

Is “For Free” the New Paradigm for Success?

Making money in a sustainable manner from service provider key assets

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Introduction

The Internet and the role it has played in facilitating real-time access to information and digital media has radically changed consumption behaviors and redefined how value gets created in the telecommunications, media and entertainment industries. For instance, the Internet’s global reach and audience has facilitated new business models that offer free multimedia and service offerings monetized through advertising and sponsorships as opposed to a fee-based model. This, of course, has led to an increased pace of new service adoption, given that end users are being offered an opportunity to consume – decoupled from their capacity and willingness to pay for the service.

Through deployment of always-on broadband infrastructures, service providers are making these new forms of usage and consumption possible. To further monetize these sessions, service providers will need to look beyond their subscription-based sources of revenue and adopt business models that leverage the new dynamics surrounding the Internet/Web 2.0.

Delivering free value over the Internet is here to stay because of the following changes in both the supply and demand sides of the equation:

Dematerialization: Today, digitized information can be reproduced and distributed at nearly no cost. This represents a major shift because prices have traditionally been set as a function of three elements: production costs, scarcity and conditions of access to a good or service. In this new environment, the first two elements vanish as content becomes an intangible asset.

Abundance: With the Internet, the need for intermediaries in the transaction chain – particularly linked to information and distribution – tends to disappear. The Web offers bargain sales 24 hours a day, seven days a week. This creates the perception that, through the Internet, everything is available and cheap, leaving no margin for markup.

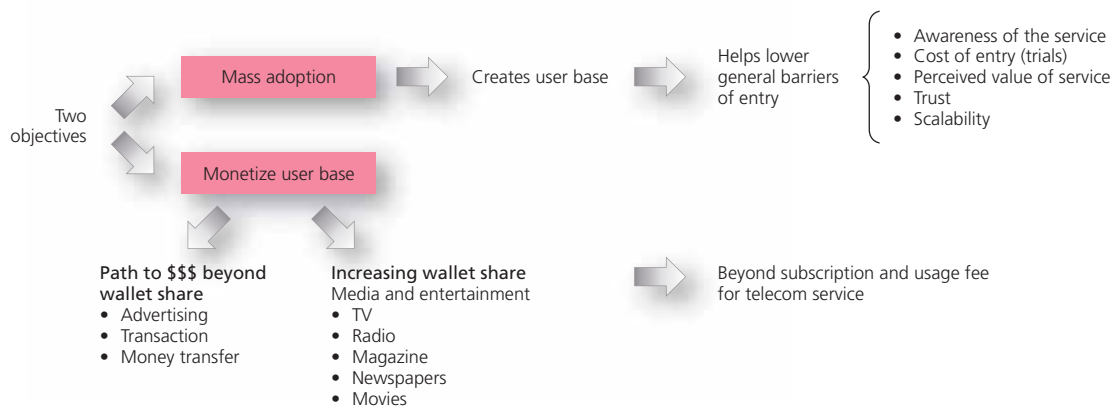
Collaboration and collective contribution represent new value propositions: Collaborative models that have emerged in the context of the Web 2.0 phenomenon are being extended beyond open source software development. As a result, user-generated content and interactions often create free substitutes to services for which we used to pay; for example, Wikipedia offers a free alternative to an expensive encyclopedia.

The good news is that service providers have some distinct assets to leverage against Internet players when it comes to converting free usage into revenues.

Key Categories of “Free” in which a Service Provider Can Make Money

Indeed, “free” is the easiest way to build an audience fast. It lowers the barrier of entry that price represents and makes viral marketing possible, which in turn accelerates service take-up (Figure 1 – see next page). But why would a service provider position a service offer for free? How do you make money out of providing it for free?

Figure 1: "Free" offers carriers opportunities for mass adoption and monetization of services



Following are some of the relevant business models that exist today,¹ summarized in Figure 2 (see next page).

Cross-subsidization and contributive offers

Cross-subsidization is a model well known and accepted by the telecom industry. The example of subsidizing a phone in return for a subscription commitment is nothing new and has proven extremely effective in attracting users. For example, Meraki in San Francisco provides free WiFi service in return for selling their WiFi gear and installation services. 3 Italia offers its mobile TV customers free access to six TV channels. WiFi service is offered free to hotel or coffee bar customers (such as at Starbucks) and for a fee to passers-by.

All-you-can-eat offers

The main issues that must be addressed by service providers wishing to implement "all-you-can-eat" revolve around optimizing networks that carry large capacity at a low incremental cost and equipping them with control mechanisms. This is enabled by:

- Keeping marginal costs as close to zero as possible by controlling the incremental usage cost by building solutions with a low cost of ownership per user
- Identifying and blocking abnormal user behavior by understanding, monitoring and determining what increases cost – such as traffic and spam
- And, of course, deploying a scalable solution that can grow from a low-cost trial service to a full implementation as user adoption increases

Popular examples of all-you-can-eat offers include data storage, broadband offers, some home zone offers and free calls between subscribers to the same network operator.

Freemium offers

Another model is for service providers to offer "freemium services," whereby an offering is free to most subscribers, but is priced at a premium for targeted subscriber segments that may require enhancements to the service. For instance, voice over broadband is offered for free residential usage (unlimited) but charged for business use; customer service support may or may not be charged, depending on Service Level Agreements. Because of the nature of the relationship they have with their subscribers, service providers are well positioned to embrace this model.

In order to separate free offers from those priced at a premium, service providers need to:

- Segment market needs and market drivers to create targeted offerings
- Differentiate these offerings across segments in order to implement the model
- Establish a low-cost service delivery infrastructure to ensure sustained profitability

¹ ©2008, Wired.com, *Free! Why \$0.00 Is the Future of Business*, Chris Anderson http://www.wired.com/techbiz/it/magazine/16-03/ff_free.

Figure 2: Ways to monetize “for free”

Six ways to monetize free

- Cross-subsidization
- All-you-can-eat
- Freemium
- Ad-sponsored
- Labor exchange
- Contributive



Necessary conditions for success

- Low marginal cost of capacity/low cost of entry service
- Addressing large scale market
- Capacity to segment users and to differentiate offers across segments
- Capacity to design offers matching customer needs
- Capacity to upgrade smoothly to a premium offer
- Capacity to identify and monitor customer behavior

Ad-sponsored offers

The strategic focus of this industry has traditionally been on initiatives that maximize the share of a consumer’s “wallet.” However, high-speed Internet access, mobile services and traditional telephony offerings to the home and office have saturated that compartment of the consumer’s wallet.

This means that additional revenue growth will have to come from someplace else. That is why there is so much interest in the opportunities associated with revenue streams that are generated beyond the end user – from advertisements, for instance. An example of this is Virgin Mobile in the United States. Virgin Mobile provides calls for free in return for advertising. Or video-on-demand provided for free in return for ads being viewed.

When solutions are put in place to improve and build on the service provider’s knowledge of its customers, coupled with ad selection and permission-based ad insertion offers, targeted advertising becomes possible. In addition to the incremental revenue generated for service providers, this increases consumer appeal, increasing exposure to preferred advertisements, elevating the value proposition for sponsors and thus creating a virtuous cycle.

Introducing advertising increases the potential revenue stream for service providers without the limitation of available end-user wallet share. Moreover, advertising has always been a key component of media distribution – it’s now a question of who participates in the economic value chain.

Labor exchange

When service providers get more value from people using the service than from selling the service, it can be offered for free to increase usage. For instance, there is more value extracted from voice mailboxes by improving call completion rates than by selling the service. An example of this is also Google’s “411” directory service in the United States, which is free but captures valuable data on voice recognition and on how people place search requests.

Primary research from Alcatel-Lucent and results from commercial implementations have demonstrated that when consumers are compensated with something of value, they are more likely to accept advertising as part of the service. In our partnership with the value-added service provider Kindsight², we enabled a network-based security solution that monitors the subscriber's traffic for evidence/signatures of malware threats on their home PC network for free in return for having the ability to monitor their surfing behavior, which is then used to deliver user-relevant advertising to finance the service.

It is important to both obtain the individual's acceptance for the service and provide notice that user information may be collected, but in an industry-leading, privacy-centric manner. The service provider can then use that intelligence to generate revenue with brand managers and performance advertisers through its own media properties (such as portals) as well as through Kindsight's advertising network.

In today's privacy-conscious environment, it is important to note that Kindsight has a unique approach, through which no historical information is retained or attributed to an individual subscriber. This is in direct contrast to many popular online applications today, such as search engines. Any information that is collected by Kindsight is fully anonymized and aggregated before being used for the purposes of targeted advertising. It should also be stressed that at no point is individual user information shared with advertisers or publishers. The Kindsight implementation sets a new standard for privacy protection for all online application providers to follow.

Conclusion

At Alcatel-Lucent, we are working with our customers who are aggressively pursuing these trends to capitalize on the "for free" phenomenon. By evaluating how to monetize tangible and intangible assets and take advantage of the new forms of usage made possible by the increasing pervasiveness of broadband and digital media, they are gaining a sustainable business advantage. In so doing, these innovative service providers are finding ways to generate revenues by providing services for free that promise to transform the economics of the telecommunications industry.

While it is difficult to say exactly how the communications industry will evolve – and certainly different service providers will successfully adapt in different ways – one thing is for sure: the "For Free" paradigm is here to stay. ●

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² <http://www.kindsight.net>

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