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Evernote: Monetization Strategy

At Evernote, in Redwood City, California, the “Project Gnome” pricing study did not take its name from the underground nuclear test conducted by the United States in 1961. Rather it came from a 1998 episode in the somewhat irreverent South Park adult animated sitcom.

In the episode, the four boys from the South Park gang, Eric, Stan, Kyle and Kenny, seeking advice on business planning, engaged with a group of gnomes who had a business model apparently built around stealing underpants, but missing an important piece. The exchange went something like this:

Kyle: “So, what are you going to do with all those underpants you steal?”

Gnome #1: “Collecting underpants is just phase 1. Phase 1: Collect underpants.”

Kyle: “Sooo... what’s phase 2?”

Gnome #1: Having no reply, shouts out to colleague, “Hey, what’s phase 2?”

Gnome #2: “Phase 1: we collect underpants.”

Gnome #1: With irritation, “Yeah, yeah, yeah. What about phase 2?”

Gnome #2: “Well, phase 3 is profit, get it?”

Stan: “I don’t get it.”

Gnome #1: Pulls up a graphic to aid explanation...

Phase 1	Phase 2	Phase 3
Collect Underpants	?	Profit

...and says:

“Phase 1: Collect Underpants

Phase 2: [silence]

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Phase 3: Profit"

Eric: Yeah, I get it.

Stan: No, you don't...

Evernote software and its supporting business model did have a Phase 2, i.e. a monetization strategy. However, to date, while it generated millions of registered Evernote users around the world, financial results were disappointing.

Evernote was a note taking application with the tag line: "Remember Everything." It was designed to offer easy capture of any idea regardless of format, e.g. typed notes, web pages, pictures and verbal records; synch them to all devices used, e.g. phone, laptop, computer; and allow easy search and retrieval from anywhere, forever. While Evernote had 150 million registered users worldwide in 2016, the eight year old company had yet to find a way to profitability. Evernote offered three versions of its software. Evernote Basic was a free offering; Evernote Plus was \$2.99/month and offered greater storage capacity plus some added features; Evernote Premium was \$5.99/month and offered advanced features. Fewer than 2% of users opted for one of the paid tiers. Evernote was burning cash at the rate of \$5 million per month. Given the 2016 atmosphere in Silicon Valley, raising additional capital was not a feasible option and a "cash cliff" was not far off.

Andrew Malcolm joined Evernote as Senior VP for Marketing in October 2015. Malcolm had extensive experience with "freemium" models, such as Evernote's, from his work at Skype. Malcolm viewed "getting it right" with pricing to be key in solving the Phase 2 problem. He commented: "pricing is unnecessarily intimidating and done well can be your best friend – it's cheap and massively impactful if we get it right."

Given the complexity and importance of "getting it right" on Evernote's phase 2 monetization strategy, Evernote had engaged the pricing consulting firm Simon-Kucher and Partners. Throughout Project Gnome, Malcolm and the Simon-Kucher team, led by Joshua Bloom and Madhavan Ramanujan, had worked closely together to find a way to 20% improvement in Evernote's rate of revenue generation over the next three months. By April 2016, the work at Project Gnome was indicating that "Phase 2" might best include both a 30%-or-more price increase for paid tiers and additional limitations on the "free" version of Evernote to provide users more incentive to pay for a version of Evernote.

Evernote was closely watched by the tech trade press and its users were a social media savvy group. So, any pricing plan change with a price increase or degrading the quality of "free tier" offering promised rapid "commentary" with some unlikely to be kind. Simon-Kucher's analysis indicated that the recommended price changes held the promise of the 20% boost – but at the cost of a decline in "monthly active users." This metric was key in some investors' valuation of a company.

Malcolm had to develop a recommendation on what to do and how to communicate it to the many interested parties: current customers, prospective customers, and the press. He noted: "How we present it will be as important as what we do." The fact that key competitors, such as Microsoft's OneNote, were largely considered "free" by users added to the challenge.

Company Background

Stepan Pachikov, the creator of Evernote, received his Ph.D. from USSR Academy of Sciences and was an early pioneer in Optical Character Recognition. In the 1980's, he moved from Russia to the United States to work with Apple on the Newton. The Newton was the first "personal digital assistant"

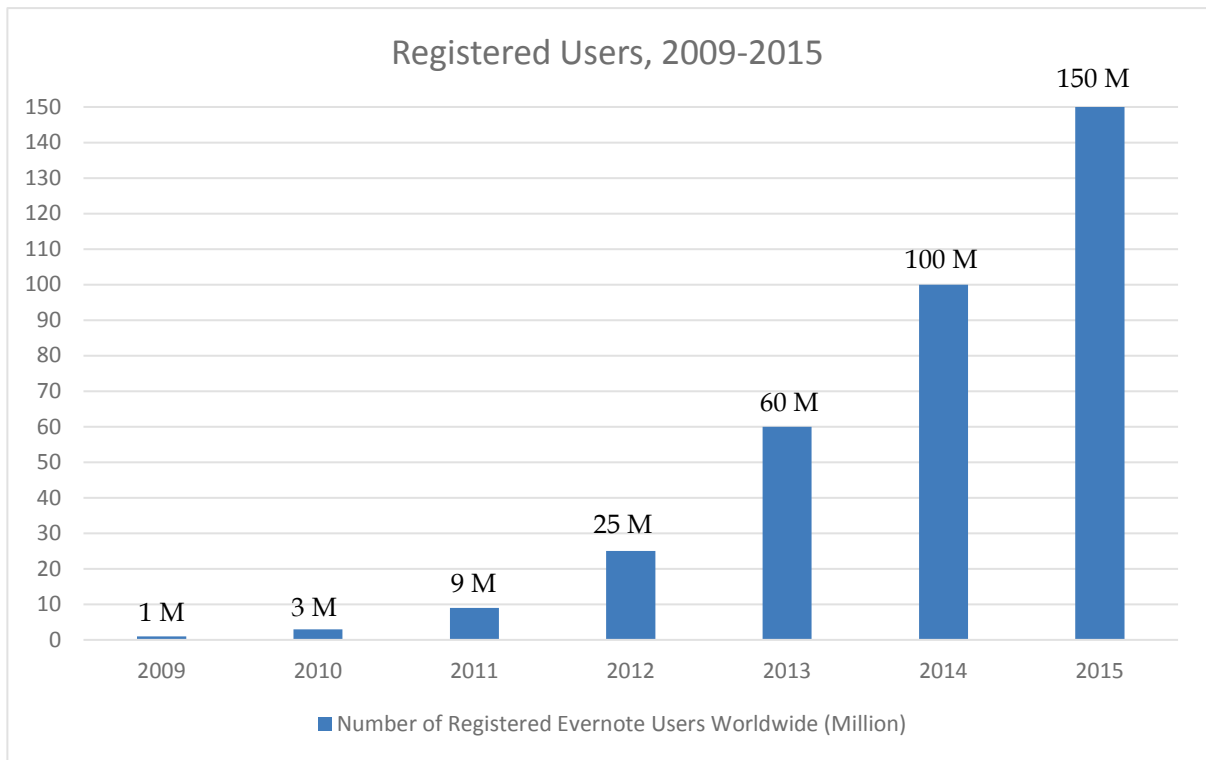
to incorporate handwriting recognition. By 2002, he was conducting research on what would become the Evernote software system. Pachikov's goal was to create an "extension of the brain. A prototype was developed by 2004 and a mobile version launched in 2008. The "information explosion" taking place in the world dramatically increased the need for "external memory." In his product design, Pachikov had paid great attention to detail to make Evernote simple-to-use, basically a frictionless way to capture ideas or things one saw – synch them to all the electronic devices owned and then be able to efficiently search later on. Once the App Store came along, the distribution problem was solved. 'save, synch and search,' solved a real universal problem.

In parallel to Pachikov's efforts, Phil Libin, who was also born in Russia, had several successful startups and in 2008 had a team focused on "electronic memory." Pachikov and Libin met and decided to merge their teams with Libin becoming CEO. Pachikov commented: "I chose Phil. He was smart, educated, and I was completely confident that he would be a much better CEO than I was."¹

In 2008, Evernote launched with a "freemium" model of two tiers, i.e. a free version of the product was offered along with a \$5/month premium product, "Evernote Premium," with a greater degree of functionality. It incorporated an elephant in its logo and "trade dress." See **Exhibit 1**. Libin later admitted that the initial \$5 monthly price for the premium product was chosen "at random... so our chances of getting it right were very slim."² He explained this casual approach to pricing the premium product stemmed from the fact that the free product was "the main version" of Evernote.³ Libin's philosophy was:

"I didn't want a clever business model. Data analysis, referrals, advertising – it was all kind of sleazy. I wanted a clever product. I wanted that product to reach hundreds of millions of people. And I wanted 99% of them to be using it for free."⁴

By May 2009, Evernote reached one million registered users and was close to Libin's "99% using for free" wish as only 1.4% of these chose to pay for the premium version. The press article reporting these results concluded, "Now, if Evernote could ever get to one million paying subscribers, that would be a decent business."⁵ Libin's retort was: "The easiest way to get a million people to pay for nonscarcity product may be to make 100 million fall in love with it. It's more important that you stay than you pay. Once Evernote gets under your skin, you never want to stop using it."⁶ In its article on Evernote as its "2011 Company of the Year" Inc. Magazine and writer David Freedman noted, "...unlike virtually all other entrepreneurs relying on that [freemium] model, Libin refused to cripple the free version... The free version was full featured and offered generous storage."⁷ **Figure 1** shows the growth in Evernote's number of registered users from 2009 to 2015, as Evernote became the leading "independent" note-taking or memory product (i.e. not from Microsoft, Google, or Apple).

Figure 1 Evernote Registered Users Worldwide, 2009 - 2015

Source: Compiled by casewriter.

In 2012, Evernote's series D round raised \$70 million at a company evaluation of over \$1 billion, qualifying Evernote as a "unicorn" in Silicon Valley parlance, meaning a start-up which achieved a company valuation of \$1 billion.

Evernote began to expand its product line, announcing new products at high profile user conferences in 2012 and 2013. In 2012, it entered a partnership with Moleskin, a leader in traditional "pencil and paper" notebooks. With the "Evernote Smart Notebook by Moleskin," users could record thoughts in a notebook with pencil or pen. Dotted lines on the paper provided for optimal alignment for picture taking to digitize the handwritten notes. This rendered the notes searchable by Evernote software. In 2013, it announced "Evernote Marketplace," an online store for high end complementary physical goods, e.g. a laptop sleeve, a wallet, a backpack and the Evernote Scan Snap, a high end scanner. Then marketing director, Andrew Sinkor explained: "These are products that can help you make good decisions, do things well, be better at the craziness that is modern living. Evernote is that. We're giving you the tools."⁸

Price Structure Change

Through 2014, Evernote retained the packaging/price structure of its 2008 launch, i.e. the two-tier "freemium" model with the Evernote Premium upgrade costing \$5 per month. The main differentiator between free and premium tiers was upload limits as set out in **Table 1**.

Table 1 Upload Allowance by Product Tier

	Free	Premium
Monthly Total Upload	40 MB	500 MB
Maximum Size of Any One Upload	25 MB	50 MB

Source: Company documents.

The Monthly Total Upload restriction for the free tier rarely impacted users who mainly uploaded typed notes, since it translated to roughly 20,000 typed note uploads per month. However, either 250 web page clippings or 400 camera picture uploads could approach this 40 MB constraint.

Evernote did little marketing but continued to enjoy strong customer recommendations and press reviews. While many different note-keeping apps had their “fans,” Evernote was generally recognized as being simple to use and feature rich. It was the market leader among standalone note-taking apps.

In November 2014, Libin described his approach to product development: “We make things we love. I think that’s critical... you make something you love, and then you find the market that it fits.”

In April 2015, Evernote announced a packaging/price structure change retaining a freemium structure but shifting from a two-tier model to a three-tier model, inserting Evernote Plus between the Basic (free) Tier and Premium Tier. Differentiation of the tiers by restrictions on uploads was maintained as shown in **Table 2**.

Table 2 Three Tier Upload Allowances – April 2015

	Basic (free)	Plus (\$2.99/month)	Premium (\$5.99/month)
Monthly Total Uploads	60 MB	1 GB	Unlimited
Maximum Size Any One Upload	25 MB	50 MB	200 MB

Source: Company documents.

The Premium Tier also had differentiation in added features such as abilities to search for words within PDF’s, annotate PDF’s, and scan business cards.

In the announcement of the new packaging/pricing, Evernote, for the first time, suggested, albeit gently, that there was a natural transition from the free tier to a paying tier. Specifically, it described the Basic/free tier as:

This is where you’ll familiarize yourself with Evernote, install it on multiple devices, define your organizational style, and establish a workflow. You’ll learn, explore and grow in this tier. Stay here as long as you like. When you’re ready, check out our more advanced levels.⁹

The \$2.99/month Evernote Plus Tier was positioned for the “engaged, active Evernote user.” Evernote Premium at \$5.99/month was billed as the “professional workhorse.”

Evernote explained the rationale for the April 2015 change noting its early efforts were focused on building the Evernote product not price optimization, viz.

We knew that our premium offering wasn't optimized for revenue, but there were always other things to think about. Over the past several months we've taken everything we've learned over the years and applied rigorous research to get our paid offering right. The process was eye-opening. As it turns out, there were three things users want: a basic level, a lower-priced tier, and a tier with unlimited uploads.¹⁰

Community reaction to the changes was generally positive. For example, the title of the Venture Beat article covering the new plan was, "Evernote rolls out cheaper 'Plus' subscription tier and boosts 'Premium' to unlimited note uploads."¹¹

Later in 2015, some tech writers voiced concern about the monetization strategy, particularly that Evernote's free product was "too useful." For example, an article in The Verge described Evernote's free offering as a "highly useful product" and "the rare company here [Silicon Valley] not to derive its revenues through invasive ad targeting." But then it noted a "drumbeat of complaints over it increasingly bloated, unfocused product."¹²

A Business Insider article on September 15, 2015 was entitled, "Evernote, the first dead unicorn" [referring to Evernote's \$1 billion company valuation in 2012]. It was a "guest post" by the founder of a firm offering a "web content editing tool." He wrote:

When we look at how a unicorn might fail, it's clear that one in particular is already well down the path to failure – Evernote...

...The core product has changed little over the past several years despite the company being flush with cash, traction, and resources...

Its core product remains too useful for free to encourage anyone but power users, of which there are becoming fewer, to upgrade.¹³

Several weeks later, a second Business Insider article appeared with the title, "The inside story of how \$1 billion Evernote went from Silicon Valley darling to deep trouble." It reported:

Despite reaching 150 million registered users this year, Evernote has been slow to develop the revenue side of its business.

...most people we spoke to seem to agree that the company has failed to take advantage of its red-hot growth and make enough money from much of its huge user base.

Evernote recently began adding new pricing tiers, designed to offer more options for nonpaying users to give the company money. That move is long overdue... the company spent too much time experimenting with random products instead of refining its monetization efforts.¹⁴

Project Gnome: Finding the Road to Profitability

Project Gnome was initiated to improve monetization and bring Evernote cash flow positive.

Usage data indicated that a great deal of "love" did exist for Evernote among users but that Evernote had not optimally converted the value customers placed on the product to revenue. Simon-Kucher research showed that of people who "usually took notes" with a note-taking application, Evernote was the most employed application with 62% stating, "I use this app." Full results are in **Table 3**.

Table 3 Percent of Respondent Who “Usually Take Notes with a Note-Taking App,” Stating “I use this app.” (Multiple Answers Permitted)

Note-Taking Application	Usage Percentage
Evernote	62%
Microsoft OneNote	44%
Apple Notes	41%
Google Keep	31%
Notability	14%
Quip	8%

Source: Simon-Kucher research and company documents.

More than 20 million of Evernote’s 150 million registered users used Evernote in a typical month in early 2016. 94% of these employed the Basic (free) Tier; 1% subscribed to the Plus Tier (\$2.99/month in the United States), and 5% subscribed to the Premium Tier (\$5.99/month in the United States). Paying users generated a \$50 million annual revenue rate for Evernote in mid-2016.

Evernote employed the same pricing structure throughout the world, i.e. a three tier “freemium” model with the same features/constraints defining the tiers. However, prices for the paid tiers varied across markets as shown in **Table 4**.

Table 4 Evernote Paid Tier Pricing - Worldwide Examples - June 2016 Monthly Subscription Prices

	Plus Tier	Premium Tier
United States	\$2.99	\$5.99
Europe	\$3.29	\$5.49
Japan	\$2.14	\$4.01
China	\$1.49	\$2.99
Latin America	\$1.49	\$2.99

Source: Company documents.

Pricing Options

Project Gnome took a “blank sheet of paper” approach to getting Evernote’s monetization strategy right. The team considered many pricing structure options assessing their impact on revenue, monthly average users, and brand equity. Several common pricing approaches were ruled out early in the process. Many firms (e.g. Spotify music streaming) employed a “freemium” model which derived revenue from the “free” tier by inserting advertising. However, brand equity considerations ruled out introducing advertising to Evernote’s “free” tier because of its “productivity” positioning. Monthly active user considerations ruled out eliminating the free tier and moving to a fully paid model.

Settling on maintaining some form of freemium model, research turned to what constraints or features could best define the tiers. Particular attention was paid to the definition of the “free” tier. As noted above, the press had often commented on the richness of Evernote’s free tier and Inc’s 2011 article on Evernote as “Company of the Year” even noted that Evernote “had refused to cripple the free version... [making it] full featured.” Malcom commented: “We needed results quickly and there was no ‘magic feature’ coming that we could put in the paying tier that would cause people to pay, so we

had to consider whether we might best 'take something away' from the free tier in an effort to generate more paid users."

To assess likely consumer reactions to possible restriction on the free tier, research was conducted in five major geographic markets – three "developed" (U.S., Europe and Japan) and two "developing" (China and Latin America) with almost 6,000 respondents overall. First, Simon-Kucher used a "direct questioning" technique to assess users' general reaction to the free tier being restricted in a particular way. In this phase of research, the question posed to survey respondents was, "How acceptable would it be for Evernote to limit their free offering based on..." Among the tested restrictions were:

- Number of "notes" uploaded in a month
- Number of different "devices" permitted for entering and accessing data (e.g. iPhone, laptop, iPad, etc.).

This phase also tested users' likely behavioral response, asking: "How would you react if Evernote limited each of the following in its free offering?" Results are in **Table 5**.

Table 5 Respondent Reaction to Possible Free Tier Limitations

Limitation	% Finding Restriction "Unacceptable"	Reaction if Restriction Imposed		
		Would Stop Using Evernote	Would Use Evernote Less	Would Not Change Evernote Usage
Notes Per Month	67%	35%	44%	21%
Devices To Access	38%	16%	41%	43%

Source: Simon-Kucher research and company documents.

Simon-Kucher noted that this stage provided a check on users' "emotional reaction" to a type of restriction as the specific level of restriction (e.g. no more than 100 notes per month or no more than 2 devices use access information) was not specified, but just the type of restriction.

The second research phase involved a "conjoint analysis" study wherein consumers were asked to make a series of choices forcing a tradeoff between features/constraints on each tier and price paid. Simon-Kucher was known for its expertise in employing this methodology in a strategic way. The methodology had been validated in widespread use.

At each screen in the computer administered interviews, a consumer was presented three alternative definitions of Evernote Basic, Plus, and Premium tiers and also the prices for the two "paid" tiers. The consumer then indicated "how likely would you be to select each offering?" with the options being the three specified Evernote tiers and an "I would not use Evernote" choice. Respondents allocated a total of 100 points to the four options presented at a given time. The consumer's answers to a set of about 20 choices of this type were then mathematically analyzed to determine his/her "value system," i.e. how he/she traded off features vs. one another and vs. price to make a choice in the product category. Each consumer's own value system was derived rather than an "average" market value system. With the value systems calculated, Simon-Kucher could then simulate the outcomes (i.e.

whether or not the consumer used Evernote and, if so, what tier was selected) for any specified set of Evernote offerings and prices.

Simon-Kucher and Malcolm worked closely together considering strategic issues and the market research to converge on a set of “packaging and price” options as potential paths forward. Agreement was reached on a modest reconfiguration of product features available at each tier.

Going forward, the free tier would enable the basic capture of data and also the ability to:

- Share notes with others
- Clip notes from the web into Evernote

Upgrading to the Plus tier additionally provided:

- Email into Evernote (previously available in the free tier)
- Offline access to notebooks

The Premium tier provided advanced features such as:

- Business card scan
- Annotate PDF's

Based on usage data, Evernote was able to assess the number of users impacted by any free tier constraints on the number of devices employed or notes uploaded in a month. It found that globally about 10% of current “free” users would “bump into” a constraint of being able to access Evernote with no more than two devices. If Evernote were to also impose a constraint in the free tier on the number of notes created in a month to 100, the percentage impacted would increase to about 30%.

Modeling work settled on a recommendation of a 33% price increase for the Plus (\$2.99 increased to \$3.99) and Premium (\$5.99 increased to \$7.99) tiers in the United States. Similar price increase levels were recommended for other developed markets like Europe and Japan. Smaller percentage increases (approximately 15%) were recommended for developing markets such as China and Latin America based on the conjoint value systems derived for those markets.

In concert with the price increases, Simon-Kucher modeled two scenarios. Scenario 1 imposed the constraint that a “free” tier user – in contrast to the company’s previous “access from anywhere, anytime” positioning – could only use two different devices to access Evernote. Scenario 2 additionally imposed the constraint of free users being able to upload only 100 notes per month. Modeling results showed that both Scenarios produced an increase in “steady state revenue” as more users paid, but they also indicated a decline in monthly average users. Both scenarios produced more dramatic results in the United States than in the rest of the world. Specifically, “Revenue Uplift” and “Monthly Average User” (MAU) results for the base of 150M current subscribers worldwide were as follows.

(Note: While these specific numbers are disguised for company confidentiality, they are useful for case discussion).

- Scenario #1: Price Increases and Device Constraint

Steady State % Revenue Uplift

% Decline in MAU

United States	35%	10%
Overall Worldwide	25%	6%

- Scenario #2: Price Increases and Combined Device/Number of Notes Constraint

	<u>Steady State % Revenue Uplift</u>	<u>% Decline in MAU</u>
United States	50%	15%
Overall Worldwide	40%	10%

While the team was encouraged by the revenue uplift predictions, the predicted MAU decline was concerning given the importance of that statistic as an indicator of business health to many.

Simon-Kucher produced a more comprehensive financial model incorporating assumptions about Evernote's future customer acquisition and reactivation strategies. The model produced estimates of...

- Number of Registered Users
- Monthly average users (MAU's)
- Number of paying subscribers
- Monthly recurring revenue.

...at 12 months, 24 months and 36 months into the future. Results are in Table 6.

Table 6 Financial Model Projections: Future Projected Values Indexed to Current Levels

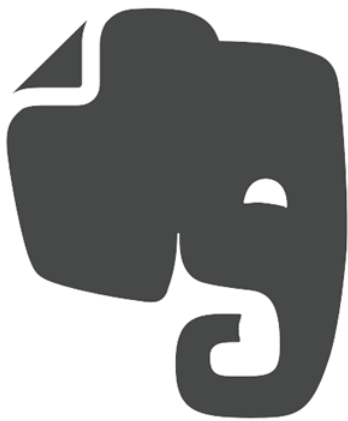
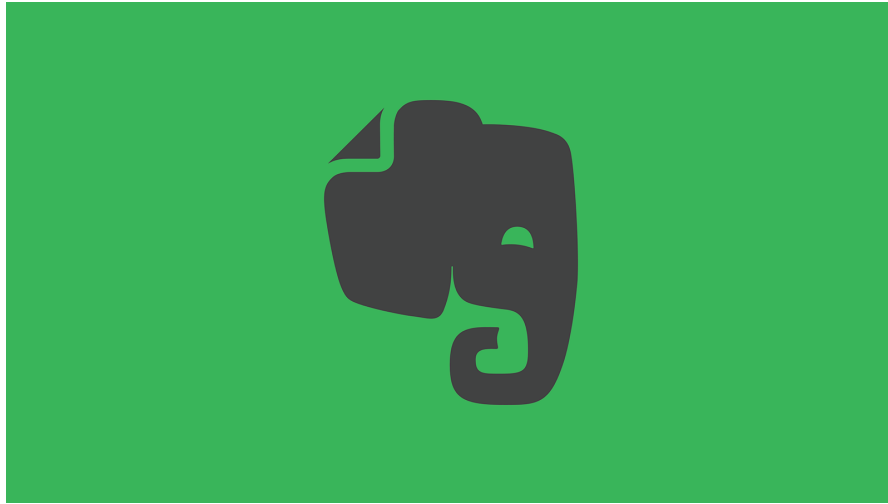
Scenario 1				
	Current	Price Increases & Device Constraint Only		
		<u>12 Month</u>	<u>24 Month</u>	<u>36 month</u>
Registered Users	150 M (100)	102	103	105
MAU	20 M (100)	106	120	130
Number of Paying Subscribers	1 M (100)	108	110	120
Monthly Recurring Revenue	\$5 M (100)	130	140	150
Scenario 2				
		Price Increases & Device + Notes Constraint		
Registered Users	150 M (100)	100	100	100
MAU	20 M (100)	90	85	80
Number of Paying Subscribers	1 M (100)	130	140	150
Monthly Recurring Revenue	\$5 M (100)	160	175	190

Source: Company documents.

Note: Specific projection numbers are disguised for company confidentiality; but useful for case discussion purposes.

Malcolm studied the results to come to a recommendation on Evernote offerings going forward. As he related to the team, “Users have entrusted us with their data – some of it very sacred. We sure don’t want to be perceived as holding their data hostage now or not being worthy of that trust anymore. So, what we do is important and how we communicate is equally so.”

Exhibit 1 Evernote Logo and Font



Source: Company documents.

Endnotes

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- ¹³ J. Dickson, "Evernote, the first dead unicorn," Business Insider, September 15, 2015.
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