



# FIGURING OUT FREEMIUM

## HOW B2B SAAS CEOS SHOULD ASSESS THE FREEMIUM OPPORTUNITY

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*introduction*

# FREEMIUM AND SAAS

Software-as-a-service (SaaS) product adoption has exploded over the past 10 years, with the average business spending \$343K on SaaS products in 2018, a 78% increase from the year prior. Much of this adoption has been driven by SaaS companies offering freemium or free trial versions of their product. With freemium, potential customers can demo certain features of the product for free before deciding if they are interested in making the full investment in the subscription. The freemium model makes sense, as it offers many advantages for customers.

With many large SaaS players like HubSpot and Hootsuite transitioning from a paid-only model to a freemium model, the question remains:

**How should CEOs of paid B2B SaaS companies decide whether to offer a freemium version of their product?**



## ADVANTAGES FOR CUSTOMERS

- As organizations become increasingly decentralized and autonomous, freemium products allow individual contributors to test products without getting management approval.
- Time to product adoption is much shorter with a freemium model – users can download the product without having to speak to a sales representative and can upgrade on their own time.

This paper will provide a framework that can help B2B SaaS CEOs assess the freemium opportunity.

## GOALS OF THIS PAPER

- Provide a litmus test to help CEOs determine the viability of a freemium model for their business
- Demonstrate the value of a free product and a corresponding path to upgrade to a paid product
- Outline considerations and imperatives for the pursuit of the freemium path, including data storage, customer success, and customer acquisition

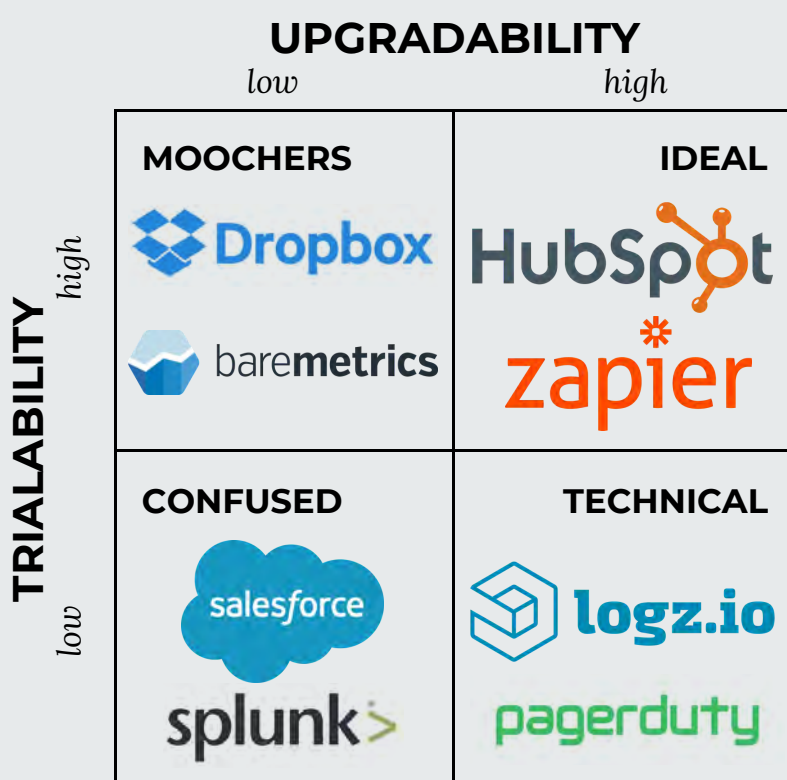
# THE FREEMIUM 2X2

*a framework to assess the freemium opportunity*

When speaking with many CEOs and senior leaders who have either implemented the freemium transition successfully, tried and failed, or avoided it altogether, two key questions consistently appeared:

1. Can you demonstrate the value of your product to a customer through a free version?
2. Does your product have the proper mechanics in place to incentivize an upgrade from a free version to a paid version without human intervention?

These questions can be simplified to two product characteristics – the **trialability** of your product and the **upgradability** of your product. When assessing the freemium opportunity, it is key to first determine whether your product lives in the upper right corner of this freemium matrix, and if not, is there anything you can do as a leader to either simplify your product for trial or add barriers to force an upgrade?



**IDEAL:** Clear candidates for freemium. Simple enough product to demonstrate value in free, but also has trigger points for seamless upgrade.

**MOOCHERS:** Easy to demonstrate value in trial, hard to convince to upgrade. What are some built-in upgrade points in the product? What additional value comes to the user from upgrading?

**CONFUSED:** Enterprise-grade products are typically hard to convert to a freemium version. With complicated, technical integrations and no history of upgrading (more contact-based), having a free product doesn't make any sense.

**TECHNICAL:** Many DevOps and Engineering SaaS products have clear points of delineation (storage, developers, etc.) but are hard to demonstrate in a free environment.



*questions to help with*

# DETERMINING TRIALABILITY

Using a 2x2 grid quickly enables the paid SaaS CEO to determine if he or she should consider investing in a freemium model at all. If the company cannot easily demonstrate value in a free product and cannot incentivize users to upgrade on their own, this is clearly not an appropriate venture for the business. But it can be challenging to determine where a product falls on these two characteristics, and a larger set of questions can help to assess the product's position.

IF A CUSTOMER WERE TO OPEN YOUR PRODUCT WITHOUT ANY EXPLANATION, HOW LONG WOULD IT TAKE THEM TO FIGURE OUT HOW TO USE IT?

HOW LONG IS YOUR CURRENT SALES CYCLE? WHAT DOES THE SALES CYCLE ENTAIL?

WHAT IS YOUR CURRENT IMPLEMENTATION PROCESS? DO YOU HAVE ONBOARDING/IMPLEMENTATION SPECIALISTS FOR CUSTOMERS? HOW OFTEN ARE THESE SPECIALISTS USED?

WHAT IS THE STATUS OF YOUR PRODUCT DOCUMENTATION CURRENTLY? WHO IS MAINTAINING THAT FAQ/DOCUMENTATION AND CAN THAT WORK BE HANDLED BY YOUR USER COMMUNITY? IS THERE A USER COMMUNITY?

WHAT IS YOUR CUSTOMER SUCCESS AGENT/CUSTOMER RATIO CURRENTLY?



*questions to help with*

# DETERMINING UPGRADABILITY

DO YOU CURRENTLY HAVE TIERED VERSIONS OF YOUR PRODUCT? WHAT IS THE PROCESS FOR A CUSTOMER TO UPGRADE FROM ONE VERSION TO ANOTHER?

HOW MANY PEOPLE MUST A CUSTOMER SPEAK WITH IN ORDER TO UPGRADE VERSIONS? HOW LONG DOES THE PROCESS TAKE ON AVERAGE?

WHAT PERCENTAGE OF YOUR UPGRADES ARE PRODUCT QUALIFIED LEADS (PQLS)? IS THAT GROWING IN YOUR PRODUCT BASE?

DO YOU KNOW WHY YOUR USERS ARE UPGRADING TODAY? ARE THERE KEY FEATURES OF YOUR UPPER TIER PRODUCTS THAT ARE DRIVING THOSE UPGRADES?

DO YOU HAVE POSSIBLE BARRIERS TO FORCE AN UPGRADE IN A FREE PRODUCT (# OF CONTACTS/USERS, EMAIL SENDS, ETC)?

## ADDITIONAL CONSIDERATIONS

Assessing the drivers of both trialability and upgradability within your existing product set is key to understanding whether a freemium opportunity exists for your business. Yet even for great candidates for a move from a paid to a freemium model, trialability and upgradability are simply table stakes for considering the move. There are other major considerations outside of trialability and upgradability to consider in making this decision. A CEO must understand the **data storage**, **customer success**, and **customer acquisition** implications of a freemium move, and thus it is important to detail the challenges of freemium in these three areas.





# DATA STORAGE

One of the most commonly cited benefits of the freemium business model is its ability to drive exponential customer growth. Because free features are a great marketing tool, the model allows businesses to quickly attract a user base without expending resources on costly ad campaigns or a traditional sales force. Yet while exponential customer growth is great for a business, it also requires exponential growth in data storage capabilities. Several CEOs interviewed noted that in the switch from paid to freemium, user count increased as much as 10-15x in the first six months after implementation. And for data intensive SaaS businesses like CRMs, email automation tools, and log management tools, a 15X increase in user count requires massive upfront investment in data storage.

## KEY QUESTIONS FOR CEOS

1. What is the current data storage cost structure for the business, and how does that cost scale if customer count grows exponentially?
2. How quickly can the business stand up new servers for data storage as customer count increases?
3. Can the business segment data storage for paying vs. free customers to ensure that exponential free customer growth does not lead to app slowness for paying customers?

In August 2015 Baremetrics, a data analytics platform for businesses using Stripe and Braintree, tested a freemium offering that almost collapsed their business. In a post-mortem writeup titled “How freemium nearly caused our business to implode,” CEO Josh Pigford noted that the massive expansion in customer count brought on by a free offering put major pressure on Baremetrics’ data centers and their ability to serve their core customers. “Within a few weeks our “free” customers were outnumbering our “paying” customers and the amount of data were both storing and processing had doubled.”

Massive increases in data storage requirements are not only costly for a business giving away a free product, but they can also lead to performance issues for paying customers and potential revenue churn. In the same article, Pigford notes that slowness of the Baremetrics app brought on by free customers led to record high churn for paying customers. So not only can offering a free product hurt profitability from the cost side with increased data storage costs, but it can also hurt profitability on the revenue side with increasing churn for paying customers brought on by app slowness.



# A NEW VIEW OF CUSTOMER SUCCESS

Exponential user/customer growth does not only impact data storage for a paid SaaS business, but it also impacts how the business will be able to answer customer questions. With a paid model, many SaaS businesses have customer success agents available to answer customer questions. Enterprise and other top-tier customers are typically assigned a customer success manager who they have an ongoing relationship with, while lower-tier customers have the option to call into a customer success number and speak to a representative who is currently available.

However, the customer success manager does not just serve the role of an FAQ. They also ensure that the customer is properly using the product and finding value in the product. They are often the customer's main touchpoint with the company and can work to reduce customer churn and upsell various other products to the customer to increase stickiness and lifetime value (LTV).

As customer count scales exponentially with the launch of a freemium product, SaaS businesses often cannot afford to scale their customer success teams at the same rate to handle this increased demand. Several key customer success leaders noted that free customers are often not given access to a customer success agent in a freemium model, but instead they must use either online chat or an FAQ page to answer their questions. It simply isn't feasible for a SaaS business to bear the cost of customer success teams for non-paying customers.

## KEY QUESTIONS FOR CEOS

1. If free customers are expected to use an FAQ to answer user questions, who will update that FAQ? Can that be handled by the customer success team, or should there be a way for users to answer each other's questions?
2. What is the cross-selling/product upgrade motion for free customers without a customer success team? How can the product identify user pain points and prompt upgrades or the use of additional products without human interaction?

While free users of a product likely do not expect human interaction with a product they are using for free, they also may not express their concerns with the product or opportunities to buy additional products without a human point of contact. Thus in addressing freemium as a model, SaaS CEOs must work to build a great and constantly updated FAQ for free customers and an easy way to flag pain points in the free product.



# CUSTOMER ACQUISITION

In the traditional B2B SaaS model, customers are typically acquired in one of two ways. Either customers find themselves on the SaaS company's website via paid or direct channels and request to speak with a sales representative or they are contacted directly as a prospect by a sales representative. In both instances, the customer is qualified by the sales representative and in initial conversations the sales representative can explain how the product should best be used for the problems the customer is trying to solve.

## KEY QUESTIONS FOR CEOS

1. Can the company's website properly articulate the value of the product without human interaction?
2. Are customers actively searching for this type of product online?
3. What percentage of paid customers are currently acquired through marketing qualified leads (MQLs)? Is this the majority of acquisitions, or are most acquisitions done through outbound sales?

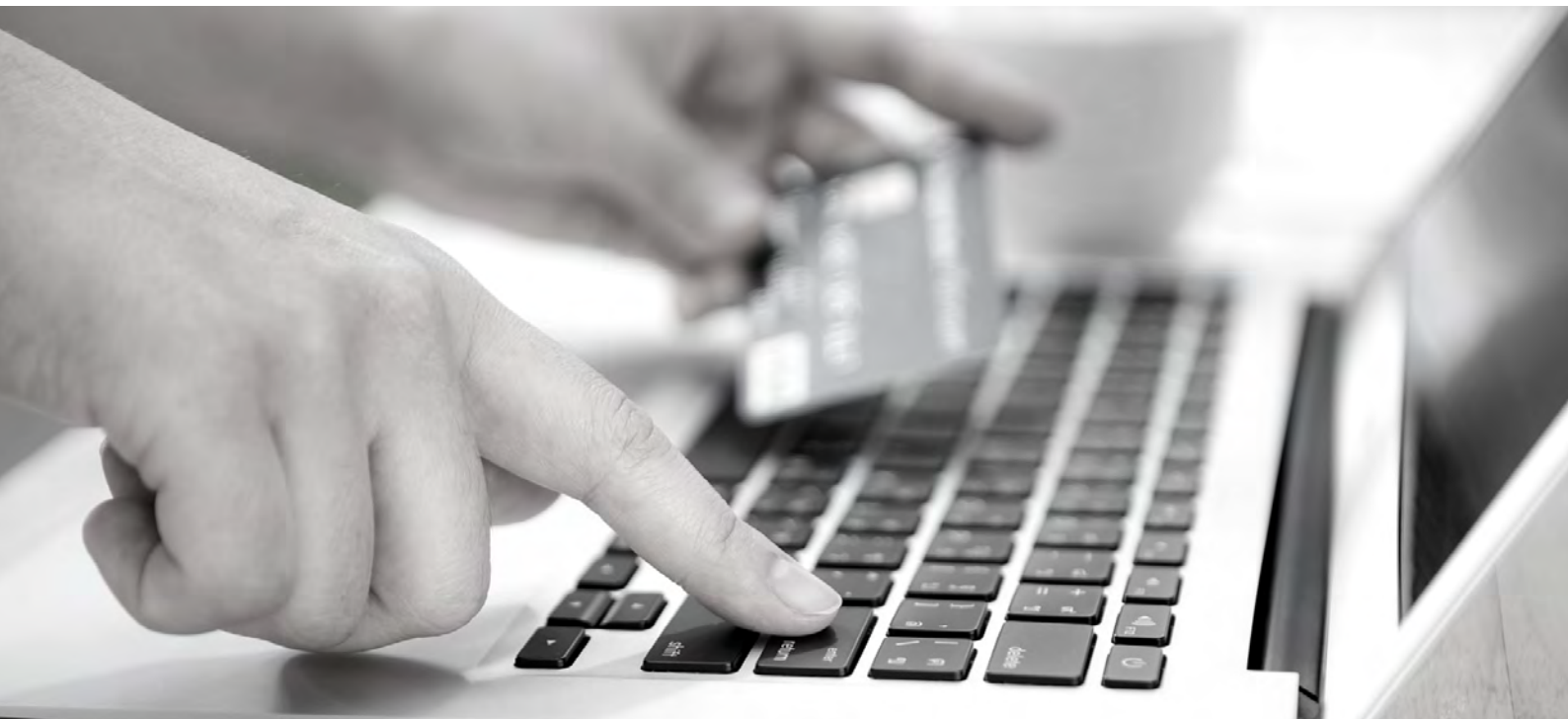
In the freemium model, there is no human contact between the potential customer and the company. Thus the company must work to demonstrate the product's value either through effective advertising, product descriptions, or testimonials. And this is all to convince the user to download the product. Once the user has the product, there is no guarantee that they will use it correctly to solve their particular problem.

Aside from the unit economics differences that exist between paid and free users – free customers have a far lower LTV than paid due to low upgrade rates – there are major psychological differences between how these users interact with the product.

Because free customers are not paying for the product, they may not use the product in the correct way, if at all. And once a customer has a less than stellar experience with a free product, there is very little chance they will move to a paid product.



# CONCLUSION



While freemium may appear to be an incredible opportunity for paid SaaS businesses to rapidly expand their customer base and thus their market share, there are many considerations that a CEO must take before launching a freemium venture. First, the CEO must understand the 2x2 freemium matrix and determine the trialability and upgradability of his or her product. If the product is determined to be both triable and upgradable without human interaction, the CEO then must consider some of the other externalities of a paid-to-freemium switch. Freemium poses new business challenges regarding data storage, customer success, and customer acquisition that must be explored deeply.

**Free users are a completely different type of user than paying users,** and the decision to move towards a free user must not be taken lightly.

If CEOs decide to make the freemium move, they must be sure to protect their core business of paid customers at all costs. **While free user growth is incredibly tempting, it only provides value for the business if those users pay at some point.** Incentivizing the move to the paid product is key to overall success.