



Stanford eCorner

Economics of Free: A New Business Model

Janice Roberts, *Mayfield Fund*

January 17, 2007

Video URL: <http://ecorner.stanford.edu/videos/1661/Economics-of-Free-A-New-Business-Model>

The latest business model for web-based companies is to provide services to the consumers for free. Roberts talks about the operations of such a model, in which advertising is the only source of revenue. She elaborates on how companies are learning to value the concept of 'nothing'.



Transcript

So, business models. They really are quite crazy out there today. So, nobody wants to pay for anything. So I talk about 'the economics of free' quite a lot, and most, I would say, of the consumer-orientated deals that we see that come into our company, the business is free. "We're going to give this to people for free." Particularly every web-based business is free. And of course the solution to making money is advertising. Advertising, advertising, advertising. Every business model is advertising. So that's sort of good. And brands are looking to advertise everywhere they can.

Particularly with the whole time-shifting scenario of the TV, advertisers are looking to more places to advertise whether it's the on-display boards, obviously online everywhere, on mobile phones, and so on. So it's interesting, but it's hard sometimes to bring together the world of advertising and the online world. Obviously Google has done it very well. But sometimes there's a mismatch in terms of ad inventory and placement. Advertisers want to place ads next to the brand. They want to make sure their brand is promoted in the appropriate way, its use of adjacency, and so on. This whole 'economics of free' is very interesting. I mentioned that I'm involved in a game company. Right now we charge, but we're having to think through, 'We have to be free.' And I think, again, it comes back to young people. People just don't want to pay.

So the question for us as we look into new markets like mobile advertising is, how much interruption would a consumer take in order for a service to be free? But certainly, for sure, I think net of Skype and VoIP and all that in the wireless world, we're moving towards free. Free rate plans. You're seeing companies already in Europe, MBNOs starting out, that they're offering free services. In order to get that free service, you'll have to get a banner ad or two or three or four on your phone. But certainly the idea is that that advertising plan will be connected to some course of action so you'll be able to discover what you're looking for. But the net of it is, this whole movement to free is a big change in our industry and we have to understand it. So selling a product, deducting the cost, looking at the gross margin doesn't happen as often as it used to. So also, we're valuing nothing. What is the value of nothing? Nothing at all. So the key point here is that in many of the business plans we see, the initial product is free.

So take gaming for an example. So the initial game is free, but customers, consumers will pay for digital goods. So if you have a character in a game, you might be prepared to train that character and pay for it. You might be prepared to dress that character in a certain way. You might be prepared to pay to upgrade that person's home or whatever, or car, if you're in a racing game. And so that's just one example, but we're seeing more and more opportunities now where people are willing to pay for nothing. So they're trading nothing. And so how we value nothing is very interesting. And so, again, you look to some of

the auction techniques or whatever, but to me, it's very fascinating what people will pay for today. So a real service, they want for free; nothing, they want to pay for.

And so I'm exaggerating to make a point, but these are some of the things that we're thinking about as we're going into 2007 and looking at new businesses. And you'll see here I put 'Beyond Boxes' because the whole old way of packaging things in boxes and charging for those boxes is gone. And in many instances, when you look even at the more traditional markets where you are providing functionality in a box--it might be a service to a home, or a service to a company--the days of those boxes are going away. It's about software, and that software might be delivered as a service. So things are changing to how you charge for things, how you provide that service--how you service that service is really changing--and we have to understand that and address it.