Not Free! Why $0.00 Is Not the Future of Business

Posted by Reuben Swartz (https://www.mimiran.com/author/mimiran/) on April 2, 2008

Wired editor-in-chief Chris Anderson recently wrote a provocatively-titled article called Free! Why $0.00 Is the Future of Business (http://www.wired.com/techbiz/it/magazine/16-03/ff_free?currentPage=all). Anderson argues that the economics of computing on the net, where storage and bandwidth costs fall even faster than the cost of processing power, will drive the price of many services to the marginal cost– in other words, $0.00.

Anderson starts by recounting the story of King Gillette, whose disposal razors laid the foundation for a multi-billion dollar industry. Now some companies have “razor blade” strategies. Think Hewlett Packard printers and cartridges, commoditized industrial products and high-margin services, Xbox video game consoles and games. The loss leader products in these examples have substantial marginal cost, which, along with antidumping laws, prevents companies from giving them away for free.

On the web, however, marginal costs are often close enough to zero to be zero for practical purposes. Anderson notes:

> Not too cheap to meter, as Atomic Energy Commission chief Lewis Strauss said in a different context, but too cheap to matter…
>
> From the consumer’s perspective, though, there is a huge difference between cheap and free. Give a product away and it can go viral. Charge a single cent for it and you’re in an entirely different business, one of clawing and scratching for every customer. The psychology of “free” is powerful indeed, as any marketer will tell you.
>
> This difference between cheap and free is what venture capitalist Josh Kopelman calls the “penny gap.” People think demand is elastic and that volume falls in a straight line as price rises, but the truth is that zero is one market and any other price is another. In many cases, that’s the difference between a great market and none at all.

This concept is powerful and disruptive for problems that are amenable to web-based solutions. It’s not so powerful if you need a giant locomotive to move goods across the country. However, if information can replace the physical goods, prepare for disruption.

Microsoft, whose Windows and Office software programs generate billions of dollars in profit every quarter, thought it was immune to the web-based threat. Microsoft thought that the web could never provide rich enough functionality for users, and users would never accept a solution that required a live internet connection. Funny thing. Google just introduced technology that allows people to use its Office-like applications without an internet connection. Meanwhile, when connected to the internet, users can share documents and work collaboratively more easily than with the more fully-featured Microsoft version. Cost for Microsoft Office? About $300 for an upgrade. Cost for Google's version? $0.00.

So where does the money come from? After all, a business is a business, and if it is to remain so, a fundamental inequality must hold true:

Value Provided to Customers > Price Paid by Customers > Cost to Provide Value

Leaving aside questions of value, the only way for a price to really be zero is if the cost is less than zero. While this may seem absurd, it's the magic behind Google. It's just that instead of serving customers for free, Google serves an audience to advertises for high margins. Anderson would like us to think that this is a fundamental change in the nature of business, but it's really as old as newspapers.

Free is not a pricing strategy. It's an advertising strategy (gather as large and valuable an audience as possible). It's a promotional strategy (offer free services to cross-sell or up-sell other offerings). It's a testing strategy (allow users to test your software for free, so that the premium version is more reliable).

Companies that take part in the "free" economy need to have a good strategy for monetizing what they giveaway at some point. And as Anderson points out, while we have more and more abundance in many aspects of our lives, our time and attention are scarcer than ever. The ability to offer something for nothing, even if the offering is valuable, is worthless if no one notices. Along with the abundance of the web, comes a strong network effect that Robert Frank and Philip Cook explored in
The Winner Take All Society (http://www.amazon.com/Winner-Take-All-Society-Much-More-Than/dp/0140259953/ref=pd_bbs_sr
In this global age, benefits accrue disproportionately to the "winners." Google makes billions from "free" search. A small group of other search companies combined makes less money than Google. But offering a free search service is unlikely to generate significant profits, unless you can find a valuable and underserved niche. Similarly, a handful of popular bloggers make good money by giving away their ideas for free, and charging for ads. I am not holding my breath for this strategy to work for pricing blogs.

So we still have to provide value to customers, whether they are users or advertisers. We better be able to charge more for this value than it costs us to provide it. Otherwise we will go out of business. Anderson is right that the cost side of inequality is changing rapidly and that this can have a disruptive effect on markets. But while $0.00 may make for a catchy headline, it is not the future of business.

(Anderson, who previously wrote
The Long Tail (http://www.amazon.com/Long-Tail-Future-Business-Selling/dp/1401302378/ref=pd_bbs_sr_1?ie=UTF8&s=books&c
is developing a book based on this concept, titled FREE, which will arrive in 2009.)

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6 Comments

Anonymous

April 3, 2008 (https://www.mimiran.com/not-free-why-0-00-is-not-the-future-of-business/#comment-166)

Reuben,

In The Long Tail, Chris Anderson was inconclusive when it cames to its implication for pricing.

If this is an attempt to rectify this situation, its only half-baked at the moment. Let's hope he cooks the idea s more before his book comes out.

At the end of the day, someone always pays….the customer…the company…

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amar rama

April 4, 2008 (https://www.mimiran.com/not-free-why-0-00-is-not-the-future-of-business/#comment-167)

Thanks for adding some sense to this myth. Some times the build up feels unreal and ridiculous.

If i understand the context right
1. company A builds product X(physical or not)
2.People want to buy X
3.company A needs to get the message and facts about X out to people.
This is the need Adwords fills.

If everybody thinks it is more lucrative to be in the adwords business rather than manufacture or create what they do currently then there would be no Adwords business eventually .

Well maybe i am too simplistic in my thinking..

Henry

April 14, 2008 (https://www.mimiran.com/not-free-why-0-00-is-not-the-future-of-business/#comment-168)

Chris Anderson's premise catches headlines but is a nonsense.
Nothing is for nothing. As Reuben says, free is a means to an end. So examine the end behind 'free'.
Facebook is 'free' because you consent to receive advertising and possibly (if you believe some journalists) allow your data to be used for wider influencing purposes.
Receiving charity is 'free' because the giver gets moral or other satisfaction.
Free will always be with us as a tactic and we have always had to look behind it to decide if a given 'free' item or service is right for us. No change there.
And if the organisation offering 'free' is cagey or unconvincing about what's attached, it almost certainly isn't. No change there either.

Jon

April 16, 2008 (https://www.mimiran.com/not-free-why-0-00-is-not-the-future-of-business/#comment-169)

I've just re-read "Free". Take a look at the graphic on the economic of the Prince CD giveaway.

One line says "London Concert GROSS" and under that is "NET Revenue"

Which is it, Chris, Gross or Net???

Jon

Henry

May 6, 2008 (https://www.mimiran.com/not-free-why-0-00-is-not-the-future-of-business/#comment-170)

Anyone interested in this might want to look at this article in today's London Guardian newspaper http://www.guardian.co.uk/money/2008/may/06/consumeraffairs.economics (http://www.guardian.co.uk/money/2008/may/06/consumeraffairs.economics)
Stuart Jeffries interviewed Chris Anderson and very gently debunks his narrow definition of 'free'. The end paragraph is very telling.
Nearly free isn't free. Bundled with something that isn't free, using somebody else's money (not free for them), cross-subsidised and temporarily free are indeed free at a trivial level but Chris Anderson's thesis rests on accepting that a narrow transaction view defines 'free' status.
Disintermediation and mass leverage by the web are powerful forces, so are ingenuity in reframing deals (Ryanair) but no-one has yet found the philosopher's stone.
Perhaps Chris should distribute his book free, unbundled, without advertising or any other future or attendant commitment, delivered to the home of anyone who orders it without charge and not pay for that himself or be subsidized by others. That would be free.
Go Milton!

Reuben Swartz

May 9, 2008 (https://www.mimiran.com/not-free-why-0-00-is-not-the-future-of-business/#comment-171)

Henry– thanks for the link. Anyone who found the post interesting should read that article.

Jon– the CD giveaway example was particularly problematic. I believe the figure was supposed to be "gross". Hopefully Chris would have used "net profit" although you never know. My problem with the example, though is that it assumes that Prince achieved the revenue from that concert because of the promotional CDs. If he really wanted to use "free" to promote the show, he could have just posted a blog message about it and a link to Ticketmaster (or the UK equivalent). He's Prince!

A more intriguing use of "free" would be a lesser known artist doing a big promotional giveaway. They wouldn't be able to get a newspaper to pay them for the rights to the CD, but for a few thousand dollars you can get a lot of CDs printed and then have band members drop them off at the right locations around a city where your possible fans can pick up a copy.

Comments are closed.

serving clients but hate “selling”

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