program."

But the interesting thing about PC-Talk wasn't the software, but the way it was sold. Or rather, the way it wasn't sold. Fluegelman distributed the program via a service called Freeware. Anyone who sent him a disk in the mail would receive the program in return, and could copy the disk for friends. If they liked it, they could mail Fluegelman $25.

He called this

> *"an experiment in economics more than altruism."*

Though slightly different to the model we see today, freeware incorporated the fundamental tenet of freemium: only pay when you get value. If you never liked PC-Talk, you were free to have it for free (minus shipping and handling).

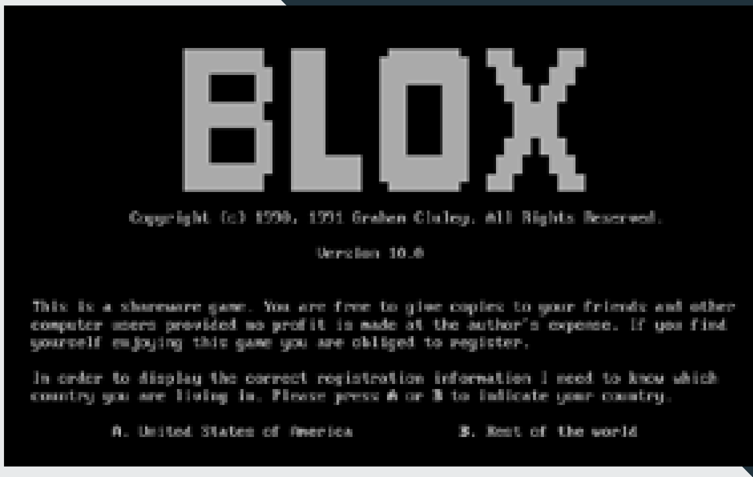
Around the same time, IBM developer Jim Knopf created a program he named PC-File, and followed the same model. He observed,"Here was a radical new marketing idea, and the computer magazines were hungry for such things to write about," he explained. The result:

> *"much free publicity for PC-File."*

Fluegelman and Knopf had uncovered the essential nature of freemium: it's a marketing strategy first and foremost.

Where utilities went, games followed. Freeware's model was embraced by gamers who were eager for others to try out their creations. Indie developers mailed floppy disks of games called shareware for other enthusiasts to try out. These disks were later aggregated into catalogues and larger disks for distribution.

Shareware fit into the gaming culture of good will, knowledge-building, and collaboration that was in tandem with the growing open-source development movement (though it's important to note that both freeware and shareware do not make source code available). It's doubtful that software would be as advanced as it is today without those who made their products free.



Screens from Blox and Crux, shareware games created for MS-DOS [source]

These DOS games and applications allowed anyone to try them for free. More than that, they had perpetual value. In this sense, they were truer to the real idea of freemium than a lot that came afterwards. PC-Talk, PC-File, Blox, and Crux gave you access to free software and games forever. Unfortunately for their inventors, they hadn't really figured out the upsell.

THE RISE OF THE INTERNET

In 1995, journalist Esther Dyson asked an important question about the burgeoning web:

> *"What new kinds of content-based value can be created on the net?"*

Dyson observed that as the web becomes populated with all kinds of content including executable software, business data, and entertainment, games, and news, intellectual property will depreciate in value. "The likely best defense for content providers," she argues, is "to distribute intellectual property free in order to sell services and relationships."

Boom! In that one sentence Dyson created the most prolific business model of the next two decades: freemium. Distribute some IP for free to get people to pay for something else.

But even by 1995, one company was already making significant headway with this idea. Give a little away in the short term to get a lot back later: AOL. Anyone over a certain age will remember opening their mailbox one morning in the mid 1990s to find an unsolicited disk. It's free, it's easy, it's fun—it's America Online.

The USPS dropped millions of AOL disks in mailboxes around the country, as other postal services did worldwide. Each disk contained a few hours of free time online for users to spend emailing, chatting, and reading the news. Just long enough for you to get hooked on the world wide web. AOL's stunt was so memorable and prolific that the disks are now on display in the Smithsonian.

THEN CAME THE UPSELL.

After your 15 hours were up (in the early days, as they transitioned to CDs, you got 1,000 hours free for 45 days!), you had to start paying at about $14/month for continued access. But it worked. From 1992 until 2002, the number of AOL subscribers grew 125X, from 200,000 to 25,000,000.

It worked because AOL had the unit economics done. Though they spent over $300M on disks and CDs, their LTV:CAC ratio was 10:1.

AOL employed the shareware method to bring its suite of services to the mass market in the early days of internet growth. Unlike shareware, however, the disks contained an expiration date, and were not copyable. This isn't yet freemium. Now there is the upsell, but no perpetual value. This model would also become common in SaaS—the free trial.

BOOM AND BUST: 2006-2017

Fast forward to the mid-aughts. Dyson's projections prove accurate, and the web is saturated with free content. Bundled service providers like AOL have phased out and cloud-based subscription services are enjoying their time in the sun.

Enter Software-as-a-Service. The smartest SaaS providers realized early on that it's not enough to build a product that is novel or useful; the most valuable products need to have compounding value over time, built-in network effects, and a high-performing infrastructure. Even so, people still expect all kinds of online content, including services, to be free. At least, at first. wVenture capitalist Fred Wilson notices a trend among fast-growing SaaS companies and extols the method on his blog:

> *"Give your service away for free, possibly ad supported but maybe not, acquire a lot of customers 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."*

Wilson calls it his favorite business model, and points to examples such as Skype, Flickr, Trillian, Newsgator, Box, and Webroot as paradigms. At the end of the post, Wilson says:

> *"I would like to have a name for this business model. We've got words like subscription, ad supported, license, and ASP, that are well understood. Do we have a word for this business model? If so, I don't know it."*

Thirty-three comments and much debate later and Jared Lukin, then of Alacra, wins with his term for this business model: Freemium.

At the time, these companies all had seen explosive growth at one point or another. And in pre-recession Silicon Valley, growth-at-all-costs was trendy. Wilson, like other VCs at the time, was impressed by large usage numbers and less concerned with monetization.

Profits would follow, they assumed, once developers and marketers got everyone and their friends using their products.

Let's look back at the companies listed by Wilson to see what their business models were then compared to now:

Skype: basic in network voice is free, out of network calling is a premium service. Acquired by Microsoft in 2011, Skype basically still operates on the same freemium model. You can make Skype-to-Skype calls for free, but have to pay to call regular phones. Skype for business is $5/user/month.

Flickr: a handful of pictures a month is free, heavy users convert to Pro. Again, the same model for the most part.

Trillian: the basic service is free, but there is paid version that is full featured. There appears to still be a free version of Trillian for personal use, but the company doesn't want you to know about it. If you go to the Trillian pricing page, it defaults to business pricing with the lowest price for business users being $2 per user per month.

Newsgator: the web reader is free. If you want to synch with outlook and your mobile phone, that's a paid service. Newsgator is gone. What was an RSS aggregator in 2006 is now an internal messaging...

app for your company in 2017, called Sitrion. Either way, freemium is gone along with all self-serve pricing on the page. Now you have to contact the sales team to even see the product.

Box: you get 1gb of virtual storage for free, but you have to pay for more than that. You can still get storage for free as an individual with Box, and they've kept with the times upping the limit to 10GB. There is no freemium for the business version, only a 2-week free trial for your team.

Webroot: you can get a free spyware scan, but for full protection you need to pay. Freemium has gone for both home and business use. The smallest plan is now $29.99 for one device for one year.

From those six companies:

- 2 look the same, with freemium option intact | (Skype, Flickr)
- 2 have freemium, but are hiding it (Trillian, Box)
- 2 have removed the freemium option altogether (Newsgator, Webroot)

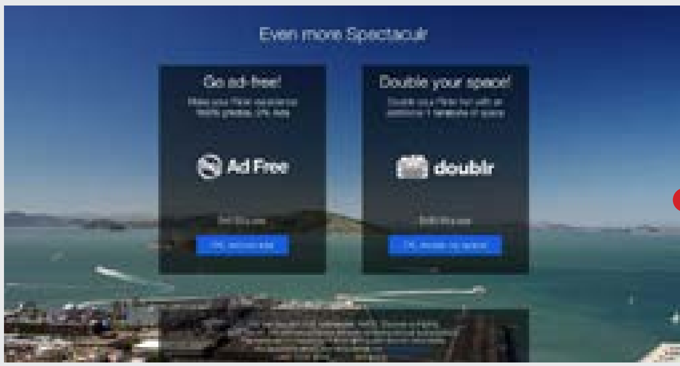
Over time, while many of these companies successfully expanded their network effects, others have obviously struggled to find a freemium structure that's sustainable. Two companies that were the doyen of the freemium movement, Flickr and Evernote, typify the struggles that this model can elicit.

FLICKR'S PRICING TRIP

Flickr's pricing now looks the same as 2006, but their pricing structure has changed time and again over the last decade to find a happy medium between revenue growth and user growth.

As other photo services have gained traction. Acquired by Yahoo! in 2005, Flickr was the first social platform based around photos, Flickr has struggled to add value to its core product. It started as a free product with an option to upgrade if users wanted to upload more than 1GB per month. While still in beta, they switched the pro plan to $24.95 annually and added another GB for uploads, which stayed more or less the same for several years. Over time, Flickr experimented with allowing free users to only upload photos that were up to 10 MB in size, or up to 20MB. They limited the number of photostream items to 200. In May 2013, Flickr moved almost completely to an ad-supported model. Most pro features were made available in the free plan.

Legacy pro users could keep their accounts, and there were still upgrades, but they were vastly more expensive and largely unnecessary, even for power users. [Source]



Flickr in 2013. [source]

These changes were unpopular with users, and a new pro plan was reinstated in 2015. The Flickr upgrade page now looks like this:

The new pricing page shows a clear difference between the plans, with notable value-adds for power users, and prices that are simple and gimmick-free. However, it may be too little, too late, for fed-up customers. [source]

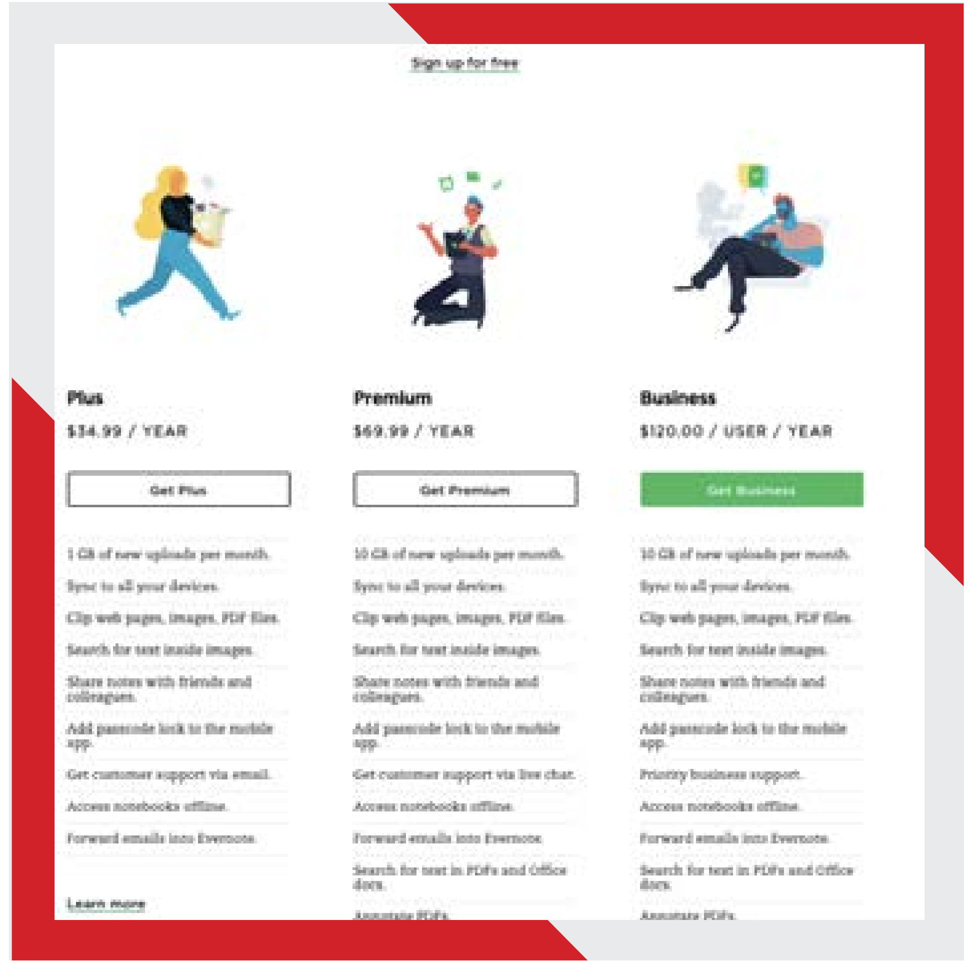
One of the problems with Flickr's pricing changes is the way they took away previously available features. This led to users getting annoyed by paying for things they expected to be free. In some cases, when users stopped paying, Flickr would hold photos "hostage," until the pro fee was paid.

In 2015 Flickr released the Auto Uploadr, a to ol that allowed users to upload batches of photos, among other things. By 2016, the tool was restricted to paid users. Wired said the move felt "a bit like ransomware."

By that time, Flickr was no longer the best and only photo-sharing site, and competitors such as Google Photos, 500px, and Instagram offered the same functions for free, with no threat of removing them.

EVERNOTE'S LACK OF FOCUS

Evernote was another product that spread like wildfire in the mid-2000s. When it launched as the first cloud-based notes app during the recession in 2008, its founders didn't raise much venture capital. Instead they relied on word of mouth referrals, the opening of the App Store, and freemium to grow to 75 million users and a valuation of $1 billion by 2013. In a 2011 talk, former CEO Phil Libin called his customers his marketing team and said, "The easiest way to get a million people to pay for nonscarcity product may be to make 100 million people fall in love with it." In 2014, they surpassed that 100 million mark.



Evernote has a beautifully laid out pricing page, but most users don't even look at it. [source]

However, as Libin proudly noted, they have pursued a conversion rate that hovers around 1%. They continue to put enormous effort into their products, and yet millions of people don't see a need to upgrade. A 2015 Business Insider article shows why:

> *Instead of focusing on its core note-taking product and on converting users to the paid service, Evernote spent more time releasing a bunch of new products and features that only helped it grab news headlines.*

Despite 150 million users at the time, Evernote had to lay off 18% of the workforce and close 10 offices. While the management team focused on partnerships with Post-it Notes and Moleskine, the actual product became secondary.

Ironically, the Evernote team was pursuing a strategy that can work beautifully. Upsell other products adjacent to your core product. This way, Evernote can increase revenue not just from their 1% conversions, but also from free users who want a nice leather-bound notebook for their written notes.

But in doing so, they forgot two things:

- Continuing to offer the core value through the app to dedicated users
- To understand their customers and what really drives them to use Evernote

Users didn't want a nice notebook, they wanted a working note app. They also didn't need to be sold on minor improvements. Rather, Evernote needed to emphasize what kept them ahead of all other cloud-based note-taking apps, and what value they offered to loyal customers — for instance, could they use machine learning to predict what you might want to write as you continued to jot things down over the years? Had Evernote made the core product more valuable to paying customers, they might not have struggled with revenue.

THE FUTURE OF FREEMIUM

It seems that freemium, like freeware, is still an experiment in economics. Just like freeware and its descendants dovetailed, freemium and free trials are now becoming distinct models. Free trials are more like advertisements — they offer a test-drive to those who need an interactive experience to be convinced. Freemium is about creating value from the start via personalized pricing tiers for specific user profiles.

And when done right, freemium allows a company to monetize properly. By gaining a greater understanding of its position within an industry, a freemium company can maximize its longterm value while reducing customer acquisition costs.

As an understanding of the freemium model has evolved, the SaaS sector has realized what doing freemium right means: getting to know your customers first and continuing to offer perpetual value whichever plan they are on.

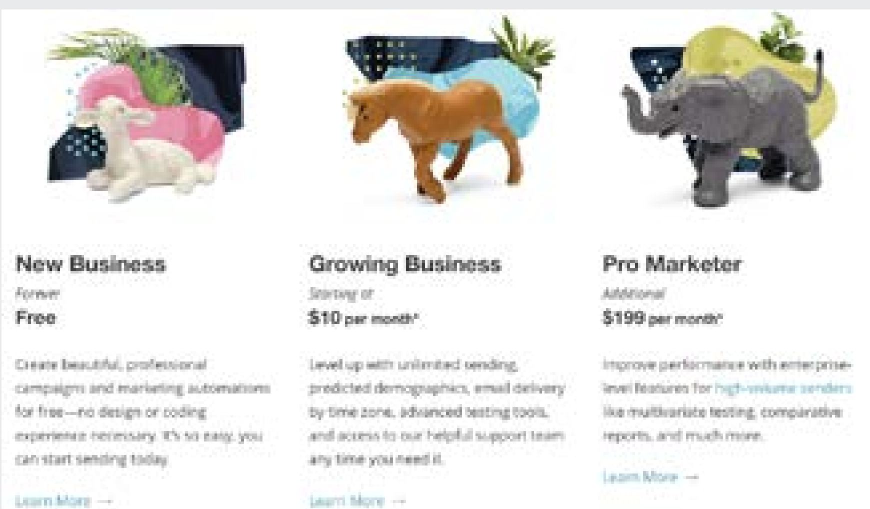
MAILCHIMP: FREE, BUT STILL VALUABLE

MailChimp took a measured approach to freemium, working for years with customer data to ensure that the products they built matched what every user wanted and needed.

MailChimp CEO Ben Chestnut made a point of saying that the company was not a startup when it launched a free plan, 8 years after its founding. In those 8 years, they tried out freemium variations such as pay-as-you go vs. monthly subscriptions, and free trial vs. free forever. By the time they went freemium in 2009, the core email product was both affordable and profitable. They had recently saved on server costs by switching to the cloud.

They named their first free plan “Forever free,” and the exact wording is still on their pricing page today. It’s used by new businesses, non-profits, and small organizations. And if you’re not sending a large volume of email, it’s an excellent service.

MailChimp pricing page in late 2009 [source].

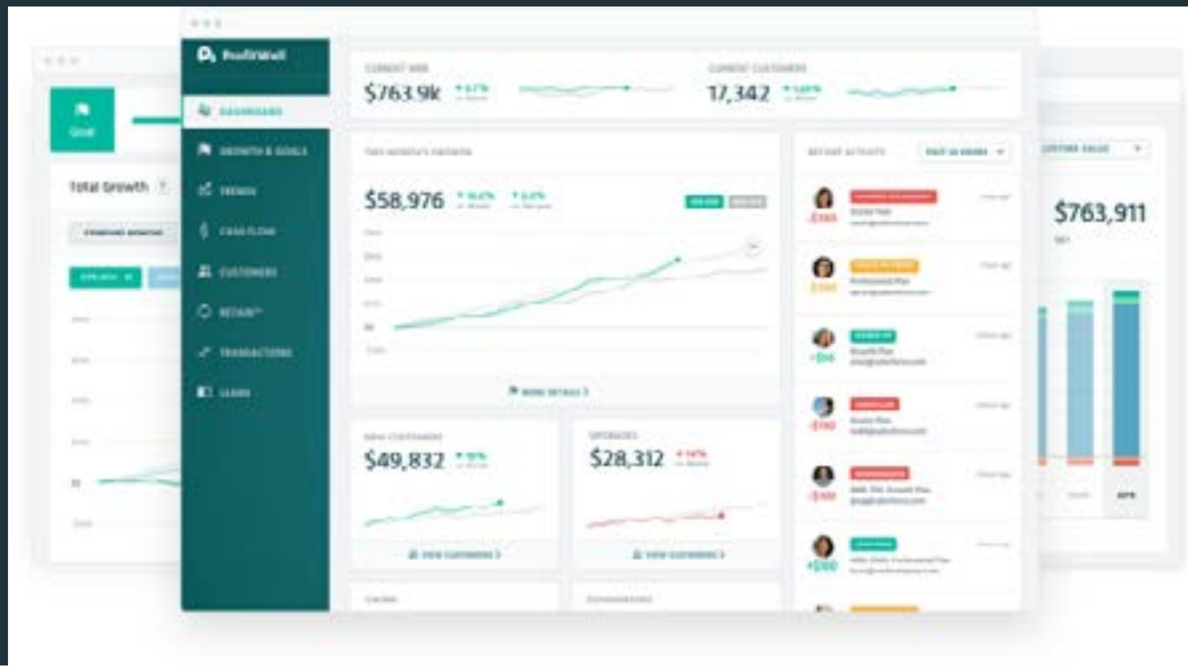


MailChimp pricing page today. [source]

A year after launching Forever Free, Chestnut wrote another blog post with the following data (h/t Drift):

- MailChimp had grown its user base 5x, from 85,000 in September of 2009 to 450,000 in September 2010.
- They were adding more than 30,000 new free users and 4,000 new paying customers each month.
- Profit had grown 650% (!)
- CAC had decreased 8% in just the last quarter to under $100 — main reason for profit growth.

MailChimp had not only created more value for more people, but they had increased their profits in the meantime. And more MailChimp emails were out in the world than ever before, meaning that people were sending better email, regardless of cost.



Profitwell Dashboard

PROFITWELL: PERPETUAL VALUE

One of the constraints most freemium models above impose on user is a value metric limit. Whether it is the storage limits of Flickr and Box, or the subscriber or email limits of MailChimp — at some point the product becomes unusable for these users without the upgrade.

This is, of course, part of the point. At these limits it is assumed that users are getting enough value that they will want to pay for the service for continued use. But the low conversion rates on all freemium show that this isn't always the case. That is why we advocate for perpetual value in freemium.

The core value should be free for whoever you are — a single user or a 1,000+ team. This is slightly akin to Skype's freemium model, at least for individuals. If you download Skype you can use the core value, calling other Skypers, forever, for free.

This is the model we want to build and that we want others to build. In ProfitWell, we want a product that is useful for any size of SaaS company, whether you have one customer or 1M, and can be used by you alone or a 1,000 member team. There is no value metric limit.

The upsell comes from adjacent products to the core value. The core value of ProfitWell is understanding your analytics. The premium part of our freemium comes from helping you do something with that information. For instance:

- Retain recovers delinquent churn (that you identified through ProfitWell) using in-app messaging and email reminders to customers
- Recognize allows you to convert your subscription revenue (which you manage through ProfitWell) into GAAP recognized revenue.

If you don't need to recover churn or don't need to recognize revenue, then no worries. ProfitWell will continue to be entirely free for you. But if you are using ProfitWell properly and getting value from the product, you will need these things. You'll understand your churn and want to stop it. You'll grow your revenue and need to get your finances straight.

In perpetual value freemium, the perpetual value leads to upsell even without a value metric.

We think any company can do this. They can offer constant value to customers whether they choose to pay or not, and still generate revenue through upsell linked to their core value. For MailChimp this might be new email designs or delivery analytics. As long as the core value is there, there is a way to upsell something that just makes that core value richer.

FREEMIUM, DONE RIGHT, WORKS

As more companies learn how to work out the kinks in their free models, we'll have more ways to think about pricing innovation, which, as a business intelligence company, is obviously very exciting to us.

More importantly, as freemium companies continue to adapt both their products and pricing, and continue to make software accessible and available to all, we can see what it takes for a software company to truly create a lifetime of value. We think that a lifetime of value comes from offering value for a lifetime—perpetual value. History will see if we are correct.

In the next chapter of The Freemium Manifesto, we'll take a deeper dive into this model, showing why it goes wrong with some companies and why it can go very right with the right ideas.

2018

Chapter 02

FREEMIUM IS FOR ACQUISITION NOT REVENUE

In the previous chapter, we saw why freemium has been so enticing. Many Silicon Valley fairy tales like Dropbox, Slack, Evernote, and Spotify have been built on the back of freemium packages that led those companies to exponential growth.

But we also saw the downside—companies acquiring massive amounts of freemium users, but never able to convert those users into paying customers. This is all because they didn't understand the fundamental truth of freemium:

Freemium is an acquisition model, not a revenue model.

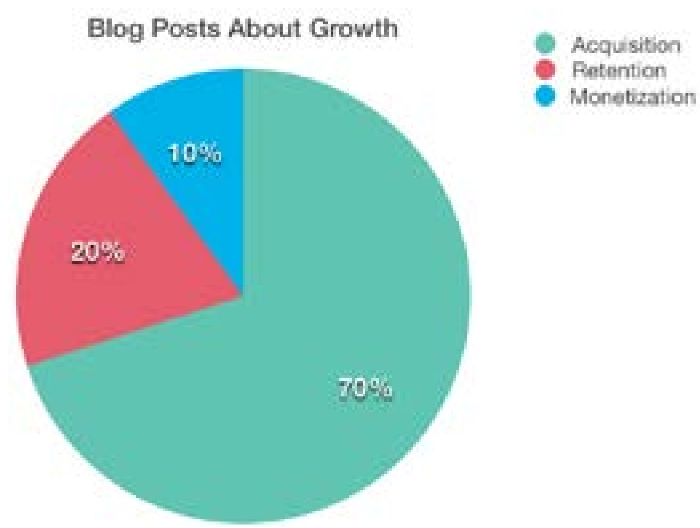
Freemium is a marketing strategy. It is another channel, potentially your best channel, to add fuel to your pre-existing monetization fire. With the right revenue model in place, you can use freemium as a low-cost channel to find, educate, and convince customers of your value. It smashes down the barriers that prospective customers face to starting with your product.

Freemium isn't a revenue strategy. If you are thinking about freemium from a revenue perspective, you're flat out of luck. With the wrong monetization model, freemium can actually increase costs while not providing long-term value to either customers or your business.

In this chapter of The Freemium Manifesto we want to deep-dive into this exact problem—why you need to build freemium from a marketing perspective, what goes right when you do, and what goes wrong when you don't.

BREAKING DOWN YOUR BARRIERS

Marketing is getting more difficult. This is particularly true in terms of acquisition-focused marketing:



70% of all blog posts in SaaS are about marketing. This is a massive problem for marketers. This stat comes from our study of 10,342 blog posts on growth. That means that when we completed this study, there were at least 7,240 SaaS blogs on how to acquire customers.

Content is saturated. Whitepapers are saturated. Email is saturated. Even eBooks like this struggle for attention within this market. You can make it as great as you can, but it is only one of dozens of blog posts or eBooks your lead has read—and forgotten—this month.

As these marketing channels get squeezed, their costs get higher. Don't just take our word for it. Here is Tomasz Tungaz, VC at Redpoint, on rising CAC in SaaS:

> *Third, the costs of customer acquisition have risen. Whether it's Facebook ads, LinkedIn ads, Google search engine marketing and retargeting, email marketing, or outbound calling, all of these channels bear some hallmarks of saturation. Response rates are declining, depressing conversion rates, and raising the cost of customer acquisition. The surge of venture capital in the last five years worsens this predicament.*

People might read your content, your eBooks, your emails, but this doesn't lead to conversion at the same rate as in previous years. This kind of talk might lead any marketer to reach for the whiskey and pearl-handled revolver. But in the middle of difficulty lies opportunity.

> *If everyone is using the same go to market playbook, there's an opportunity to develop a new one. Inside sales models. Inbound lead generation through content marketing. Mobile app distribution. Advertising on consumer platforms to drive B2B sales. All of these are advances that go to market teams have developed in the last 10 years. We will see many more. I don't know what they will look like. Perhaps they will be channel based. Perhaps they will leverage virality and word-of-mouth. I don't know. But I do know, this is the moment, when everyone else is following the same playbook, to develop a new play.*

We've seen from chapter one that freemium isn't a new play. The concept has existed for decades. But the shift in thinking about freemium from revenue to marketing allows us to treat it as such. Freemium is a new play in acquisition terms simply because people have focused on it as a revenue model for too long. Freemium is the future of product.

Why? Because freemium breaks down the barriers cited above. It is a channel that doesn't suffer from saturation and a channel where you can keep the costs low. If your product is great (which we are taking as a given here), then your best marketing is always going to be that product. Freemium allows you to translate some of that latent marketing power and leverage distribution.

A free product is inherently valuable for customers. Content, ads, emails—all these can provide some value for customers. All of them can start the relationship with your prospective paying customer. But nothing is as valuable as the product itself. Freemium products give us the ability to not just start these relationships, but build them over time and become more and more enticing.

The caveat to all of this? You have to do it right. You have to think about it from the marketing perspective and you have to have the right pathway to monetization. Without either of these, freemium fails and your company fails.

THE RIGHT TYPE OF FREEMIUM

To make freemium work you need your free product to:

- Have continual value to the user
- Have a way to monetize these users eventually

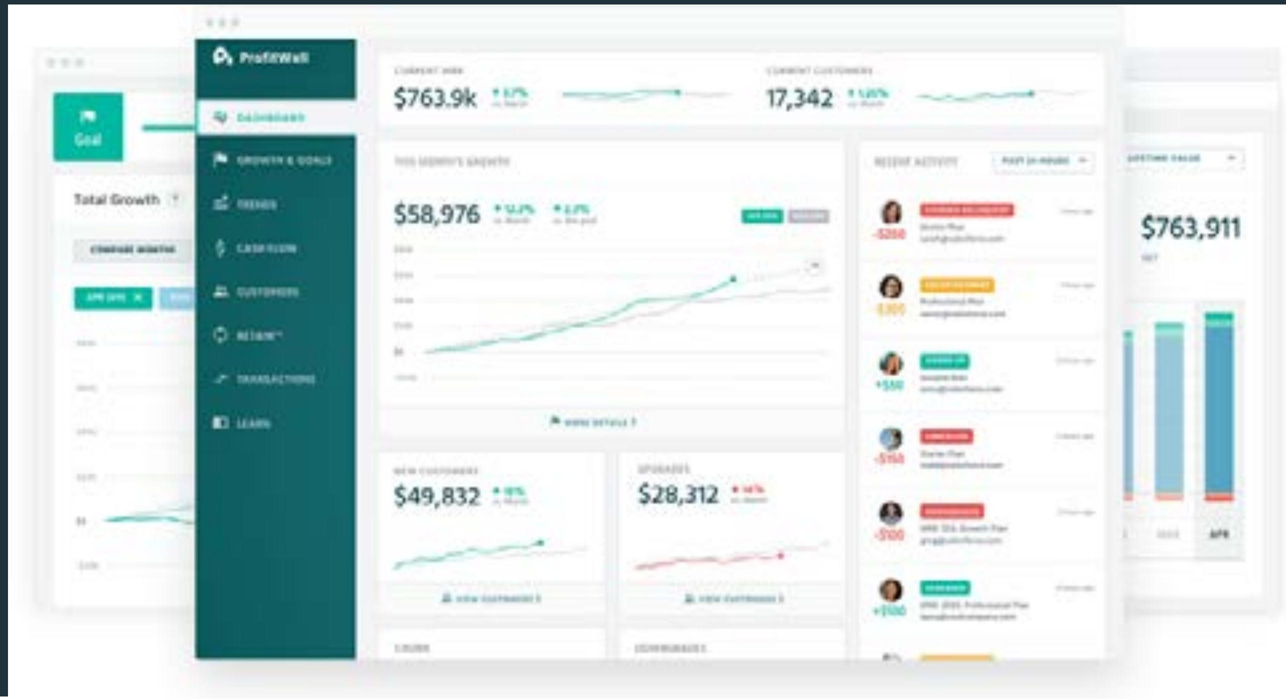
When companies choose the freemium model, this is the first point they fall at. The freemium model with the two points above is called the perpetual value model. A user can sign up for free and basically get the value offered for free, forever. Monetization is through logical add-ons that work alongside this core product.

The model most choose we call the faux free trial. The free product is at the lower end of the companies value metric. If they have 3 tiers offering 5, 10, and 15 widgets for $5, $10, and $15 respectively, faux free offers a free tier where you get 2 widgets. There is a value metric limit.

Ostensibly, this makes sense. A user uses up their two widgets quickly and need to upgrade and start paying. This looks like quick and easy monetization. The problem is that this is insanely difficult to get right. We go into more detail about this below, but briefly—it requires intimate knowledge of your customers. You cannot start with this and hope for any real revenue.

Unless you get it perfect, the limit on the value metric in the faux free trial can backfire. You are naturally putting a limit on your value to that specific user. If they don't find value in those 2 widgets, then the product is useless to them, free or paid. And they won't pay for a useless product.

The perpetual value model circumvents this problem by, as the name suggests, giving the core value of the product away free, perpetually. Let's run through how this works with an obvious example—ProfitWell.



PROFITWELL FOLLOWS THE PERPETUAL VALUE MODEL:

1. **Users can always get value from the product.** You can be a solopreneur with 5 customers or an enterprise finance team with 50,000 customers. You get to see all your numbers. There is no fake limit on either team size or analysis size. If ProfitWell offers it, you get it.

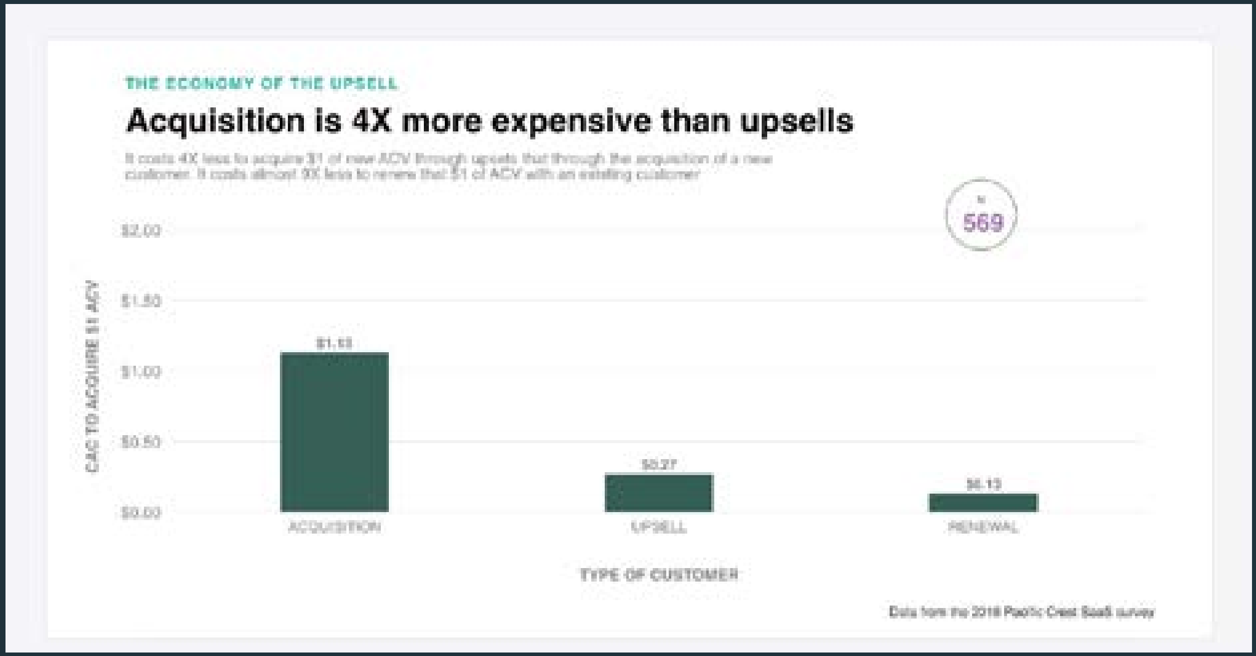
2. **Users are monetized through logical add-ons.** Monetization through ProfitWell is achieved through offering other products that complement the core product.

When you sign up for ProfitWell you get the core value for as long as you have an account. But, we expect, you'll find success with the product so will need one or more of our other products:

- **Retain**—If you find that your churn is hurting your growth, Retain helps you fight delinquent churn, churn from users who haven't updated credit cards details, have hit their limit, etc. Our revenue from this depends on how much we help you recover *(You get nothing, we get nothing).*

- **Recognize**—As your company grows and you shift from SaaS metrics to GAAP metrics you need to recognize revenue effectively. Recognize helps you create audit-proof revenue recognition more easily than hiring a team of accountants.

- **Pricing Strategy**—Monetization is the part of business that holds most of SaaS back. At Price Intelligently, we have helped thousands of SaaS companies develop the optimal pricing strategy for their market.



There is a common theme within each of these. They all only work because you've already tasted the core value of ProfitWell. Without the metrics from the free product, you don't know your churn, whether you're at the right stage for rev rec, or whether you need to change your pricing. In this way, we make money when you are successful with our free product—this is the paradox of successful freemium.

WHY THIS WORKS—THE UPSELL

So how does free something you give away for free become a strong revenue driver? Especially if you don't think about it as a revenue driver?

This might all sound like an enigma, but it isn't—it comes down to a well-known factor of SaaS economics: **Upsell is where its at.**

Your growth comes from your existing customers. If they find value, they want more and more and more. The customers on the bottom rung are negligible in revenue terms to those on the higher tiers—what the lower rung guys will become one day. You constantly want to provide opportunities for customers to upgrade their plans and to give you more money in exchange for more value.

[Adapted from: Software by Rob blog]

A value metric is one way to do this. You upsell them through those widget tiers. But you need to get them on that bottom rung. And that is the biggest step. This is one of the reasons free trials can struggle (more on that later). Freemium gets them on that bottom rung **for free.** All of your investment can then go into retention and upsell instead of acquisition.

The users are already having a quasi-customer experience. From their perspective, they are already customers. This means the jump, for them, is easier. It is also easier for you. The cost for upselling a customer is far less than acquiring a customer:

Once they are in your ecosystem, finding value, the upsell becomes easier. This is the path to monetization from free. Getting this right comes down to understanding what your customers want. And it is this that freemium failures get wrong.

WHY FREEMIUM SO OFTEN FAILS

That is what successful freemium can look like. But that version of freemium doesn't look like most on the market. Here's why.

When Ruben Gamez launched Bidsketch, a proposal-maker for designers, he thought freemium was a "no-brainer." He sent out a beta version of the product, with both free and paid versions available, to his list of email subscribers, and saw an uptake for the paid version of over 50%.

conversions dropped dramatically. After two weeks only 7% of users were on the paid plan. After six weeks the conversion rate from free to paid was just 0.8%.

"My user base was growing fast but the money was barely trickling in," Gamez wrote. He had expected revenue, and what he got was acquisition. He hadn't thought about how to turn newly acquired users into paying customers.

The fundamental mistake SaaS companies make with freemium is two-fold:

- They see it as a revenue driver. They don't put the strategic thought into working out how to make it produce profit.
- They incorporate it from the start.

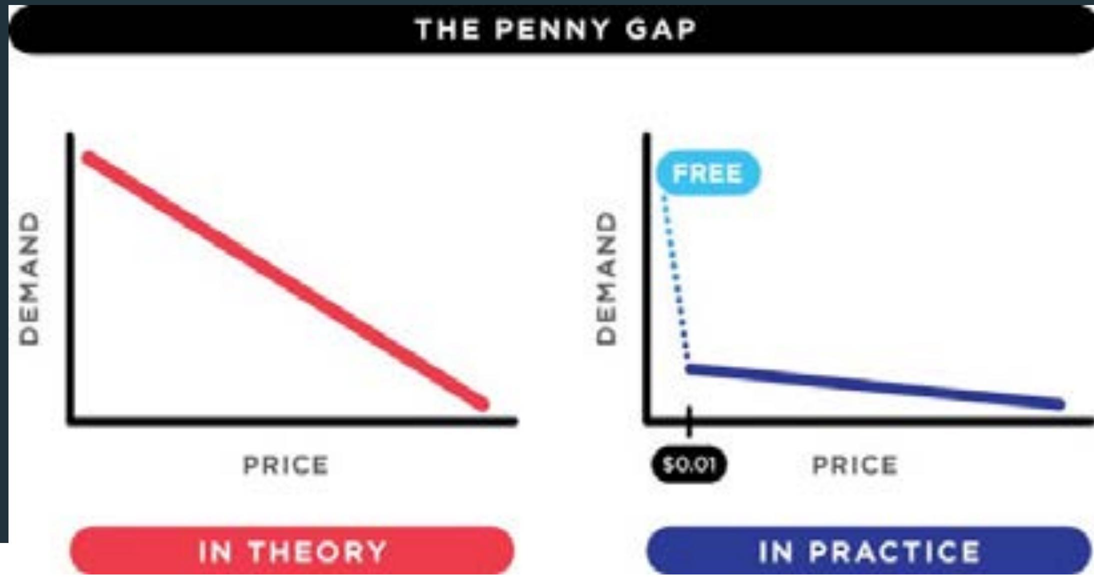
These two problems are intrinsically linked. Most startups aren't ready for freemium at the beginning because there is no strategic thinking behind their monetization plan. Freemium becomes "build it and they will come" thinking.

This fails because of three critical factors:

- **They don't know their customers yet**—You need to know what features customers value in order to deliver value and monetize.
- **They have no buffer to accounts for costs**—Offering a free product is investing in acquisition. It takes a while to see returns on the investment.
- **They haven't figured out their other messaging**—You need to continue to add value and communicate that value to new and returning customers.

You can see each of these issues with Bidsketch. The company only survived because Gamez killed his freemium experiment. When he did, conversions from the site increase eight-fold.

Freemium can work, but only as part of an already functioning framework. You need these three critical factors dialed in and revenue turning before you can turn on the freemium faucet.



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Before freemium: know your customers

> *"It's hard to have any conviction about the worth of your product if no one has paid for it before."*
>
> *-Wistia co-founder Chris Savage*

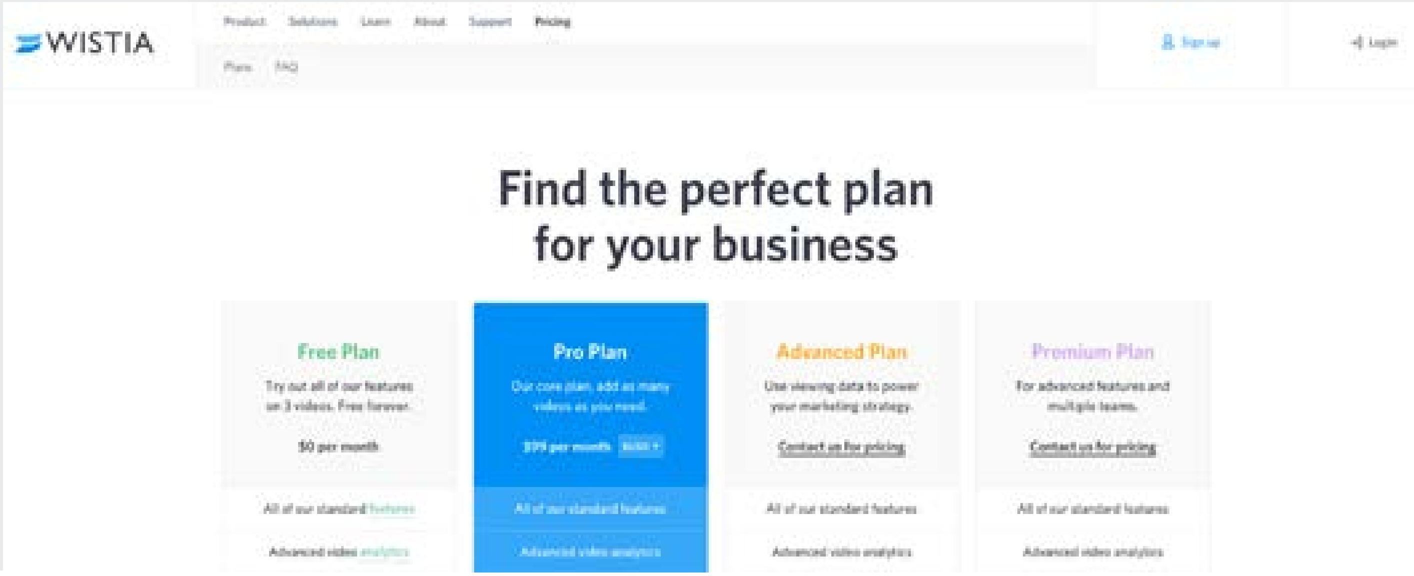
You don't really know the value of your product at launch. No matter what prior market research you do, you still need to iterate and test pricing to find the point at which product value and customer value align.

Freemium too early hurts value perception and circumvents this iteration. The freemium model, particularly the faux free trial model, doesn't create motivated buyers because there is no urgency or fear of loss. In fact it can have the opposite affect. Most people are happy to freely use the the limited features in ignorant bliss of what your product's true value can give them.

Beyond a lack of buyer motivation, a freemium model hurts your product's value perception, especially when the majority of users have yet to pay and vouch for its value. When you start with free, it is an uphill battle to convince people to pay.

The Penny Gap theory suggests that people put up a huge barrier between free and a penny. Once your product is perceived as free, you create a much larger challenge for yourself to convert them to a paying customer.

Theoretically, as demand increases so should the price. But when you start at free, this dynamic completely changes. There is a value disconnect once something is given away for free. For example, upgrading a customer from free to $5 is actually harder than going from $5 to $25.



Current Wistia pricing

SaaS video-hosting platform, Wistia, has a freemium tier. You get three videos with all features hosted for free. But this is a relatively recent addition to their pricing plan. They didn't start out giving away the farm.

Wistia knew from day one they had a valuable product because they landed a paying customer. They offered 3 pricing options and the customer took the best, priced at $400. From this they learned:

- Any price is better than no price at all
- If a product fulfills a need, people will pay a premium for it
- A direct line of feedback will keep you informed of customer needs

For six years after that, Wistia only offered paid products. Having fewer customers at the start allowed them to form better relationships and receive trustworthy feedback. Paying customers offer the best feedback because it serves their interests, too.

Only after years of fiddling with the pricing model, talking to paying customers, and refining the product, Wistia decided to offer a free option. Freemium then helped expand Wistia's reach to new audiences.

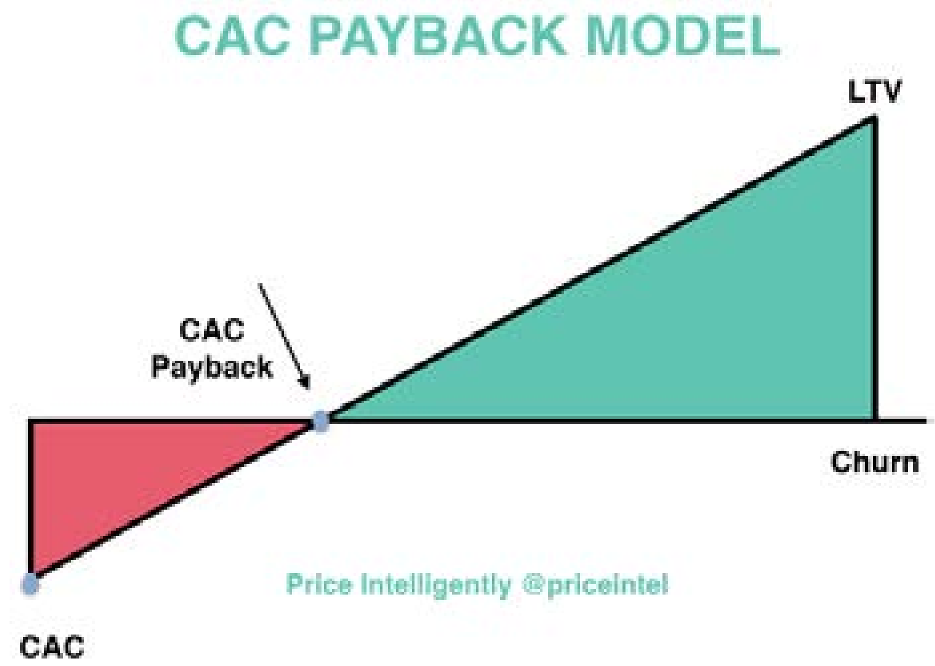
Companies like Wistia are always iterating on their pricing—they've changed their free option 3 times.

If you find yourself asking how pricing can be improved, your customers will often have the answers. Past relationships with customers pave the way for the relationships you build with newer users. It can take years to foster mature relationships and gather enough data to see how a free plan fits into your pricing scheme, so it helps to be profitable first.

Before freemium: build a buffer If you're bootstrapped, you're growing slowly and investing time and money in drumming up new business via advertising, sales, and marketing. These efforts contribute to a high customer acquisition cost (CAC), but also a strong understanding of the customer base.

As we showed above, freemium can lower CAC—the product becomes the marketing channel and the sales rep. But without the right path to monetization, other costs can start to lower your per-unit profit.

Server space, product development, support, storage costs, support and developer salaries and tools don't often factor into CAC calculations, but they are all outgoings required for a non-paying customer to engage with a free product. With a conversion rate of 1%, you have 1 paying customer supporting 99 free users.



Source

If you really understand your value and customers you can offer high-value, high-price upsells that negate this problem.

You want to be profitable before implementing a freemium model because it takes time to see a return on investment in acquisition.

If you don't, you are left in the same position as Bidsketch. As Gamez observed that with an influx of visitors, ***"Support was starting to get tricky, which left me uncomfortable at the thought of what things would look like six months down the line."***

Free music does not exist—Spotify is absorbing the cost of what it takes to create a player that distributes millions of free songs to millions of devices used by millions of people around the world. They can do that because they have raised over $1.5B from investors. It isn't so simple if you don't have cash to burn.

In your unit economics, CAC relates to customer lifetime value (LTV) to give you an understanding of how strong business growth is. If LTV > CAC, then over time your profits can give you the buffer to support a free tier. But LTV comes from paying customers, so you need that first.

By accurately assessing CAC and LTV, you can understand the unit economics of free users vs. paying customers and whether the freemium model will be profitable in the long term. If it's not, then your free product should not be prioritized over other sales and marketing channels.

BEFORE FREEMIUM: UNDERSTAND YOUR MESSAGE

When SaaS companies build freemium-first, they then deemphasize other marketing and sales channels. Yes, these channels are saturated, but you still need them. They miss out on nailing their message that will ultimately get free users to upgrade.

The revenue spent on building and supporting a free version has better uses in the early days:

- **Content**—write thoughtful, deeply researched blog content and customers will trust you not only for technical support, but for business advice and thought leadership.
- **Outreach**—reach directly into the inbox of potential customers and sell your product on its value to them.
- **Market research**—sit down with current and prospective customers to find out what they really think of your product and determine their feature preferences and willingness to pay.
- **Pricing strategy**—create pricing personas through value analysis with the most engaged customers. Focus on selling the advanced versions to those customers, and the more basic plans to users who need only one or two features.
- **Upselling**—get your paying customers moving up your tiers. Only then will you find out if a free tier is viable as an acquisition channel.

All these are opportunities for early revenue and monetization. Early on, a free tier will struggle to bring in more revenue than these channels combined, especially if you have a faux free trial without understanding of the correct upsell potential. Even if you can justify a small conversion rate, you'll still need to maximize LTV to continue to grow. You need marketing to keep people engaged and happy over time.

A free version can be a time-consuming, resource-sucking distraction from other sales and marketing functions, it can be your biggest acquisition channel, or it can be both. Measure and compare the free channel's performance to other channels on a regular basis to justify its contribution to your bottom line. If it's not pulling its weight, cut it.

If you check out Bidsketch pricing now, you'll see no freemium:

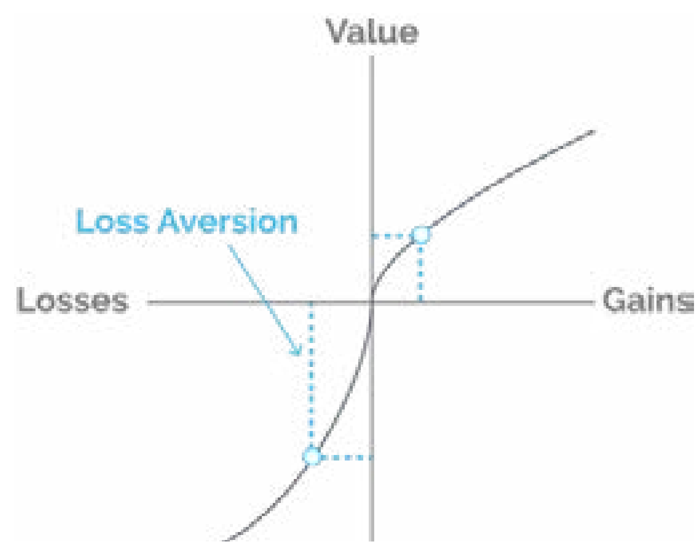
Instead, you'll see six magic words: **All plans free for 14 days.** Bidsketch has switched from freemium to a free trial. This seems to be working well for them, so we applaud the choice.

Free trials that work work for the same reason freemium planes that work work: They offer all the value available. However, free trials can struggle for the same reason that people like them: time.

Real estate agents love a motivated buyer. A motivated buyer is someone who really wants to make a purchase quickly usually due to time constraints. For example, a prospective home buyer may have already sold their home and now they need a new place to live ASAP.

A limited free trial for your B2B SaaS product creates a similar buyer dynamic where customers are happily using the product, but the clock is ticking. The impending termination creates a sense of urgency that motivates a customer to purchase before time runs out. The psychological aspect that drives this positive motivation is called loss aversion.

Most people would rather choose not to lose something over gaining the same thing. The negative feelings coming from the loss are much stronger. So much so that studies have suggested that the desire to avoid a loss can be twice as powerful.



Once your customer has full access and your product helps them do their job better, they won't want to give it up. Their desire to keep what they already have will motivate them to make the purchase instead of losing something that has already brought them value.

Limited time free trials reinforce people's natural inclination to experience ownership and avoid losing access, creating more motivated buyers when the trial comes to an end.

The problem arises in getting this timing right. Too little time in the trial and the user is never going to understand the core value and want to upgrade, too much time and then you've got yourself a faux faux free trial. It is freemium with a time limit.

The other reason is the one outlined above—the upsell. In a free trial, your triallers still have to make the jump. You are not upselling them at this point; you are still acquiring them. Unless you got your trial length perfect and they found value, this decision boundary is a big one for them—they have to decide to pay right here, right now. If they don't, your trial is wasted and this is a lost opportunity.

Contrast that with freemium. Their decision isn't time-bounded. They have time to transition from user to quasi-customer naturally and become sensitive to upselling materials instead of acquire materials. You have circumvented the most difficult, expensive part of SaaS for free.

THINK ACQUISITION, GET REVENUE

If you expect that freemium will work just because it has for others, you are going to struggle. Just like everything in SaaS, nothing truly comes for free. Successful freemium stems from knowing what your core value for your core customers is, and offering that—and only that—for free.

Then monetization comes from the upsell. You can layer on more opportunities that are tangential to this core value and charge for them. These can become premium services that you use to fuel your growth and fuel your freemium.

This isn't easy, and isn't guaranteed success. In the next chapter we will take a look at the unit economics underpinning freemium and how to choose whether this will work for you.

But freemium done well can be the future of product. Just as long as you understand the model.

Chapter 03

FREEMIUM ECONOMICS

Initially, we were skeptical of freemium. We had seen companies come along with freemium plans and perish. It didn't seem like a sustainable business plan—how can you sustain a business when you give away the product for free?

But as we dived deeper into the topic during the development of our own product, ProfitWell, we started to see the beauty of the model. We weren't looking to build a freemium product. We only did so because the unit economics made sense. We realized, done right, freemium can lower costs and increase revenue.

In this chapter of The Freemium Manifesto we are taking you through the most important consideration of your transition to freemium: the economics of the decision. If you can't make the unit economics work, you can't make freemium work. This is where most people trip up. They don't understand how to use freemium to acquire valuable customers economically.

But you can make it work. You have to understand where your costs come from and how you can reduce them through offering your core product for free. You have to understand where you make money and how to make more through offering premium expansion opportunities. Get these two sides of the unit economics equation right, and freemium can drive acquisition that drives revenue.

+ + +

A RECAP OF UNIT ECONOMICS

Your unit economics are what keep your business alive. Fundamentally, you are asking your metrics a simple question:

> *Will I make more money from this customer than it cost me to get them?*

If the answer is yes, you have a viable business. If the answer is no, you aren't going to grow.

Within this simple question is a lot of nuance. Even if you receive more value from customers than they cost, growth still isn't assured.

Also, as you might have realized in the crazy tech world, getting zero revenue from customers it cost a lot to acquire seems to suite some companies just fine. In some cases, particularly where market capture is paramount, unit economics come secondary to rapid acquisition. This is why companies need investment.

But a profitable SaaS company requires you to have positive unit economics. This means a positive LTV:CAC ratio. These two numbers, your LTV and your CAC, are critical to long-term growth:

- LTV (lifetime value)—the total value of a customer during their entire customer lifetime. If your average revenue per account (ARPA) is $100 per month and each customer stays for ten months (a churn rate of 10%), your LTV is $1,000:

EQUATION:

$$\text{LTV} = \frac{\text{ARPA}}{\text{Customer Churn Rate}}$$

SIMPLIFIED:

$$\text{LTV} = \frac{\left(\text{Sum of all customer MRR / Total \# of customers}\right)}{\left(\text{\# of customers who churned / Total \# of customers}\right)}$$

EXAMPLE:

$$\text{LTV} = \left(\frac{\text{\$100 ARPA}}{\text{0.1 Churn Rate}} = \text{\$1000 LTV}\right)$$

- CAC (customer acquisition costs)—how much you have to pay to acquire each customer through all of your acquisition channels. If you pay $18,000 per month on sales and $18,000 per month on marketing and get 1000 new customers, CAC is $36:

EQUATION:

$$\text{CAC} = \frac{\text{Total Cost of Sales \& Marketing}}{\text{\# of Customers Acquired}}$$

SIMPLIFIED:

$$\text{CAC} = \frac{\left(\underset{1}{\overset{\text{S\&M}}{\text{Salaries-Tools-Spend}}} + \underset{2}{\overset{\text{S\&M}}{\text{Salaries-Tools-Spend}}} \cdots \underset{n}{\overset{\text{S\&M}}{\text{Salaries-Tools-Spend}}}\right)}{\left(\underset{1}{\overset{\text{Acquired}}{\text{Customer}}} + \underset{2}{\overset{\text{Acquired}}{\text{Customer}}} \cdots \underset{n}{\overset{\text{Acquired}}{\text{Customer}}}\right)}$$

EXAMPLE:

$$\text{CAC} = \left(\frac{\text{\$36,000 (Sales \& Marketing Spend)}}{\text{1,000 (Customers Acquired)}} = \text{\$36}\right)$$

LTV:CAC ratios can be segmented into three categories:

- **=< 1:1 ratio.** These unit economics lead to failure. If you are spending more to acquire customers than revenue you receive from them, your business can't survive. The only way such companies do survive is through outside investment.
- **>1:1 ratio but <3:1 ratio.** With unit economics like this scaling is achievable. You do have profit with which to invest, but growth will be inevitably slow.
- **>3:1 ratios.** At this point, every new paying customer generates 3X or more in revenue than their acquisition cost. For every new dollar, you can spend two on growth.

But these numbers alone don't tell the whole story about unit economics. When you graph out these contrasting ratios in terms of customer payback periods, the difference becomes even more stark. If we plug the LTV numbers from the example above into a model, with identical acquisition numbers (100 new customers per month) but different acquisition costs (a 1:1 ratio with CAC of $1000, a 2:1 ratio CAC of $500, and a ~3:1 CAC of $300), we can see the problem with low LTV:CAC ratios:

If you have a 1:1 ratio, you're screwed. Not only do you not grow, you go further and further into a cash trough. This is because, in the recurring revenue model of SaaS, CAC is an upfront payment, whereas LTV is only realized over time—10 months in this instance. For each individual, the balance of payments during their customer lifetime looks like this:

Basically, they are never profitable. What's more, that initial outlay for CAC means you immediately go into the red. In fact, the more successful you are in acquiring customers, the worse it becomes. That's why in the first graph, the trough keeps going down and down and down. It does eventually plateau but beyond the two-year mark. And if you were to keep acquiring customers it would never do more than that. If you stop acquisition, all that would happen is that you would eventually go back to zero dollars.

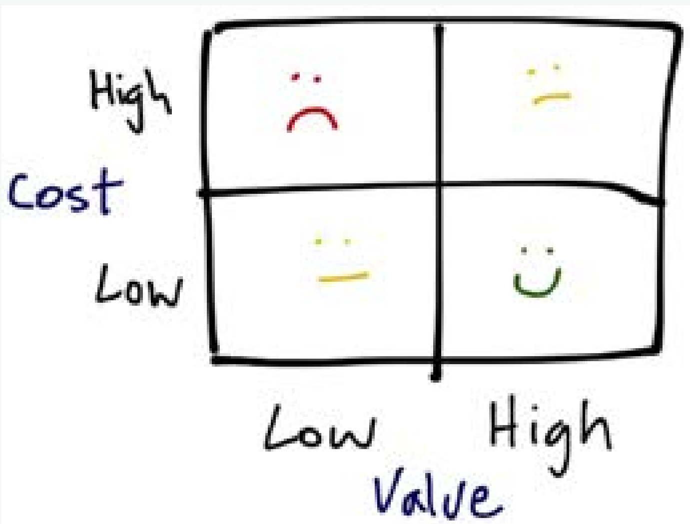
Contrast that with the more positive unit economics. If you are paying $500 for every $1,000 LTV customer, the trough bottoms out at ~$120,000 in this scenario. The company becomes profitable after about 14 months. Initially, this might seem achievable, but within those 14 months, you have outlaid over $1,000,000 in customer acquisition costs. This is why investment is often needed in tech—companies don't have the right unit economics.

But when we start to get around a 3:1 ratio, the picture shifts dramatically. The cash trough only lasts six months and is a cumulative sum of ~$130,000. Tough, but doable. Especially when you look at the upside. With 3:1 ratios, after two years you have an MRR of almost $900,000, an ARR of over $10M. This is 2.3X the 2:1 ratio.

If you want to grow, and grow sustainably, you have to have great unit economics. Great means over a 3:1 LTV:CAC ratio. To do that, you either have to have a great monetization strategy, very low acquisition costs, or both. Freemium can give you the latter.

FREE: THE LOWEST BARRIER TO ENTRY

Lets think more about costs and value:



(source: LinkedIn)

If cost is high, you are never a winner.

- If you have **low LTV/high CAC** at the same time, then you are going backward, paying for customers that are never going to pay even themselves back let alone allow you to grow. You are below the worst-case scenario in the graph above.
- If you can also manage high LTV, then you can grow, but growth will be slow or plateaued. **This high LTV/high CAC** range is the stage that a lot of enterprise-level SaaS companies are at. They have to spend like crazy to acquire customers, and then charge like crazy to maintain workable unit economics.

But what if costs are low?

- Then you might be able to survive with low **LTV/low CAC** ratios. But this is only survival, not growth. In this scenario, revenue will always be low in SaaS as it simply doesn't have the market to make these numbers work. This is the 1:1 type ratio above, but with smaller numbers. You might not get into millions of debt, but neither will you see millions in profit.
- This leaves **high LTV/low CAC**. If you can find high LTV customers while keeping costs low, that is the channel to the >3:1 ratio needed for continuous growth.

Unsurprisingly, SaaS companies want and thrive on customers that cost little but give a lot. You have to lower simultaneously your costs and raise the amount of revenue. Freemium can do both of these.

FREE LOWERS COST

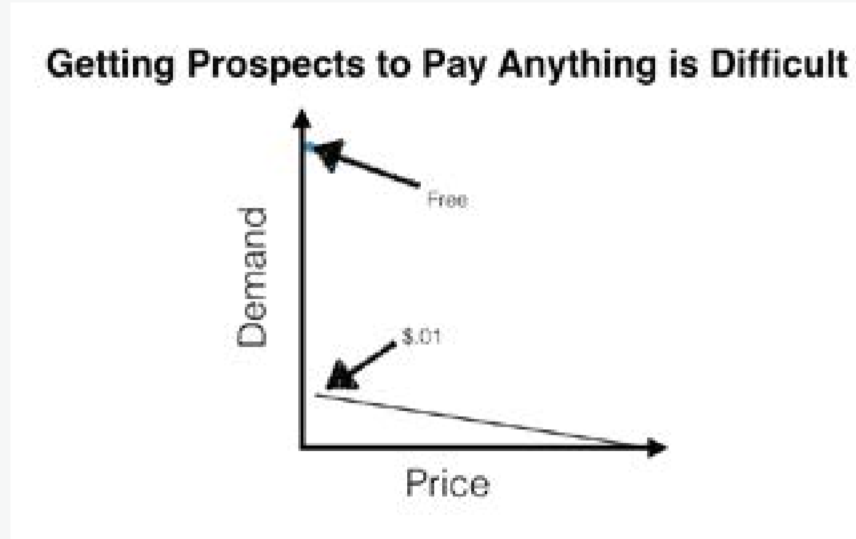
The biggest gap in payment is that between nothing and something. This is called "The Penny Gap."

When a product is free, demand is high. But once you ask for payment, even one cent, you are asking your customers to assign a value to your product and demand drops. As Josh Kopelman, Partner at First Round Capital puts it:

> *The truth is, scaling from $5 to $50 million is not the toughest part of a new venture - it's getting your users to pay you anything at all. The biggest gap in any venture is that between a service that is free and one that costs a penny. I can't think of a single premium service that has achieved truly viral distribution. Can you?*

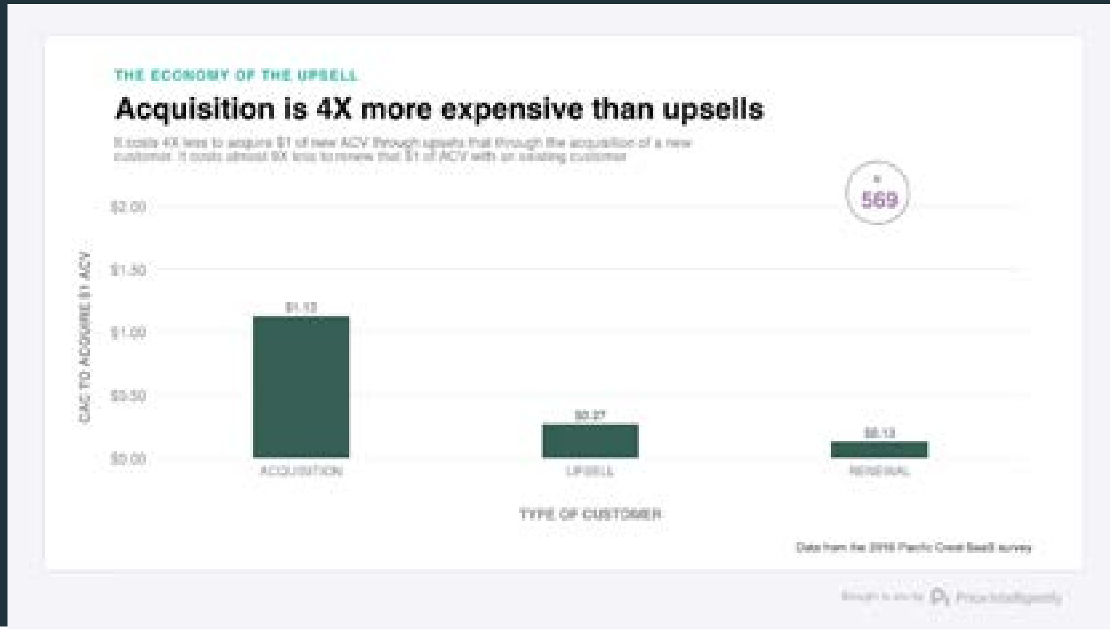
There is a massive barrier standing between the potential customer and use. When a completely new visitor finds your product, they have zero information. They have no idea if the product is right for their use-case or right for their company. They have no idea how to use it effectively, or what the eventual ROI is going to be for the tool.

The higher the price, the higher this barrier becomes. If you are asking $1,000 per month for your product, then potential customers need a lot of convincing that the product is going to be worth



it. They have to **know** they have the right use-case. They have to **know** they can use it effectively. They have to know it has a $1,000+ per month ROI.

Getting over this barrier is what the "cost" of customer acquisition cost is. Content, ebooks, whitepapers, webinars—all your lead sources—are there to get people over this barrier and help people decide to use your product. If you are charging $1,000, you have to do all that per customer for less than $300 per month that they will stay customers.



Lowering the price lowers the barrier, but only to a limit. Unless you go free. At the free price point, your CAC can be reduced substantially for three sequential reasons:

1. **First, the inverse of the penny gap supervenes and costs lower significantly.** Demand rises as potential customers no longer require significant marketing andsales to overcome that price barrier. They know there is little commitment so are happier to try the product.

2. **Then your product becomes your lead source**. Instead of spending more on marketing, marketing is performed by the core product itself. This then further cuts down costs. When customers can use the product, they will know the use-case, how to use it, and the ROI.

3. **Finally**, **customers shift from acquisition mode to expansionary mode.** When the time has come for the upsell, it is an upsell rather than a sell. Customers already understand the value of the product and are primed to expand. Expansion revenue is 4X cheaper than acquisition. If you reduce your CAC 4X through driving upsells instead of acquisition, you can achieve the >3:1 LTV:CAC ratio needed for growth with the same LTV as before.

This is why we say freemium is for acquisition rather than revenue. It allows you to dramatically reduce your CAC and acquire customers that you then cheaply upsell into more valuable plans. Freemium lets you use your product do the talking.

Free can raise value

When we were first developing ProfitWell, we came across an interesting problem. As a company that specializes in pricing strategy, we researched the market for the monetization opportunities that were available to us. We wanted to build a product based on sound monetization principles.

We found that there simply wasn't the market for a paid ProfitWell:

The willingness to pay effectively topped out at $50 per month for a SaaS analytics product. With such a low price point, to increase LTV to a level that we could spend the required CAC to bridge the penny gap, we would need extremely low churn to increase customer lifetimes.

But the beauty of willingness to pay is that, as well as giving you a quantifiable price point, it also tells you the intrinsic value of your product. Here, this number taught us two things:

1. **CAC was going to be high.** Potential customers weren't convinced of the value of SaaS analytics, so the barrier to entry was going to be significant.

2. **Churn could be an issue.** As customers didn't see value, they might not spend the time needed to be convinced by the product itself.

We had faith in the product, but even getting customers to that stage was going to be a struggle. Additionally, the SaaS market just isn't big enough for these low-LTV numbers. SaaS has grown, but at the time the number of SaaS companies was ~10,000. If you completely consume the market, that is still only $500,000 MRR, or $6M annual revenue. Good, but not the mindblowing number you would expect if you cornered an entire market.

And, of course, you can't corner a market, especially with a premium product customers aren't sure is worth the money. Even Salesforce only has ~20% of the CRM market. If ProfitWell was the Salesforce of analytics, it would only see revenues of $100,000/month—the picture wasn't rosy.

But in the same research, we did see what potential ProfitWell customers did value, for instance, revenue recognition. The willingness to pay for this was 20X the WTP for the core analytics. But that value is only realized if the customer uses the core product.

This is how free can raise value. By allowing customers to use the core product for free, you can monetize other components that are more valuable than the initial product.

THE UNIT ECONOMICS OF DIFFERENT FREEMIUM OPTIONS

The two types of freemium—the "faux" free trial and perpetual value—each have separate unit economic considerations. Let's dive into each to look at where they can help you cut costs and increase value.

THE FAUX FREE TRIAL

The faux free trial exists at the bottom of your pricing structure. It offers a small portion of your value metric for free, hoping that this tester will show the overall value of the product and users will upgrade to paying customers to get more.

A	B	
1	Year	Videos in free tier
2	2009	0
3	2010	0
4	2011	0
5	2012	3
6	2013	3
7	2014	40
8	2015	25
9	2016	3
10	2017	3

With some companies, this can work. But it only works in select circumstances:

1. You need already to have a good monetization strategy.
2. You need to understand customer usage to segment tiers optimally.
3. You need a good marketing strategy to move free users up to the paid tiers quickly.

We can see how this all combines with Wistia:

Wistia has a free plan that acts like a faux free trial, with the value metric being videos hosted. You get all the standard features of the paid plans, but can only upload three videos. Three videos are enough to get a feel for the product, but not enough to experience fully the value of using video in your business. You have to move to the Pro Plan if you really want to use Wistia effectively. But this pricing strategy didn't appear out of thin air. It has been honed over almost a decade of price optimization by the company. This is how many free videos you could get on their free tier over the years:

For the first three years of Wistia, it wasn't freemium. During this time they were assessing the value of the product, and building their revenue and monetization and marketing strategies. Only once the company had a good foundation did they try freemium.

With the initial success of their small trial with this, they increased the free limit to take further advantage of the acquisition potential. But then they fell foul of the biggest problem with this type of freemium—you have to find the right balance for your value metric to keep conversion rates high. They had monetization and marketing locked, but the segmentation of tiers caused problems.

In the last two years, they have reverted to their initial freemium offer: 3 videos. This is the right balance between allowing free users to get a feel for the product and making sure they upgrade to unlock the full value.

Conversion rates can kill this type of freemium because the jump from free to paid is usually not high. If we use the Bidsketch example once more, you can see this problem in real life.

When Bidsketch launched the basic paid plan was $9 per month. But only 1 in 125 users was converting through the freemium to even this basic paid plan. This meant that this $9 per month had to cover costs for not only that one paying customer, but also 124 other users (about 7 cents per user per month available in CAC). A freemium option lowers CAC, but not to these levels.

At ProfitWell, we considered the value metric and faux free trial route. But found that we would have hit upon the same problem. The $50 price point was just too low to cover costs and growth effectively unless we had a massive conversion rate. But the lackluster response to the idea of paying for an analytics product showed that we wouldn't achieve the numbers needed for the economics to make sense. That is one of the reasons we chose the perpetual value model.

PERPETUAL VALUE

There were two other reasons we chose perpetual value for ProfitWell's freemium model.

The first is that the value metric is a problem for analytics companies. What should the value metric be? There are two obvious answers:

- **Users**—as companies grow they have more team members that need to use the product. Therefore, you can use "seats" as your growth axis.
- **Revenue**—as companies grow they have more revenue to manage. So you can use MRR levels as your growth axis.

Both are options, and both are bad. With users as a value metric, you immediately silo off your product from the whole team. The company will want the fewest team members to use the product to keep cost down. This means there will be no team buy-in to the product and lower retention. With seats, you are making sure the majority of your customer's team don't use or care about your product.

With revenue, you are penalizing your customers for doing well. Additionally, there is no extra value for a $50M ARR company than a $1M ARR company. There are just more zeroes on the numbers in their dashboard.

Either way, you are restricting value instead of enhancing it. When you try to work these into freemium becomes acute. Why would a company add users to go over the free threshold if they weren't needed? A company will immediately rethink their use of the product if they trip over a revenue threshold but see no discernible value for their added payment.

We wanted to offer customers perpetual value. Expansionary revenue lets us do that. In perpetual value:

- The core product is free in perpetuity.
- The company pays for expansionary products at a premium.

This then becomes the truest definition of freemium:

Free + Premium = Freemium

Give users something great for free and something great for a premium price. Then freemium works.

Let's say you have a premium add-on for your core product. You set the price for this at **$1,000 per month.** You have over 100X the revenue that Bidsketch had from their freemium experiment. Even with the same low conversion rates, you have a ton more money to spend on CAC each month.

But you won't have the same conversion rates. Because these customers have already seen perpetual value from the core product, conversion/expansion rates will be higher. For the same reasons, retention rates will be higher. This means:

- **CAC will decrease.** Because you have a valuable free core product, you will have to spend considerably less on acquisition. The product will be doing your marketing for you.
- **LTV will increase.** The two components of LTV are ARPA (average revenue per account) and churn. Your ARPA will be high because you can charge so highly for extremely valued expansion features. Your churn will be low because you are adding such wanted value on top of a perpetual value product. These customers need your product.

$$\frac{\$1{,}000}{0.01\%} = \$100{,}000$$

Churn can be very low—in the 1% vicinity. This can, theoretically, put your LTV into six figures:

In this scenario, you can now spend $30,000 on CAC and **still be above the 3:1 LTV:CAC needed for successful growth.** The customer lifetime here equates to just over eight years. This is a long time in the nascent field of SaaS, but this shows that the high pricing available through high value expansionary upsell and the low churn available through delivering that value can make freemium a winner for your unit economics and growth.

UNIT ECONOMICS: YOUR MOST POWERFUL TOOL

Let's step back from freemium for one second. Every business decision you make in your SaaS business should be dictated by your unit economics. This doesn't mean cut costs and hike prices as much as possible. This means you constantly have to look at your business as the balance between costs and revenue. If you've got high costs and low revenue, it simply isn't going to work.
You need to get to that 3:1 ratio (or better) if you want to succeed.

Freemium is a great channel to do exactly that. It lets you cut acquisition costs and focus on upselling. It lets you develop truly premium products that can strongly enhance your customers success, and for which they have a high willingness to pay. Just as with everything in pricing, it requires constant attention and testing. But we firmly believe that the unit economics of a freemium SaaS business can be a success.

Freemium lets your product do what it does best—give value to customers. Once they see that value for themselves, they will want more and more, either through your value metric or your upsell and will be amazed that they get to use all that initial value for free.

Chapter 04

COMPANIES THAT TOOK THE TIME TO MAKE FREEMIUM WORK

After companies like Dropbox, Evernote and Slack went from 0 to $5M in less than two years, everyone was trying freemium.

And soon afterward, freemium as a pricing strategy started getting a lot of heat. As we've seen, in his article Why Free Plans Don't Work, entrepreneur Ruben Gamez of Bidsketch told his readers about how switching to Freemium lost him most of his core base, and less than 1% of customers were opting for his paid plan. A WSJ article that came out the following year tells a similar story of Chargify—a company that was on its way to bankruptcy because none of their free customers would convert.

There were just as many cautionary tales flooding the internet as there were success stories.

But **freemium isn't a pricing structure, it's an acquisition strategy.** If you don't understand your customers and your unit economics before you launch freemium, you'll fight to build a business without a strong customer and revenue base.

These are what determine freemium's viability. In chapter 2, we looked at what you need to do before building freemium. In this chapter of The Freemium Manifesto, we want to show you those techniques in practice.

Companies like MailChimp, Wistia, and Grammarly all waited over five years before offering free versions of their product. They spent that time learning from the people who already valued them—their paying customers. Then, once they knew precisely what the market was willing to pay for, they could confidently offer a free product.

BEFORE FREEMIUM, GRAMMARLY UNDERSTOOD ITS CUSTOMERS

This past May, a spell-check app raised $110 million in their first venture round. Although headlines have been spreading the news about the Ukrainian founders who seemingly came out of nowhere—Grammarly was anything but an overnight success. They've been cautiously bootstrapping their business for the past eight years.

The founders, Max Lytvyn and Alex Shevchenko, were careful about the risks they took. As Alex explains:

> *We're bootstrapped, so we've always had to focus on profitable and responsible growth. It wasn't 'growth at any cost.' That's sort of been a forcing function. How do we balance being bold and audacious while still keeping an eye on our life?*

They applied this mentality to their pricing strategy. Grammarly's first consumer pricing plan back in 2009 was dead simple: one subscription gave you access to all their features.

> *forcing function. How do we balance being bold and audacious while still keeping an eye on our life?*

They applied this mentality to their pricing strategy. Grammarly's first consumer pricing plan back in 2009 was dead simple: one subscription gave you access to all their features.

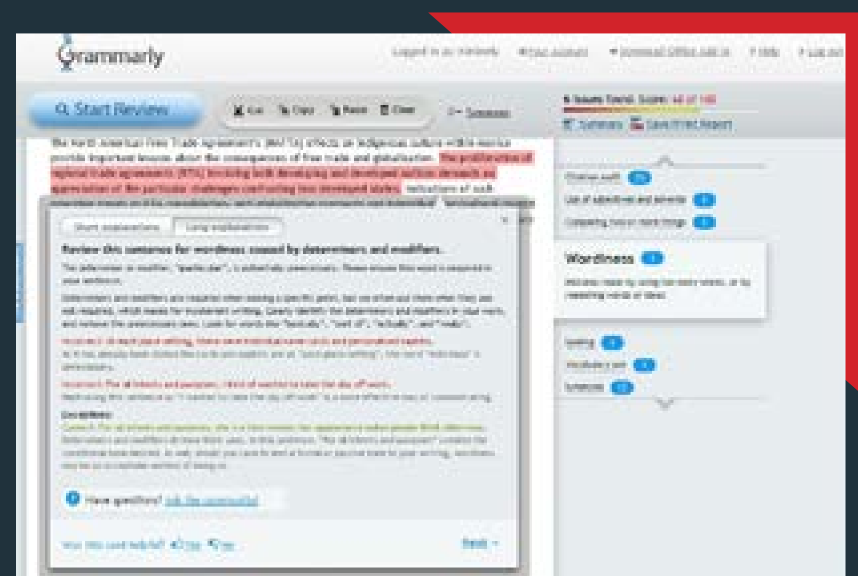
By giving customers three options, Grammarly was able to test how much value a site visitor saw in their product based on their first impression. If they bounced once they saw the pricing, they'd get an email that asked why and be offered a 7-day, money-back guarantee.

This conversion strategy enabled them to

- test the effectiveness of their current acquisition strategy, and
- open up a direct feedback line with future customers.

Grammarly was focused on learning who their customers were and getting feedback from the onset. After enough product iterations, and user feedback, they were able to raise their prices to roughly $25 for the monthly subscription, $17 for the quarterly, and $10 for the annual.

But Alex Shevchenko wanted to learn more, faster. They decided to build feedback into the app experience. Every Grammarly correction that a user would read through also had a thumbs up or thumbs down rating:

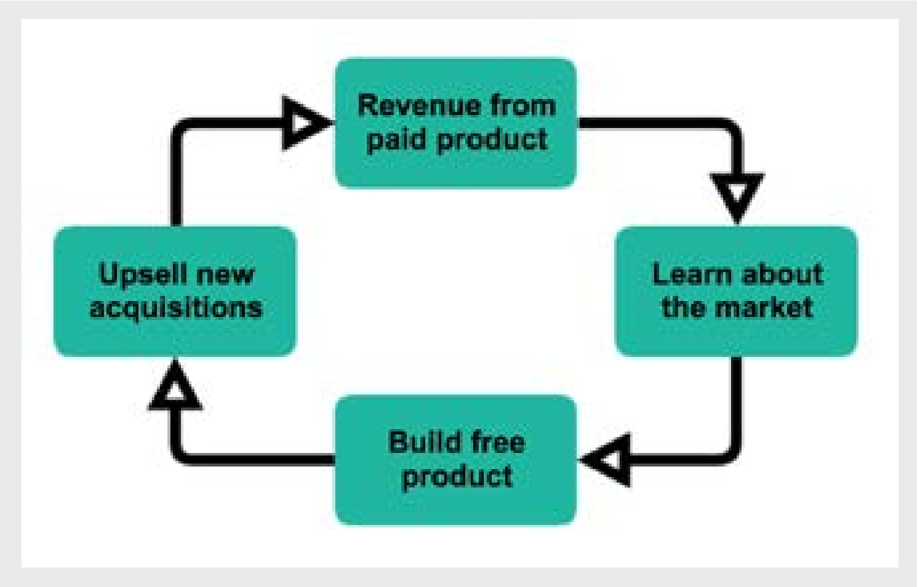


Through this simple feature, Grammarly was able to assess which functions were most valuable to their customers. Because customers were already paying for their product, they were invested in its success. Free users, wouldn't have been compelled to upvote "yes" or "no" on a product that they were just test driving.

It wasn't until 2015, when they had eight years of user data and over 3 million registered users, that Alex and Max finally made the switch to freemium. They created free browser extensions that allowed users to check their spelling and grammar right where they were writing. Their most valuable features—a plagiarism checker and vocabulary builder— remained a part of the premium plan.

This is the flywheel of growth that freemium can access:

- You use your paid product to understand your customers. As these customers are invested in your success, they will give important feedback to make your product better.
- You learn about the market, what they value and what they'll pay.
- You can then use this information to build a free product at the lower end, offering features that don't make economic sense in the paid version.
- The free product then becomes your acquisition tool, as newer free customers understand the value of those features and the extended value of your paid product. You upsell, get invested paid customers, and the cycle begins again.



Their free product helped Grammarly spread like wildfire. Everyone from lawyers to bloggers to academics took advantage of the handy plug-in, and a significant portion of them converted to premium users. Today, they have over 6.9 million daily active users.

BEFORE FREEMIUM, WISTIA DEVELOPED ITS MESSAGE

Wistia has become one of the most popular B2B video hosting services on the web, but that's not exactly what they're known for. If you've ever stumbled across their blog or seen one of their rap videos, you've seen the immense community that they've built around their product. When founders Brendan Schwartz and Chris Savage first launched their company, it was a video portfolio site for artists. They didn't have much luck in that market, so they decided to pivot and work on a product for businesses. But, as

Chris later admitted, they had no idea what they were doing in this space.

Chris's has said:

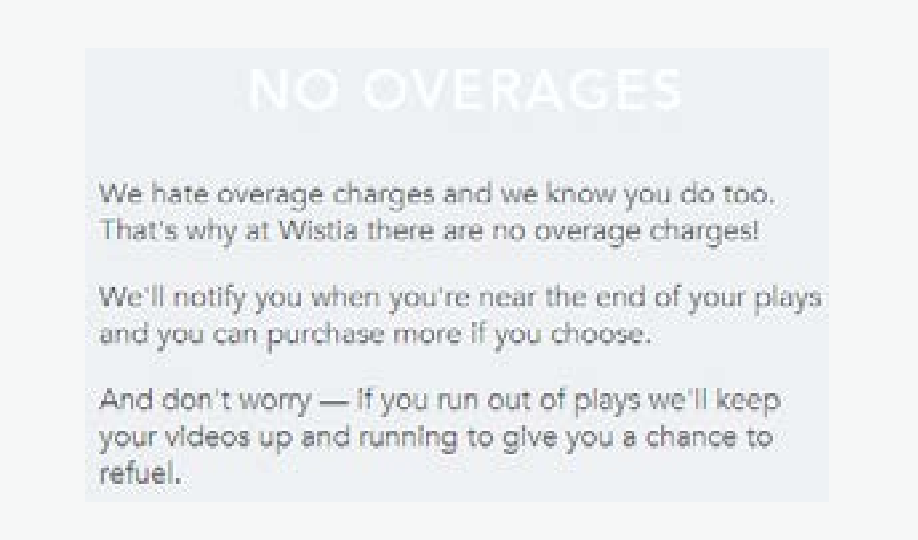
> *The #1 question when you're starting out as an entrepreneur is whether or not you are building something that people actually want.*

Their first pricing "strategy" was three numbers scribbled onto a piece of paper—"Lite, $99/mo—Medium, $200/mo—Heavy, $400/mo." They wanted validation to make sure that someone would pay money for what they were building. When the customer went with the "best" plan, they knew they were on to something.

Soon after they put together a pricing page that looked like this:

- **$79/** month for **Basic**
  - **1** Manager
  - **50** Contacts
  - **Unlimited** Projects
  - **10 GB** Storage
- **$179 /** month for **Enhanced**
  - 4 Managers
  - 200 Contacts
  - Unlimited Projects
  - 25 GB Storage
- **$379** / month for **Premium**
  - 10 Managers
  - **Unlimited** Contacts
  - **Unlimited** Projects
  - **100 GB** Storage

The bottom of the pricing page had this note about overages:


NO OVERAGES

We hate overage charges and we know you do too. That's why at Wistia there are no overage charges!

We'll notify you when you're near the end of your plays and you can purchase more if you choose.

And don't worry — if you run out of plays we'll keep your videos up and running to give you a chance to refuel.

It was a good start. The number of "managers" of the account was a good proxy for business size, so it was easy for a site visitor to choose the plan that was best for them. The note on overages was icing on the cake since this was a differentiator from big-fish competitors like Brightcove and Ooyala.

Within a few months, they added a two-week free trial. Within a year, they added another tier, the "Solo" for $39/ month, to get more customers downstream. Over the course of five years, Wistia experimented with dozens of iterations of their pricing page. They experimented with:

- **The number of tiers**
- **The packaging of the tiers**
- **The nomenclature of the tiers**
- **The disclosure of the high-tier prices**

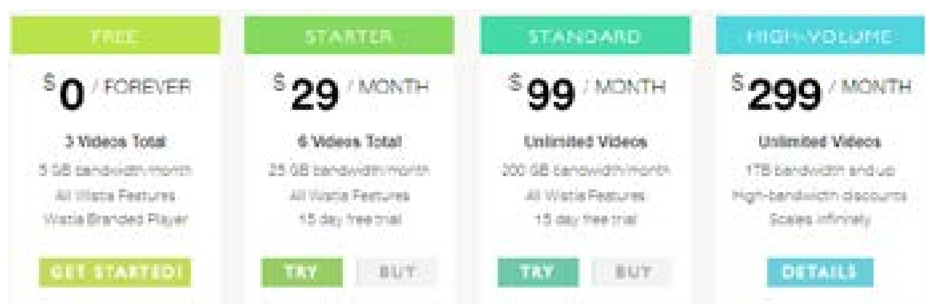
Five years of experiments made Wistians confident in what their product was worth, and what exactly their users were willing to pay for. But according to Chris Savage, the biggest benefit of this constrained growth, was the opportunity to establish their culture and form a tight-knit community around their brand. The small user base allowed Wistia to learn from people intimately—through site-visits, personal emails, and through their online community.

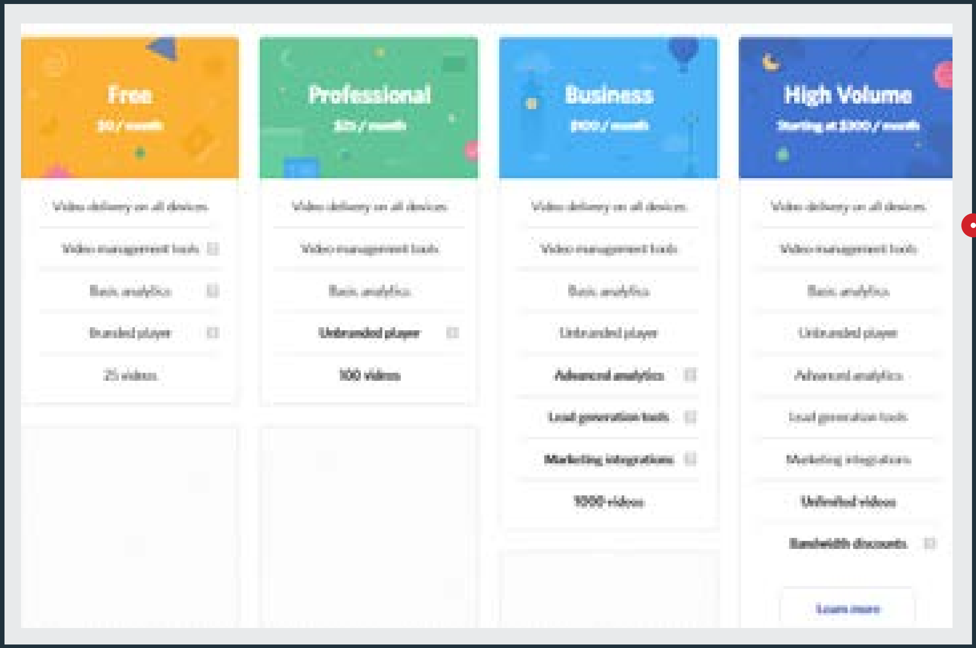
When they finally announced their free plan, it was five years later, and in their, unique Wistia style:

[embed free plan rap: https://wistia.com/blog/free-plan]

But their pricing experiments didn't stop there. They updated their free plan several times to find the sweet spot between how much to give away for free and how much to save for the premium plans.

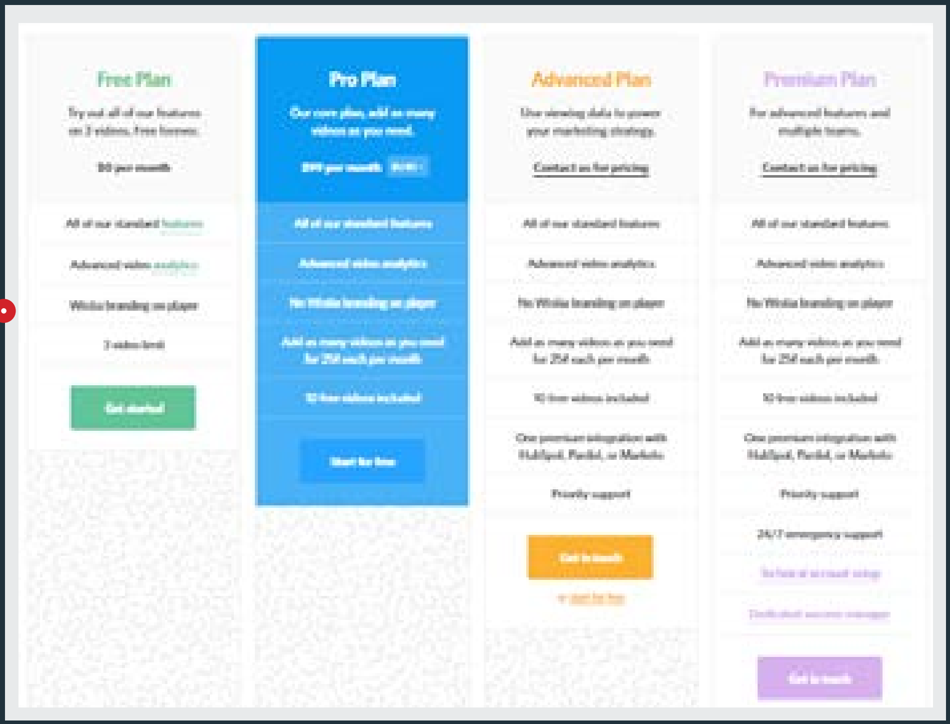
The initial free plan only allowed for users to upload three videos to the platform. It was a small offering, but they immediately saw an uptick in signups:

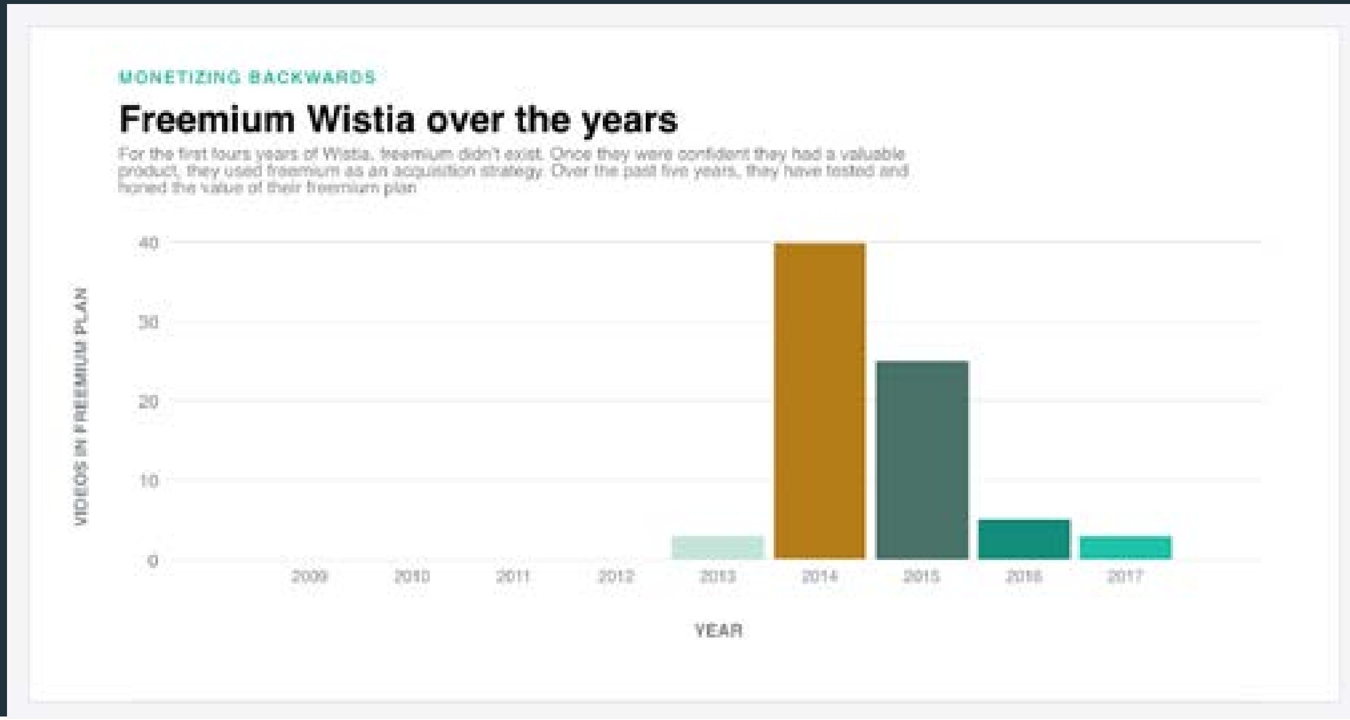




Wistia eventually settled on their original 3-video free plan to ensure that enough customers used it as a starter plan and then would eventually upgrade:

If you chart out their freemium plan over the course of Wistia's lifetime, you get this:





For the years 2009-2012, Wistia were understanding themselves. The message they wanted to send and the value they wanted to bring. Once they were confident they understood these components of their business, they used the freemium flywheel to drive growth through acquisition.

One thing that should be obvious from that graph—they got it wrong. Initially, the freemium package they offered was too large. This meant that free users were missing the emphasis to upgrade for more videos (the Wistia value metric at the time). From 2014-present they have iterated on their freemium offer to tailor for the correct market and upsell balance.

Another thing that should be obvious from the graph—though freemium is for acquisition, not revenue, once you implement it you have to treat it as part of your pricing strategy. That means testing and iterating the freemium package constantly. You won't get it right first time. You need to learn what the most valuable package is for your customer and for you.

Without the constraints of slow growth, Wistia would not have had the time to understand their message. Years of learning from a small group of customers set them up to be well-prepared for an iterative acquisition strategy that put Wistia into the hands of over 300,000 businesses across 50 different countries.

BEFORE FREEMIUM, MAILCHIMP BUILT A BUFFER

MailChimp is practically a household name in marketing, boasting over 15 million customers and over 500 million in revenue. But, as a Times article pointed out, they had a very unsexy growth story: "No venture capital, no Bay Area presence, no crazy burn rate: MailChimp's founders built the company slowly by anticipating customers' needs and following their instincts."

MailChimp, founded in 2001, was one of the earliest email marketing service providers. It was initially started as a side-project by the Rocket Science Group, a design consultancy firm based in Atlanta. When client after client raved about the fun and intuitive design of the product, founders Ben Chestnut and Dan Kruzius decided to make that the sole focus of the business.

To test the waters, here's the first pricing structure they came up with

Signup For Your Mail Chimp Account

We respect your privacy. This is our pledge to you.

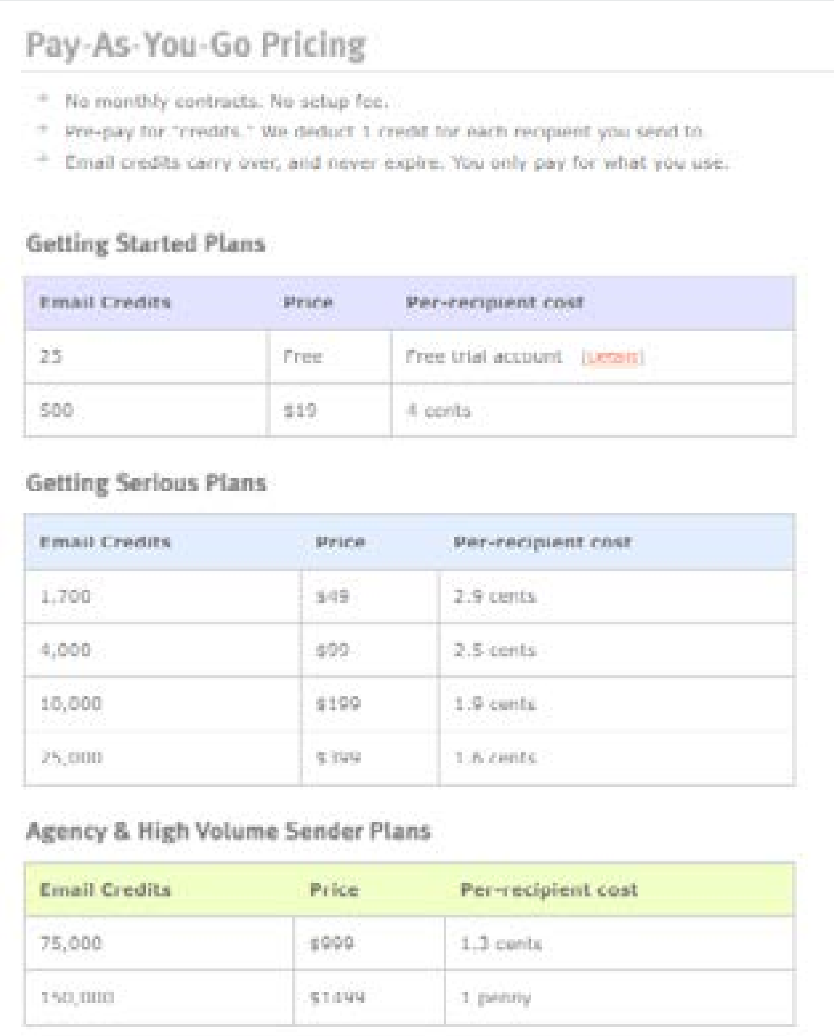
Your data will not be shared, sold, or given away to anybody. Ever.

(*) indicates required info.

Select your account type:*				
◉	Free Trial	25 emails	Try out Mail Chimp Today!	
○	$50	2,500 emails	Great for test-campaigns!	2¢ per email
○	$100	8,000 emails	Perfect for small businesses	1.25¢ per email
○	$250	25,000 emails	For larger lists, or lots of clients	1¢ per email (best buy)

Back in 2001, their only offering was rich HTML emails. They separated each tier by the volume of emails, and tied each value to a buyer persona. Over the next ten years, they changed their pricing half a dozen times as they diversified their offerings and expanded their customer base.

In 2005, they had a pay-as-you-go plan with a free trial, where customers only paid for as many emails as they sent:



Pay-As-You-Go Pricing

- No monthly contracts. No setup fee.
- Pre-pay for "credits." We deduct 1 credit for each recipient you send to.
- Email credits carry over, and never expire. You only pay for what you use.

Getting Started Plans

Email Credits	Price	Per-recipient cost
25	Free	Free trial account [details]
500	$19	4 cents

Getting Serious Plans

Email Credits	Price	Per-recipient cost
1,700	$49	2.9 cents
4,000	$99	2.5 cents
10,000	$199	1.9 cents
25,000	$399	1.6 cents

Agency & High Volume Sender Plans

Email Credits	Price	Per-recipient cost
75,000	$999	1.3 cents
150,000	$1499	1 penny

By 2007, they had re-introduced a monthly plan:

Monthly Plans for Frequent Senders

The convenient way to send multiple campaigns to your customers every month, for one low price. Send weekly campaigns, surveys, or special promotions, and never worry about paying added hosting fees or setup charges.

Your Email List Size	Monthly	Non-profits	Comes with:
0-500	$15	$12.50	• Free image hosting • Free multiple lists • Free campaign reports • Free signup forms • Free support • Free email templates
501-2,500	$30	$25.50	
2,501-5,000	$50	$42.50	
5,001-10,000	$75	$63.75	
10,001-25,000	$150	$127.50	

Try MailChimp Free! (no credit card required for free trial)

* Send up to 8 campaigns to your contacts each month

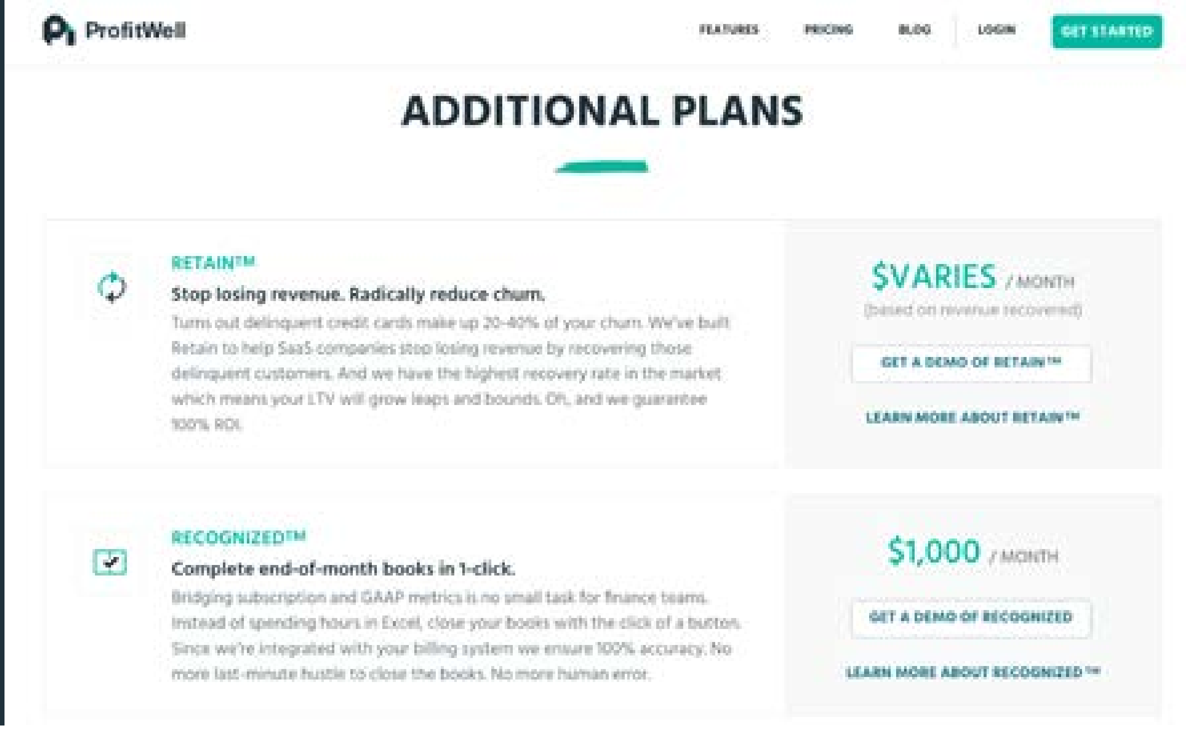
** Email list size is total across all lists in your account

Along the way, MailChimp was obsessed with tracking data on pricing. They tracked their revenue, the order volume, any upgrades and downgrades, and refunds—all of which proved instrumental later, when they were deciding which features to offer in their free product.

But they weren't waiting to find the perfect pricing structure, or looking to form a connection with their customers before switching to freemium—they waited until they were profitable.

In a post that celebrated the first year of freemium, Ben explained that MailChimp wanted to make sure that they had the extra cash to support the expenses that a free product required. They had slowly grown to 85,000 users and attained profitability as they worked to create an "affordable, scalable, self-serve product." When they moved to the cloud, they had the money to support a freemium tier.

Support for freemium comes in the form not only of support costs for non-paying customers. If your freemium is the ***faux free trial*** variety, you also need that buffer so you can do what Mailchimp and Wistia have done—test pricing. With a buffer, you can afford to get it wrong before you get it right. If you build freemium from the beginning, you run into the problems of Bidsketch and Chargify without a buffer. You have to either get it right first time or you risk anchoring customers to a free plan and lose the ability to upsell properly.



As MailChimp had this buffer, they could launch the freemium flywheel and have iterated every since. Even in that first year, MailChimp grew the number of paying customers 1.5x and increasing their profits 650% in just one year.

BEFORE FREEMIUM, PROFITWELL UNDERSTOOD THE NUMBERS

Though slightly different to the companies above, you could also say ProfitWell monetized backward. Our strategy arm, Price Intelligently, was bootstrapped, profitable, and gave us a strong understanding of our customers before we chose to launch ProfitWell. Without this foundation, ProfitWell probably wouldn't exist.

But, as we saw in the previous chapter, the ultimate choice of freemium for ProfitWell came from the unit economics. Wistia and MailChimp are faux free trial freemium. ProfitWell is more akin to Grammarly offering perpetual value. We offer the core package for free and charge for premium features. With Grammarly, those are the plagiarism checker and vocabulary builder. With ProfitWell, they are Retain and Recognize for delinquent churn and revenue recognition.

But our path to this decision is different to Grammarly (and MailChimp and Wistia). We launched ProfitWell as a freemium product from the beginning, which goes against everything we set out above. But we had already learned the foundational data from Price Intelligently:

- As we had seen inside more SaaS companies than anyone else, we understood the customer and what SaaS companies needed from an analytics package.
- We knew how to speak to these customers and get them to *(a sign up for the core package, and b)* upgrade to the premium packages.
- We had built up a buffer with Price Intelligently, which we had bootstrapped to be profitable from day one.
- To this, we added another data point—willingness to pay. Initially we weren't set on building a freemium product. Instead we let the data lead us to that conclusion. Our WTP research showed there wasn't the market for a paid analytics product. There was a market for some premium offerings associated with those analytics. Slicing the product into a free core and paid extras was what the data said would make ProfitWell revenue positive. The decision was made.

Freemium only works if the numbers work.

IT'S NOT NOW OR NEVER

Freemium is a polarizing concept. Ask ten different entrepreneurs and half will tell you it's the way to fast growth, and the other half will tell you it's a sure way to shoot yourself in the foot.

But as these companies have proven, you don't have to start with Freemium if you're not certain that it's the right acquisition strategy. You can take months, years, or even half a decade to learn from your customers, and then make a well-informed decision to offer a free product. Taking the time to understand your customers, understand your business, and understand your numbers is how any company can make freemium work.

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Chapter 05

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TACTICAL GUIDE TO MAKING FREEMIUM WORK

Your most valuable marketing asset is your product, and a freemium approach can be a cost-effective way to highlight the product's value and acquire new customers — if done right.

In the previous chapters we shared the Why of freemium. In this final of The Freemium Manifesto it is finally time for the How. Stories and case studies are great for learning, but at the end of the day you need to apply the insights to create and execute your own freemium plan.

After working with thousands of SaaS companies, we put together a freemium tactical guide to help you quickly show value, align your customers' needs with the right value proposition and present them with a clear path to upgrade.

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THE PATH TO UPGRADING YOUR FREE USERS IS A PROCESS NOT AN EVENT

The key to making money using the **perpetual value model** is based on your ability to upsell.

At ProfitWell, we dramatically reduced our CAC and got a ton of new users when we decided to give away the core product for free. In this model, we provide our new users with a quasi-customer experience where they still received all the support and value from the core product. Our monetization goal then becomes a clear and compelling path for them to purchase our premium features.

Priming your new users to pay for more value is a process. You need specific progressions to get you there:

- **Step One:** Establish your core product's value immediately — You can't upsell a product that adds no value.
- **Step Two:** Identify what your customers need — It's easier to upsell a feature that solves a real pain point.
- **Step Three:** Upsell the right message at the right time — How and when you communicate makes a difference.
- **Step Four:** Keep measuring, learning and iterating — Your customers tell you what they value. You improve your products and find more ways to upsell.

Selling anything is hard, but when you are able to tie the right upgrade features to meet your customer's needs and help their business grow, upselling becomes a matter of presenting the right value at the right time.

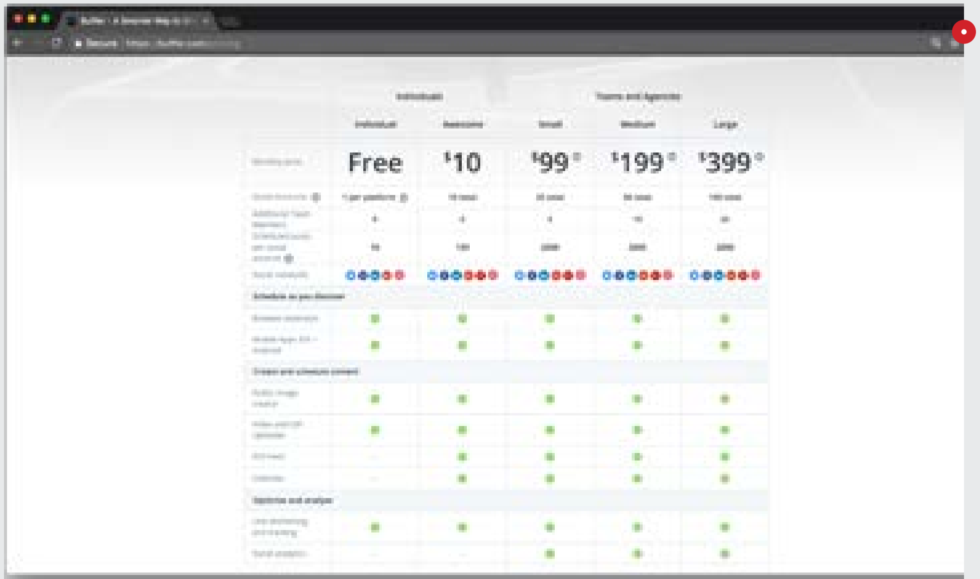
STEP ONE: ESTABLISH PRODUCT VALUE IMMEDIATELY TO DRIVE ADOPTION

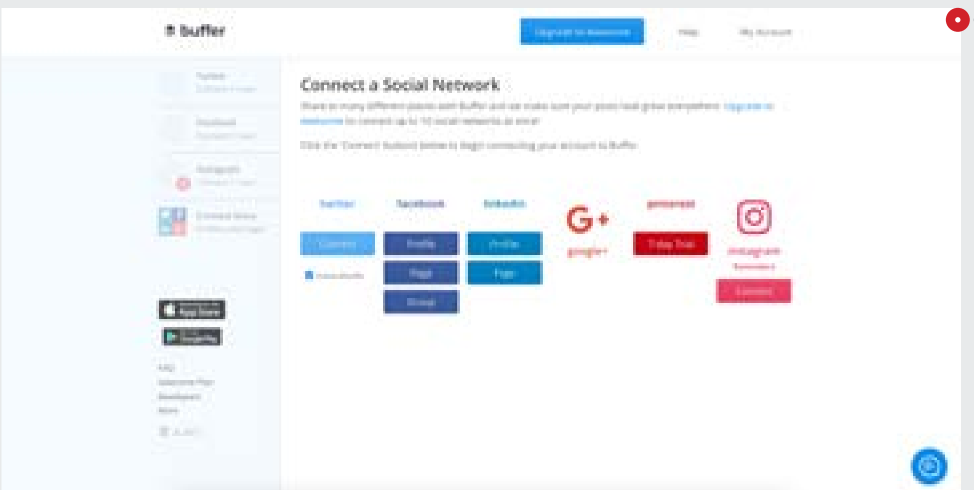
Before you can think about upselling, you need to sell the free product first.

You can't tell users that your product is the best or promise it will help grow their business and expect them to take your word for it. You need them to use the product to understand that value. This is the power of freemium in the first place—you can show rather than tell. Freemium lowers the barriers to entry, but, once entered, the old rules still apply—users have to see value.

Considering 40-60% of users open an app once and never log in again, the first 24 hours is a critical window to onboard your users. Groove found their users were 80% more likely to convert to paid customers if they completed onboarding on the first day. User adoption comes down to making an impactful first impression that gets them working (experiencing the value) immediately.

This is why the concept of the (quasi-)customer experience is so important. Treat people like free users and they won't become customers.





Treat people like paying customers and they will become paying customers. If you want them to become $1000/month customers, then onboard them like they are already paying $1000/month. At this point, they are your customers to lose!

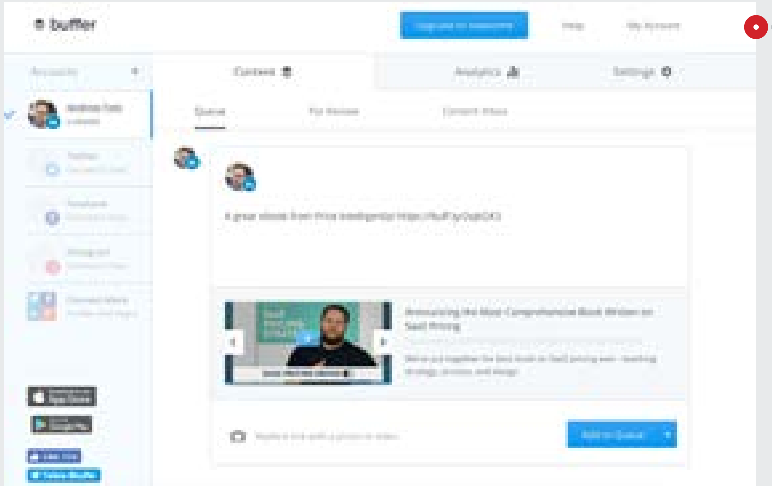
HOW TO TURN A FREE CUSTOMER INTO A USER

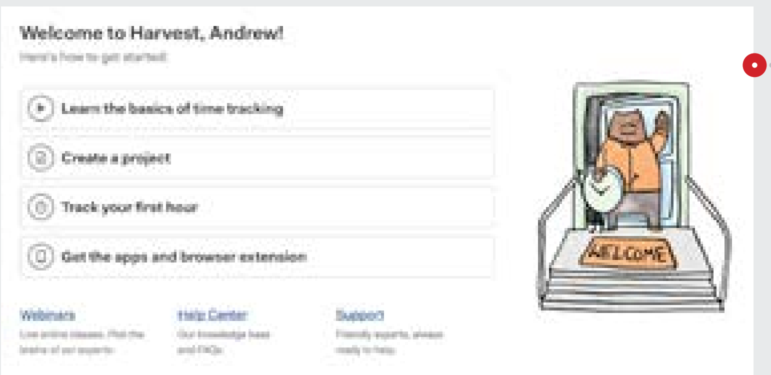
As we mentioned earlier, your best marketing asset is your product. Get them to use your product and you are on your way to pushing them down the path to an upsell.

Let's look at how social media management tool Buffer does this. Buffer has a hybrid freemium plan. The plan expands into payment across different value metrics (accounts managed, scheduled posts, team members), but also offers an upsell to the Awesome plan through add-on value features *(calendar scheduling and enhanced analytics):*

But if you sign up for Buffer you can immediately use the service. The core value is open to all. The onboarding flow works the same if you are on the free plan or the large team plan. The first step is always to get connected:

Then you are immediately transported to the dashboard for your accounts so you can get started sharing:





You are now underway with Buffer. You can add one account from all your social media, and queue up to ten posts. This is the core value of buffer—what it started out as—so even if you never pay a single penny, you can use Buffer for its intended purpose with the freemium account. You are treated like a paying customer, even if you never do.

This approach is even more important with more complicated products. [Harvest is a time tracking tool]that has a perpetual value freemium option. When you sign up, instead of being taken straight into the app, you have a welcome screen that guides you through the initial setup:

Because it is more complicated than social media scheduling, they provide a handy video to help you through setting up your project and tracking your time:

Again, this is the onboarding flow for everyone.
You are a Harvest customer whether you pay or not.

The first step to a successful freemium program is to treat users like they are paying customers by providing an exceptional on-boarding that gets them working on the first day. Of course, user engagement doesn't end with the initial onboarding, but the best opportunity you sell your product starts on day one.

This is how long it took people who **Used Feature** to come back and do **Used Feature** between **April 1, 2015 - September 30, 2015**

Used Feature		Used Feature again by Weeks												
Property	People	1	2	3	4	5	6	7	8	9	10	11	12	> 12
feature a	322	46.4%	22.7%	17.4%	16.9%	12.3%	12.3%	10.9%	11.1%	11.2%	11.1%	9.1%	8.9%	24.4%
feature e	199	50.3%	18.1%	15.6%	12.1%	15.6%	12.6%	11.6%	8.5%	11.1%	5.5%	6%	5.5%	21.1%
feature c	127	52.8%	26%	13.4%	15%	20.5%	15%	16.5%	12.6%	18.1%	11%	16.5%	11%	32.3%
feature f	76	57.9%	23.7%	22.4%	18.4%	14.5%	13.2%	9.2%	11.8%	9.2%	3.9%	5.3%	6.6%	22.4%
feature b	46	69.6%	26.1%	23.9%	23.9%	13%	13%	6.5%	8.7%	15.2%	6.5%	4.3%	10.9%	10.9%
feature g	36	72.2%	41.7%	52.8%	36.1%	36.1%	30.6%	27.8%	22.2%	27.8%	22.2%	22.2%	27.8%	36.1%

Export Data Schedule Display: Percentage of people Showing: 15 1 - 6 of 6

STEP TWO: IDENTIFY THE VALUE LEVERS THAT DRIVE YOUR CUSTOMERS TO PURCHASE

Upselling is a marketing initiative, and the foundation of a successful marketing campaign always starts with understanding your target customers and communicating the right value proposition that will resonate and lead to a sale.

As your customers use the product, they become a treasure trove of marketing insights that will help you fine-tune your customer personas and prioritize the upsell features that they would likely pay for.

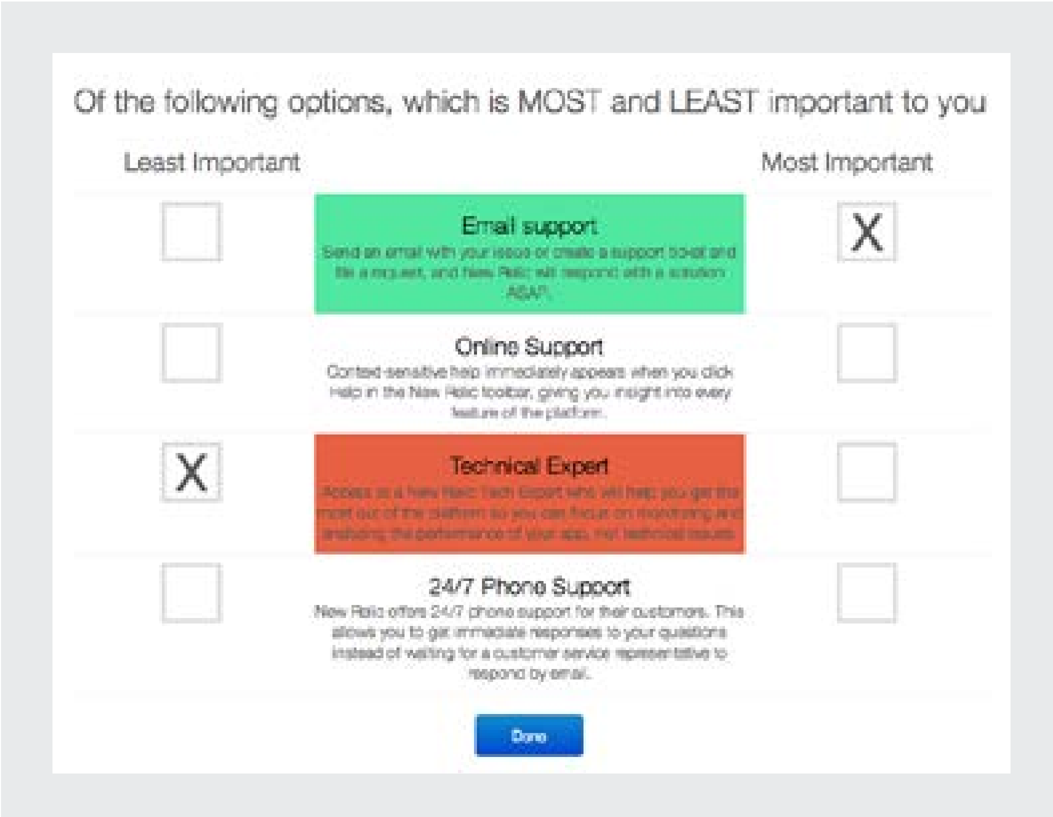
This is how we built out ***Retain*** and ***Recognized*** at ProfitWell. We found out what additional features our customers craved once they understood their core analytics through ProfitWell, and offered them this opportunity.

When you analyze how your customers use the product, you can identify which features drive repeat usage to uncover your customers' needs. Understanding your customers' pain points will give you insight into crafting your upsell messaging and choosing the right add-ons that will sell. **If you can anticipate a need and deliver a solution for the right price, upselling is not as hard.**

Here are the two types of analyses to identify which features drive the most value and a third analysis to determine their willingness to pay for those features:

1. **Track feature usage by customer persona**

A cohort analysis from an analytics product like Amplitude tracks the behavior of a predetermined group of users to understand which features are being used. Over a period of time, you can see how many times each group came back to the same feature.



In the visualization above, you can see the features and the # of people that used each feature on the left side. The chart shows the percentage of people who used the feature again with the darker shades showing increased usage.

Cohort analysis gives you the insight you need to know what works well within your product and what doesn't. This can then inform your choice for what the upsell should be. If, for example, you run a SaaS metrics analytics product and see that the most consistently used feature is the churn graph, you can then look at n the visualization above, you can see the features and the # of people that used each feature on the left side. The chart shows the percentage of people who used the feature again with the darker shades showing increased usage.

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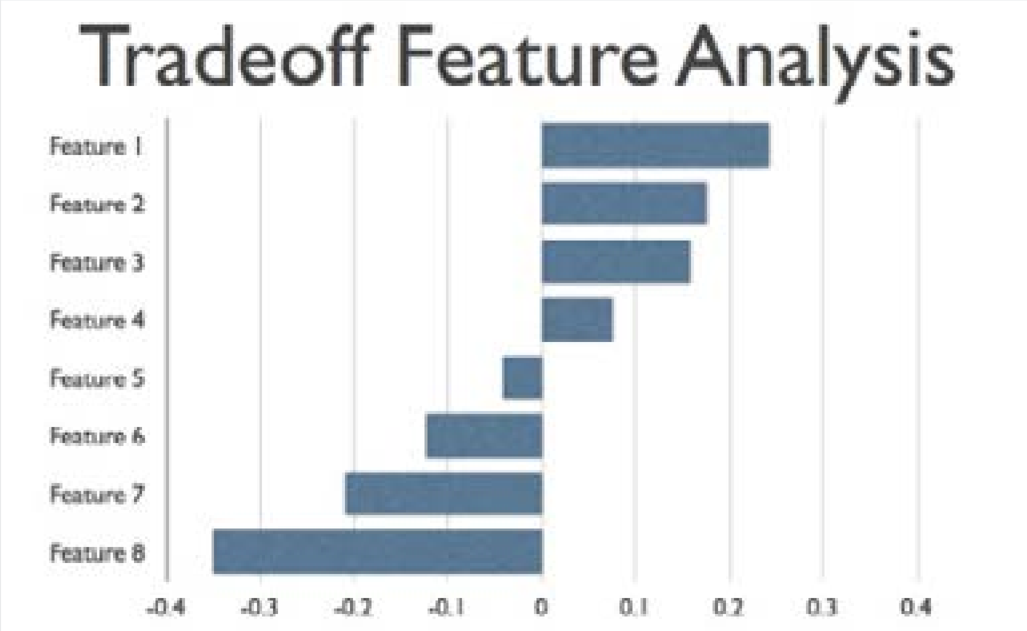
2. FORCE YOUR CUSTOMERS TO MAKE TRADE-OFFS

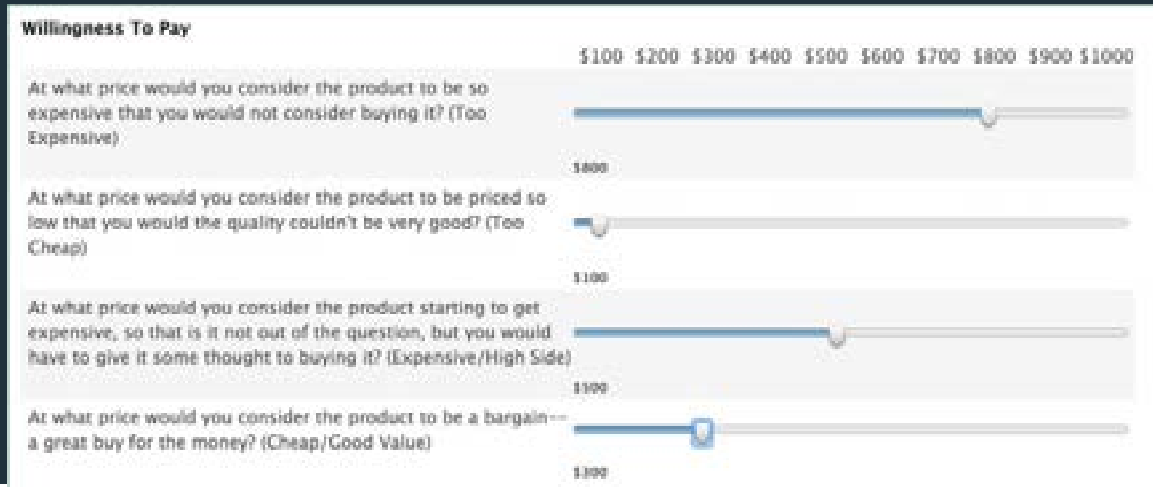
If you don't have a research budget for a cohort analysis, or are just starting out so don't have the data available, a simple alternative is to run a feature value survey. Asking the right questions in the right way can be the difference maker in collecting actionable data.

Instead of asking your customer to prioritize features, it is more effective to ask them to make trade-offs between the features. Given a choice of 5 new features for your product, which one would they most like, and which one would they least like: When you graph all the responses, the differentiation between the features becomes more clear, helping you make decisions.

The features that are most important to your customers will help you determine how to select and package your add-ons in a way that makes logical sense for customers to upgrade.



For instance, in the above survey we performed with New Relic, they might choose to use email support as a premium add-on to a freemium product. This is inherently valuable to customers, so it's a great place for New Relic to derive some of that value from customers, while leaving users that just want the core features able to enjoy them for free.



The approach is based on four questions as seen below.

3. PRICE YOUR UPGRADE FEATURES ON VALUE

Discovering which features resonate with your users is only half of the equation. The second variable is in deciding how much to charge. For your upsell strategy to work you need to figure out their willingness to pay for the feature. Beyond finding the right price point that won't deter a purchase, you also don't want to leave money on the table or choose a price that is not profitable.

Don't make the mistake of pricing your upsell products or premium tiers based on competitors or your costs. In both cases, you run the risk of undercharging. The optimal price point should deliver the most value to both you and your customers. You can start to set your pricing based on this value driven approach using the Van Westendorp's Price Sensitivity Meter.

This tells you that, for this product, the sweet spot is around $500. If you go much lower than that, you risk devaluing your brand. Much higher and people simply won't pay.

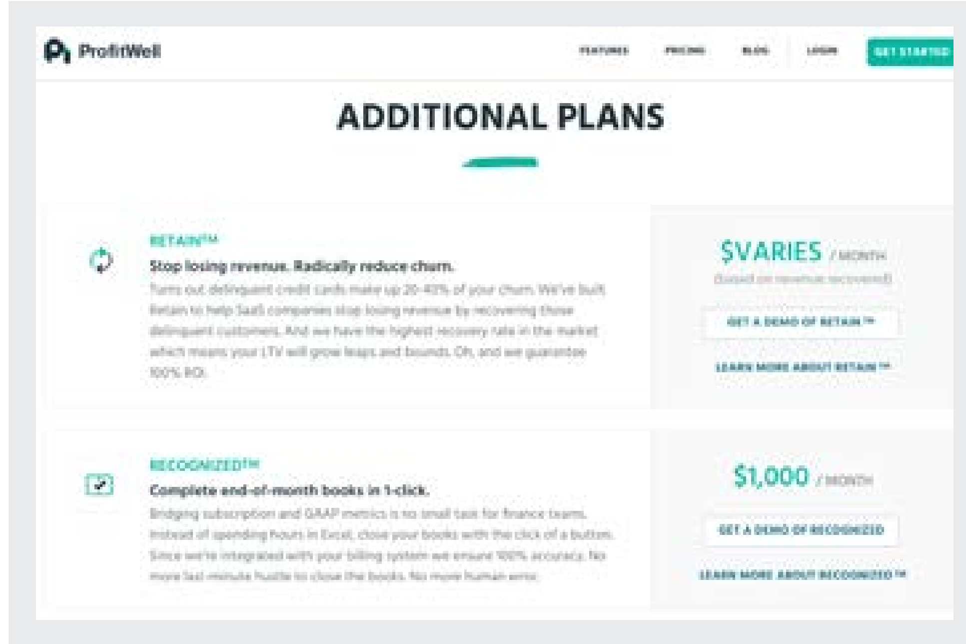
This technique is not only invaluable for determining the price of your premium product, it is invaluable in determining the price of your free product as well. You should continually run price sensitivity surveys across your product stable. This is for two reasons, both related to your unit economics:

- In the early days, you want to find out whether you have a viable product, freemium or otherwise. Using willingness to pay, we found that there wasn't going to be the right lifetime value for ProfitWell at any significant price point. Not enough people were willing to pay high enough for there to be a workable market. So we chose freemium. Willingness to pay should be a deciding factor in your freemium decision as well.
- As you expand out your product and offers, the willingness to pay of your market will change. It could be that your best monetization strategy changes from freemium to fully paid. Without constantly checking with your customers, you won't know this and won't be able to improve your unit economics.

STEP THREE: UPSELL WITH THE RIGHT MESSAGE AT THE RIGHT TIME

You've given away your core product for a very good reason: it's a lot easier to grow revenue from your quasi-customers who are already happily using the product. Not to mention, acquiring a new customer without freemium is five times more expensive.

If you've done a good job providing your users with continual value, but don't push hard enough with upgrade opportunities, they will continue to use the free product forever. Your monetization goal is to upsell. If you've done your research from above, you'll already have a good idea of which add-ons and price points will resonate for each customer segment.



The next step is to communicate the added value with your customers in a way that doesn't interrupt their experience while making it easy for them to convert. Here are three marketing tactics to help upsell your users:

1. CREATE ADD-ONS THAT RELY ON THE CORE PRODUCT

Your upsell marketing tactics will work much better if the upgraded features are intrinsically linked to the value of the core product.

For example at Profitwell, we designed two upgrade products, Retain and Recognized that rely on the metrics from the core product to be relevant. A third, developing your pricing strategy through Price Intelligently, is also intrinsically linked with the thriving businesses we want our users to be growing through ProfitWell. Without the insights generated from our free version, our customers wouldn't have a clear picture of their churn to need Retain, they would not see the value in recognizing revenue effectively to buy *Recognized or care about optimizing pricing with Pricing Optimization.*

The add-ons are compelling

because the free service delivers enough value for the customer to want to go to the next level of analyzing their business. If your add-ons anticipate the customer's needs and build off the free version, the other tactics are a matter of communicating that value.

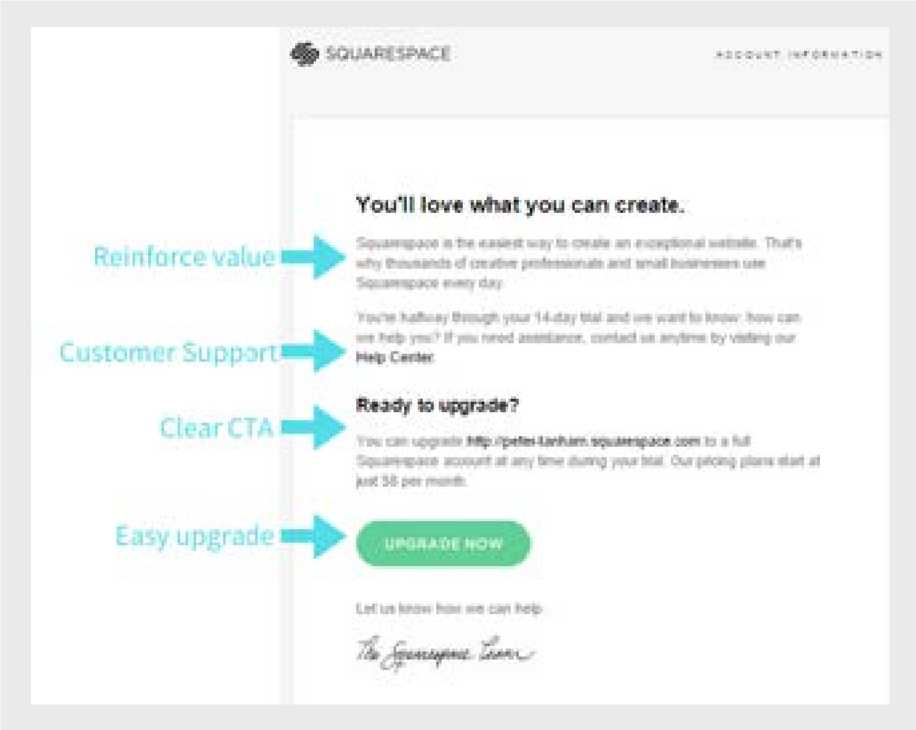
2. BUILD RELATIONSHIPS AND COMMUNICATE VALUE WITH EMAIL

Believe it or not, email marketing is still the most effective channel to build revenue with existing customers. Email allows you to segment and personalize so you can send different upsell messages to target specific customer personas.

Here are some email best practices to keep in touch with your customers, giving them multiple opportunities to add new features when the time is right for them to upgrade:

- **Personalize based on behavior:** Create an email campaign around behavioral triggers, so when a user takes a specific action using your product, they will receive a timely, personalized email.
- **Always show support:** The number one reason customers leave is because of poor customer service. Most customers won't ask for help, so it is important that you are proactive with customer support. Your customer team plays a critical role in the upsell.
- **Motivate customers:** Always include a call to action (CTA) to give your customer a clear directive that reinforces the value message. Be specific and lead them to the sale.

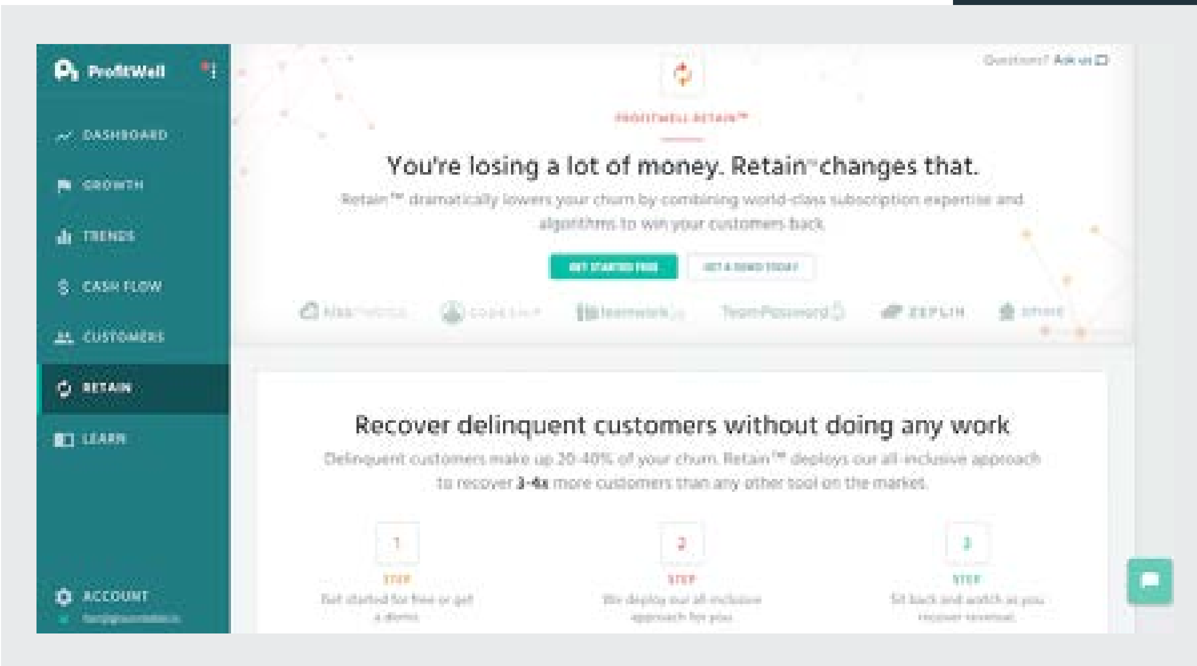
Technically, Squarespace has a free trial rather than freemium, but their emails show all the signs of great upgrade emails:

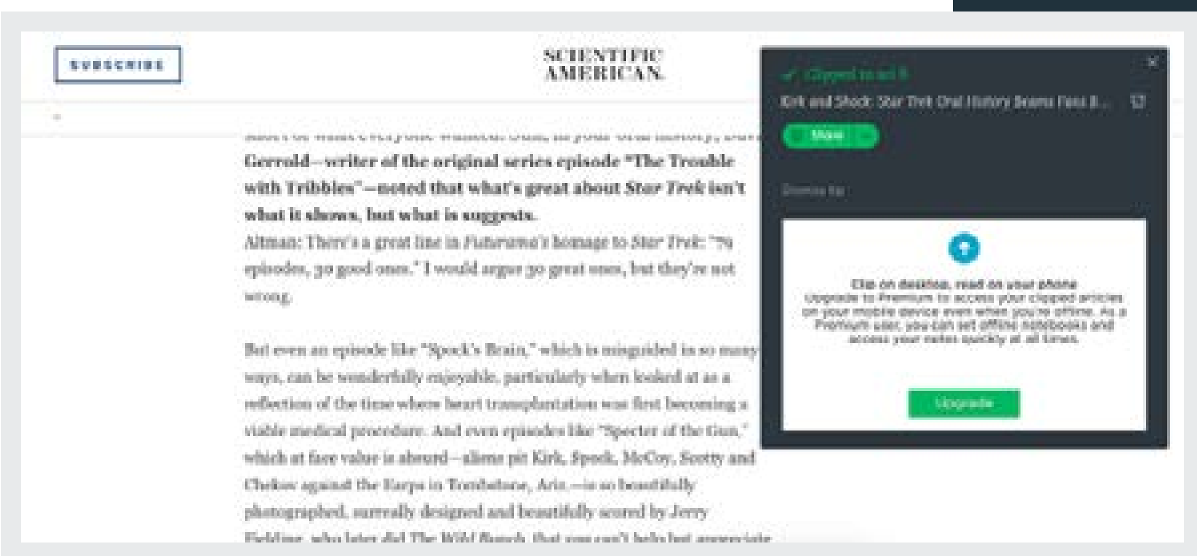


This is also one of the places where freemium can learn from free trials. Because of the time limit inherent in free trials, they need to hone that upgrade message more. With freemium, you don't have the time imperative, but you still want people to understand your value and how they can get more by upgrading.

3. INTEGRATE UPGRADE PROMPTS WITHIN THE PRODUCT

Your customers are busy working on your product and the last thing you want to do is interrupt them with an upgrade message. At the same time, they are not actively looking for new features.





They are focused on their jobs, and need reminders that premium features will help them even more. Integrating subtle upgrade prompts at the right time is necessary, but you'll have to find the right balance to avoid annoying your users. Here are some examples to help you think about your in-product approach:

- At ProfitWell, we want our users to need our upgrade products, such as Retain. The data that they receive from the free versions gives them visibility into their business's churn that begs for a solution. Our Retain feature is available for users at all times on the nav bar to facilitate a seamless upgrade.

When you clip an article using Evernote, an upgrade message reminds users that the premium feature enables them to access their clips offline. The message is specific to the user's action and is integrating into the experience without disrupting the workflow.

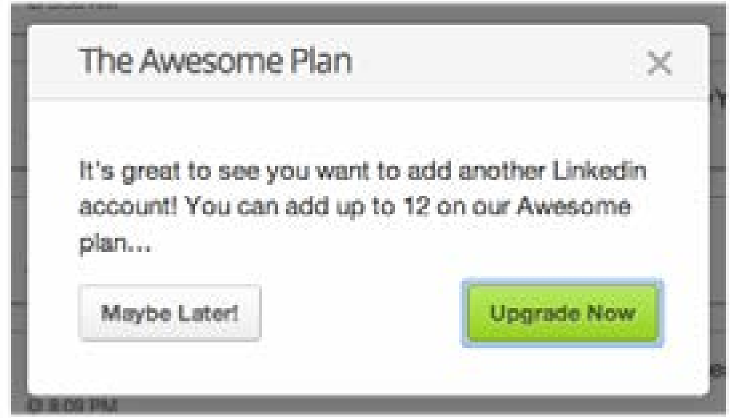
LinkedIn uses a pop-up notification triggered by an action that would benefit from an upgrade. While this type of message can be interruptive, it is highly relevant to the user at that moment and could possibly help the customer. Limit this type of pop-up for specific event-triggered actions that add value to the user experience.

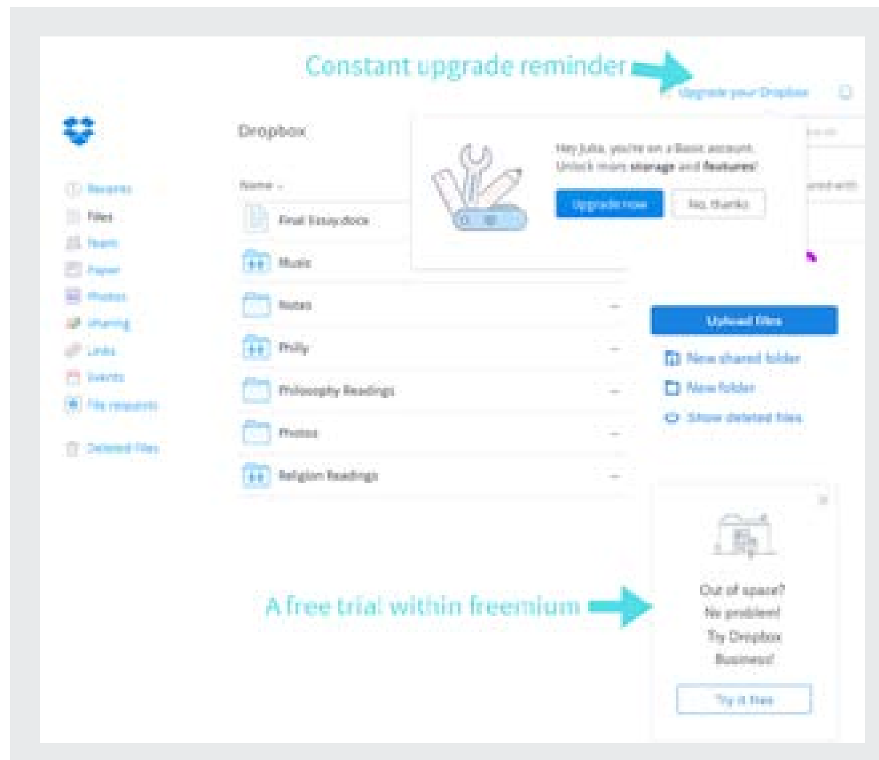
- Dropbox constantly reminds users that they can get more storage with an upgrade. The benefit to upgrade (more storage) is simple and clear. When storage fills up, it is incredibly easy for them to purchase. Another interesting tactic below is offering a free trial within a freemium product. The strategy is smart because once a user gets more storage, they are less likely to go back.
- Don't shy away from reminding your freemium users that there is more to your product. The wupsell options you provide are there to help them (if not, why are they there?) Telling users about these options and helping them upgrade will help them succeed better.

STEP FOUR: KEEP MEASURING, LEARNING AND ITERATING

There is no perfect marketing campaign, no perfect pricing model, and no perfect product. This is good news, because it always leaves room for you to improve and find ways to help customers more and beat your competition.

A healthy SaaS business relies on monitoring several metrics, including monthly recurring revenue, customer lifetime value and cost per acquisition. In addition to these core business metrics, there are three key performance indicators (KPIs) to keep at the top of your dashboard when you are trying to upsell within a freemium model:





1. MONITOR YOUR UPSELL FUNNEL

The process laid out in this section is a tactical guideline to improving your upselling potential. You can continue to improve the process by tracking every step to identify barriers and finding solutions. An upsell funnel analysis would track:

- **Visits to your site**
- **Freemium sign ups**
- **Onboarding success (activating the core feature for the first time)**
- **Upgrade to a paid plan**

You have intimate knowledge of the tactics in each phase of the funnel, so when you spot a barrier or want to improve a phase of the funnel, you will know exactly which areas need to change.

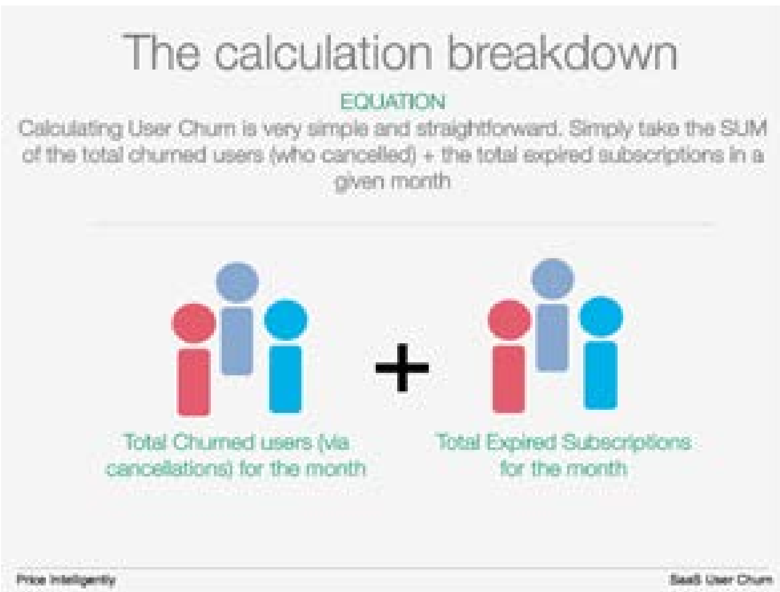
To do this, you can take advantage of one of our favorite processes—the scientific process. Previously, we've set this out showing you how Brian Balfour uses this to increase retention. But the same concept can be used to increase expansion:

- **Define your goals:** Your ultimate goal is to improve upsell. But you want to start with much smaller goals (increase upsell of one product by 10%) and compound growth from these small goals.
- **Observe your data:** Look at what your data is currently telling you. This is from both your analytics and your customers using the techniques above.
- **Determine your hypothesis:** Set out what you expect to happen if you change X. Maybe you decide to add a video to your onboarding like Harvest. What is the impact of this change?
- **Test your ideas:** Add the video and collect the data. Set up a control group with no new video so you can see the difference.
- **Refine, reject, repeat:** Then, like tortoises, it is iteration all the way down

2. REDUCE CHURN TO PROVIDE CONTINUAL VALUE

A critical piece to making your freemium model work is ensuring you are delivering value to your free users right from the start. The best way to measure if you are providing value is through your churn rate.

Here, you need to look at two types of churn. Firstly, straight user churn within your freemium plan:



You want to understand how many people are signing up for free, but still aren't getting the right value from your product. For your expansion churn, it is more valuable to measure net dollar churn, which tracks both the revenue lost from customer churn and the gains that result from expansion (upsell) revenue.

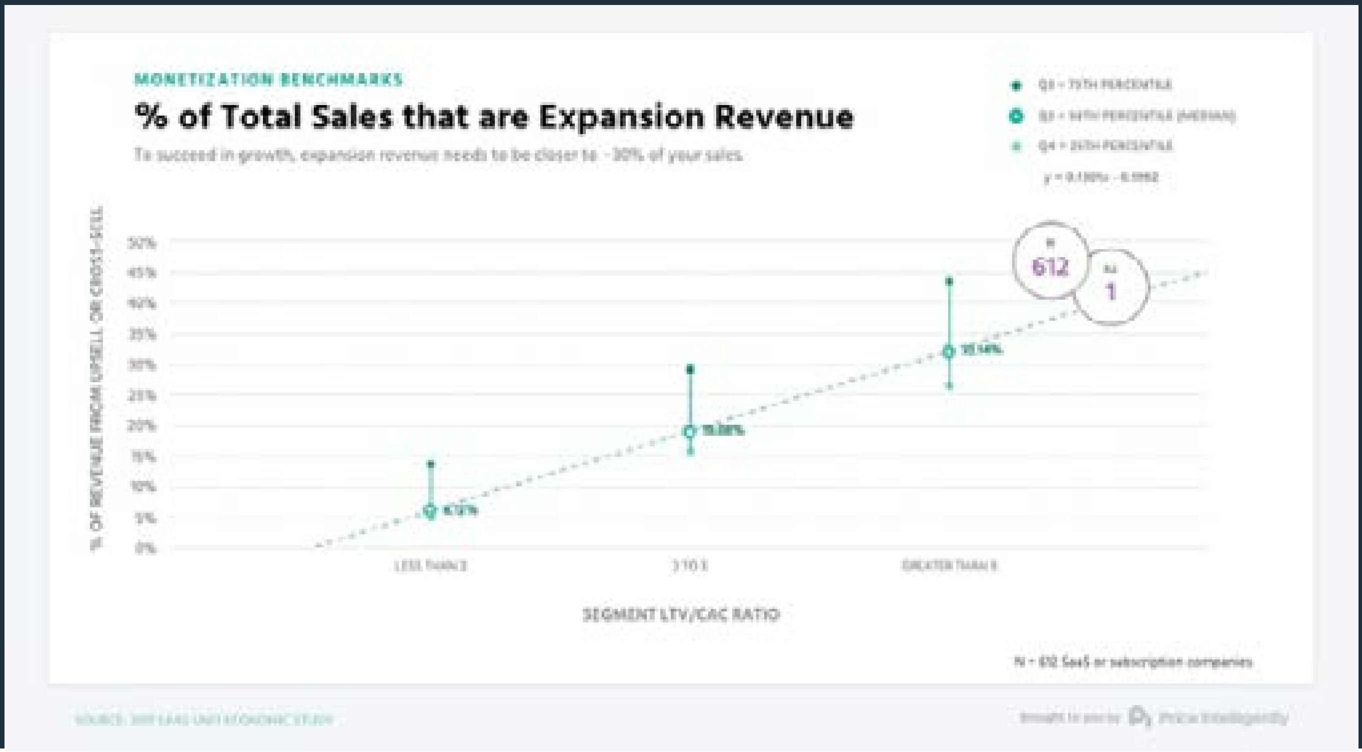
[Source]

This way, you will understand your churn on both a customer and a revenue level and use this data to effect both.

3. MEASURE YOUR UPSELL PERFORMANCE

Growing your business with the freemium model relies solely on the upsell, which makes your expansion revenue an important indicator of business success.

Expansion revenue is the new revenue that comes from upselling your current customer. While churn will help you find areas for improvement within your product, expansion revenue measures where your upsell initiatives are working to get customers to pay for upgrades.



All of the tactics with the perpetual value model process are linked. The more you learn about what customers care about, the better you can make your upgrade features and find new ways to upsell. Your customers win with a better product to help them conduct business, while your business grows the more you learn and improve.

FREEMIUM WORKS, BUT NOT HOW YOU THOUGHT IT WOULD

The freemium fairy tales of yore make great case studies for the history books, but basing your business model on them could lead to disaster. Freemium is not dead; it has evolved into a marketing strategy. The new generation of freemium is about removing the friction for acquisition to grow your user base and upsell them with add-ons that will add value to the product experience. When used correctly, freemium can take your business to the next level with a flood of new users, as long as you have a process in place that leads them down the path of an upgrade.

ProfitWell