

This sheet is a handout material from Udemy course:

[Essentials of Software-as-a-Service \(SaaS\) Business.](#)

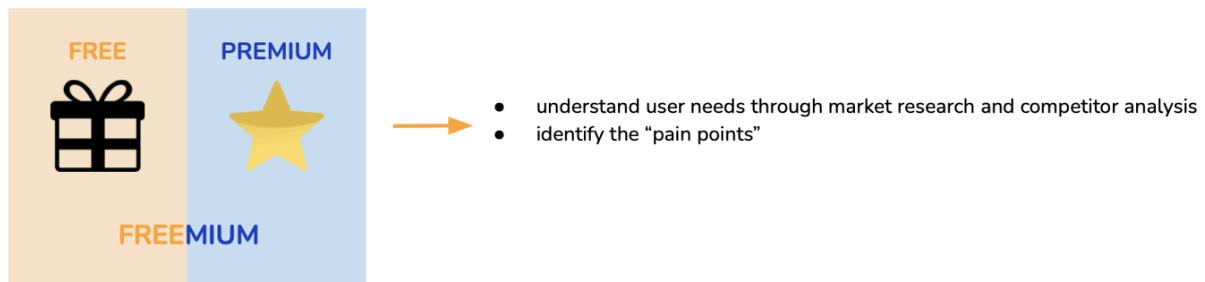
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4.8 Challenges in Designing the Freemium model

Once we decide to implement a freemium model, we must understand that crafting an effective one is not a simple task. The real challenge lies in perfectly balancing the value offered in the free version to attract a substantial user base, while reserving essential features for the paid version. Let's examine some of the challenges that might arise in areas such as feature segmentation, user expectations, conversion rates, and economic viability.

1. Feature segmentation

It is difficult to decide which features should be free and which should be reserved for the premium package.



One of the trickiest parts of designing a freemium model is feature segmentation. Or in other words deciding exactly which features should be free and which should be reserved for the premium package. If we offer too many valuable features for free, there's little incentive for users to upgrade. But if we offer too few, we might not attract enough users to build a viable customer base. So, how do we strike this balance?

We start by really understanding our users and their needs, which often involves a lot of market research and competitor analysis. We need to identify the 'pain points' that our product can solve and decide if these solutions should be part of the free package or if they are premium features. It's also about anticipating user progression and thinking about what will make users feel the need to upgrade.

2. User expectations

“Lock-in” effect: Users often expect that features available for free will remain so indefinitely.

- communication is key
- enhance the free tier
- segment your users

When users sign up for the free version of our software, they typically expect the included features to remain free. This expectation creates a 'lock-in' effect. It means that once users get used to accessing certain features at no cost, restricting these to a premium tier can lead to significant disappointment and potential churn. So, how do we manage this expectation effectively?

First, **communication is key**. Before making any changes to the availability of features, it's important to communicate the reasons behind these changes. Explain how these adjustments are necessary to sustain the quality and development of the product. Users are more likely to accept changes if they understand the value and necessity behind them.

Also you could **enhance the free tier** simultaneously when premium features are expanded. If users see improvements or new features being added to the free version concurrently with changes to the premium tier, they might feel less like they're losing out and more like they're part of a product that is growing and improving.

Another approach could be **segmenting your users** based on their usage patterns and preferences. For those who heavily rely on a feature that's transitioning to a paid model, consider personalized offers or a discounted upgrade path as a token of appreciation for their loyalty.

3. Conversion rates

Struggles with reaching and maintaining a good conversion rate.

Even with a large user base, converting free users to paid subscribers remains a challenging task. The freemium model must be designed so that the free version acts as an effective lead generation tool. It needs to demonstrate enough value to justify a paid upgrade, but it should not satisfy all user needs completely, preserving the appeal of premium options.

Let's take a look at how conversion rates differ across different industries. I found an interesting report by FirstPageSage, an SEO agency, which details freemium conversion rates across various SaaS industry segments.

Industry segment	Visitor to Freemium	Freemium to Paid
Advertising/AdTech	13.9%	3.6%
CRM	12.8%	3.4%
ERP	14%	4.8%
Education/EdTech	13.9%	2.6%
IoT	15.5%	4.1%
RegTech	14.2%	5.8%

Source: <https://firstpagesage.com/seo-blog/saas-freemium-conversion-rates/>

The data was gathered from over 80 clients of the agency who implemented a freemium model between 2018 and 2023. The table provides two metrics for each segment: the conversion rate from visitor to freemium (that is the percentage of website visitors who sign up for the free version of the software) and the freemium to paid conversion rate (that is the percentage of those free users who later upgrade to the full, paid product).

Interesting finding is that industries like Internet of Things (IoT) and Regulatory Technology (RegTech) have relatively high freemium to paid conversion rates, 4.1% and 5.8% respectively. This might suggest a greater dependence on value perceived in the premium features within these sectors. On the other hand, the Education segment shows a lower conversion rate at 2.6%, indicating that users in this sector may be more cost-sensitive or adequately served by the free functionalities.

In general, an ideal conversion rate typically ranges from 2% to 5%. To achieve or surpass this benchmark, SaaS companies can integrate strategies like targeted marketing campaigns and periodic promotions such as limited-time discounts or bundled offers.

4. Economic viability

Supporting a large number of free users significantly strains company resources.

- server costs
 - infrastructure maintenance
 - development and deployment costs
 - data storage costs
 - technical support
 - marketing and acquisition costs
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- automated processes
 - cloud management
 - optimization of data usage and storage
 - performance monitoring tools

The last challenge in designing a freemium that I want to discuss is economic viability. Supporting a vast number of free users can significantly strain a company's resources. This includes not only server costs but also the expenses related to customer support, infrastructure maintenance and many others. To manage these costs, we must ensure that they do not exceed the revenue generated from paid conversions. Companies might employ various cost-management strategies to maintain economic viability in a freemium model. For instance, implementing automation across customer service, billing, and onboarding can significantly reduce labor costs and enhance operational efficiency. Also regular audits of data usage and storage can lead to substantial cost savings by optimizing data management. Additionally, utilizing cloud management services that offer dynamic scaling helps align resource usage with actual demand, further reducing unnecessary expenditures.