

Primium – business models for a privacy-conscious world

Offering privacy control at a premium

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With increasing consumer awareness and emerging regulatory changes around consumer data privacy, the latent demand for digital products that give users better control of their privacy is becoming an attractive market segment. Players who differentiate their offerings by making privacy control a key product attribute – Primium offerings – are likely to find a sustainable niche with potential for market disruption. We estimate the potential market for putting privacy control in the hands of users to be USD 5 – 6 billion by 2020.

For centuries, Chinese restaurants have been offering private dining rooms at a premium price. French restaurateurs met the demand for intimate meals by charging more. Paying a premium for privacy is therefore not new. Awareness and concern among users and governments over data privacy has been rising steeply, helped by recent revelations of government-backed data gathering¹. Players in the digital domain will find the return of this old concept appealing.

Based on the then nascent Operations Research discipline², Arthur D. Little pioneered the scientific analysis of customer data and its use to improve business performance from the 1950s onwards. Since then, customer data analytics has made great strides. The growth of digital technology opened the doors to monetizing user data by offering advertisers fine grained target-

Today's Internet users expect many services to be free of charge. In the current business model intermediaries provide a free service to users, and in exchange they are allowed unfettered access and full control over user data. In a Freemium model, the user pays for enhanced features, the most common being the absence of advertisements. In this article the authors lay out the idea of another business model, "Primium" digital services in which customers pay more, but have control over privacy of their data.

¹ We focus on business implications arising from privacy concerns in user data markets, and not concerns on state-sponsored surveillance per se

² John F. Magee, *Operations Research at Arthur D. Little, Inc.: The Early Years*, *Operations Research*, Vol. 50(1), 2002, p.149–153

ing. This also led to the widespread adoption of the Free and Freemium business models that are now standard in the digital domain. Intermediaries provide a free service to users, and in exchange they are allowed unfettered access and full control over user data. Intermediaries sell to advertisers targeted data for ad placement. In the Freemium model the user pays for enhanced features, the most common being the absence of adverts. Users are the suppliers to intermediaries from a revenue generation perspective. Value appropriation by the intermediaries in Free and Freemium business models rest on the insights from user data (acquired on the user side of the platform), being sold in the market for digital advertisements. Wholesale/ B2B markets are emerging for anonymized user datasets and pre-packaged insights. Buoyed by the expected market potential, firms in many industries, ranging from telecoms and retail to automotive, are making investments in user data gathering and analytics.

While Free and Freemium business models rely on access and control over user data to generate and grow revenues and profits, user concerns as well as regulations that curtail access and control will undermine this value appropriation. Primium provides a way for players to think differently about value appropriation – how can it be gained by addressing user concerns? With Primium business models, challengers to incumbents can potentially create sustainable niches. Access providers can look at new revenue streams by helping their customers address privacy concerns. For incumbent intermediaries, it is time to start innovating within their business models in order to avert a potential loss of revenues, profits and valuation.

What is Primium?

Users are willing to pay for better privacy control – Chinese and French restaurateurs would vouch for it. Privacy at a premium – Primium – considers privacy control by the user as a key product attribute that can be used to differentiate the offerings from current free and paid (including Freemium) offerings that provide low levels of privacy control to users.

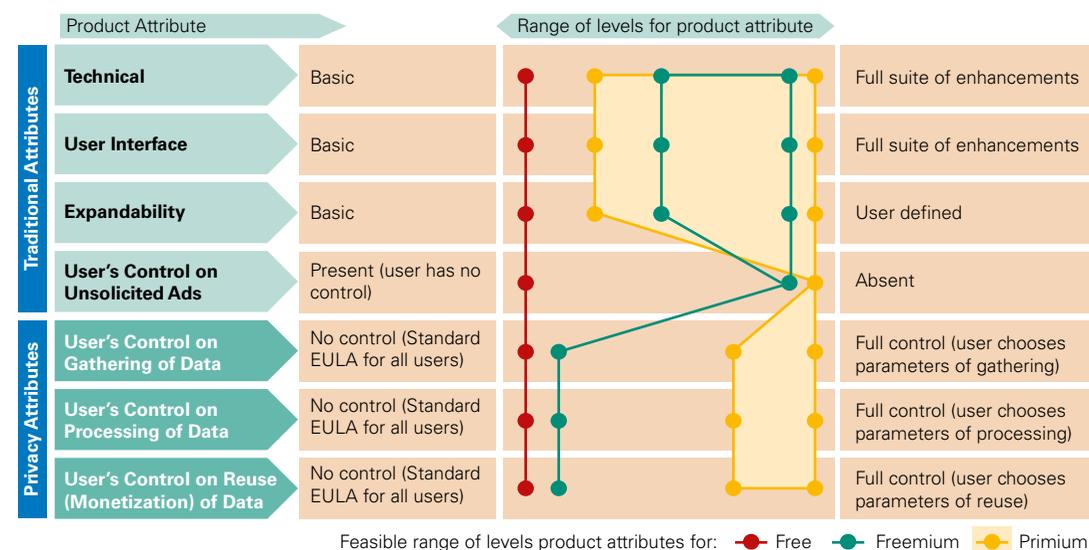


Table 1 Product attribute configurations for Free, Freemium & Primium Source: Arthur D. Little analysis

The wide range of options to play with in the product attributes around traditional and privacy control allow players to come up with differentiated offerings that appeal to various customer groups. User markets can be segmented by the importance they place on privacy control. The distinctiveness of segments and their corresponding attitudes to privacy would vary across different products and services, driving discrimination based on price.

What is Primium's business potential?

Some intermediaries are already offering Primium-like products to specific customer segments such as schools, government institutions and enterprises. However, the sizable consumer market has limited options that offer privacy control. In this article we are therefore focusing on this large sector with a sizable latent demand for Primium offerings. We estimate the potential market size for Primium offerings to reach USD 5 – 6 billion by 2020. This is based on additional growth in the market for current Free/Freemium offerings, as only a small proportion of users are estimated to adopt Primium.

In the Free business model, all of the value appropriation by businesses derives from the non-user side of the platform – the advertisers and marketers. In Freemium, some users who are paying customers become a source of revenue as well. Primum provides yet another stream of revenue from users – the binary segmentation of the user base in Free/Freemium will evolve into more segments, with product configurations built from traditional and privacy-based product attributes. Willingness to pay, price elasticity of demand, and the revenue potential of Primum will depend on how players configure Primum offerings.

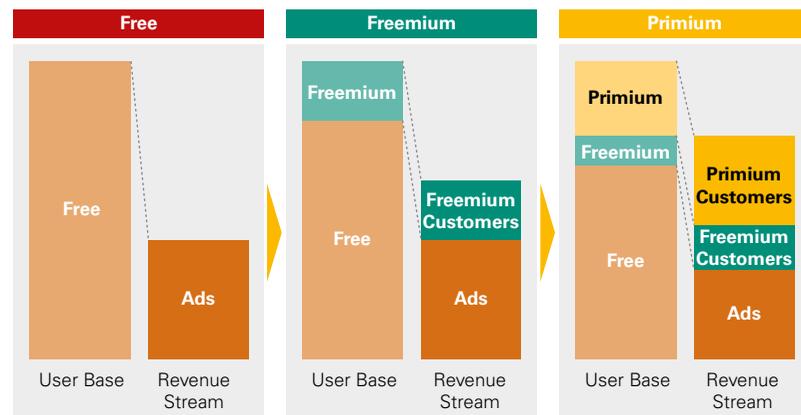


Table 2
Market evolution with Primum business models

Source: Arthur D. Little

Market composition in terms of user base (indexed) and revenue streams

Our estimates indicate that the market size for Primum offerings will reach USD 5 – 6 billion by 2020, based on the top five product/service categories by usage. This is based (Table 3) on a two segment Primum market representing both ends of the privacy-attribute range – a minimalist product offered at a low price and a full-featured premium product, both offering privacy control. For the two product configurations, the subscriber base and price was estimated from literature review in order to arrive at the market size.

In our research we have adopted a conservative view of the proliferation of Primum offerings, especially in social networking, which has the potential to grow to a significantly higher size if Primum social networking platforms supplant existing ones.

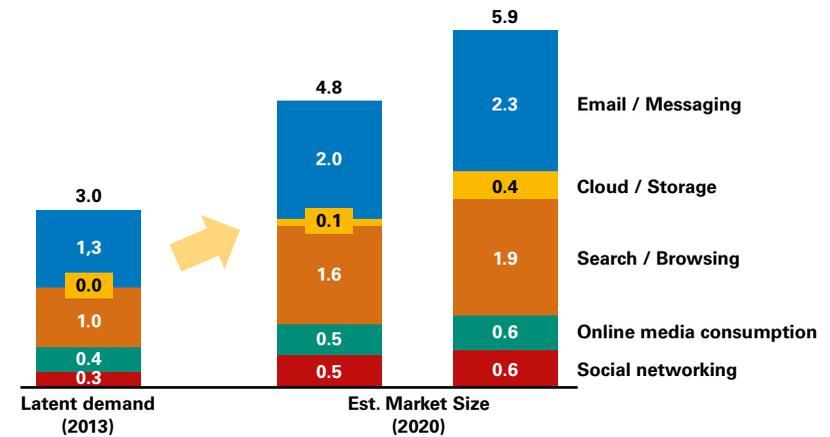


Table 3
Estimated market size for Primum offerings by 2020 (in USD billion)
Arthur D. Little estimates³

Methodology Note: Latent demand estimates for 2013 based on secondary research reports covering (addressable consumer base) · (interest in privacy) · (willingness to pay for privacy and/or similar ad-free, secure services); Potential estimate for 2020 arrived at using available segment growth projections and adoption of Primum offerings within each product/service category

Value appropriation in a privacy-conscious world

The potential demand for Primum offerings sets the stage for a disruption of current Free and Freemium-driven value appropriation by intermediaries and service providers. Challengers, including new entrants, can circumvent key drivers of incumbent advantage and persistence of market dominance in order to establish sustainable niches. Access providers, given their direct connections to customers, can build new revenue streams through Primum. Incumbents facing the innovator's dilemma – to continue to rely exclusively on Free/ Freemium business models or to move to Primum – are best placed to adapt, but it will not be easy.

³ Estimates based on literature review – Surveys by Univ. of Colorado Boulder (2012) on willingness to pay for privacy; Pew Research Center study in the USA; Tristan Louis, *How much is a user worth*, Forbes, Aug 2013, Emarketer reports on digital advertising growth, Gartner ICT spending reports, Radicati consumer email / cloud market sizing, Annual reports of Facebook, Google, Yahoo, Microsoft and analyst estimates on segment-wise contributions, Web research for price points of similar services existing in the market, Press search for VC investments in anonymity / privacy offerings in 2002, 2007 and 2013

For challengers – disrupting (current) dominance with Primium

Challengers need to look for products that allow them to circumvent the advantages of dominant incumbents offering Free/ Freemium products, such as network effects, customer lock-in, superior access to resources, technology and markets, and learning, built up over time.

Primium-only-play

- Look for products with high interoperability – helps counteract the user-side network effects and customer lock-in enjoyed by incumbents, even piggybacking on them.
- Avoid products involving many-to-many interactions – side-steps typical winner-take-all dynamics.
- Focus investments in the core offering – lowers entry barriers in terms of capital requirements. The Primium-only play involves only one constituent – the user-customer, so there is no need to invest in other sides of the platform such as advertisers/marketers.
- Build features that reduce switching costs to customers – overcomes customer inertia by providing them with easy ways to switch from incumbents.
- Enter into partnerships to gain access to customers/resources – brings complementary capabilities for customer access, intermediate resources and technology through mutually beneficial partnerships.

Product-markets that are characterized by high interoperability and one-to-one or one-to-many interactions constitute 90% of the estimated market size for Primium offerings by 2020 (Table 3). These product-markets are highly likely to be disrupted by challengers and new entrants, seeking to develop and dominate Primium segments that will co-exist with the current Free/Freemium offerings from incumbents.

Products characterized by low interoperability, and especially those involving many-to-many interactions (such as social networks) demonstrate winner-take-all dynamics and strong user-side network effects, making it difficult to challenge the incumbent's position. Here, new entrants need to grow the customer base for products, creating privacy-respecting service platforms from the ground up. In a Pew Research survey in 2013, 51% of respondents considered the ability to authorize access to the content of their online chats as very important, with another 12% considering this somewhat important⁴. By extension, this translates to about one billion customers (in 2013) for whom privacy controls are important in social networks – a sizable addressable market for privacy-respecting social network platforms that challengers can target. What works in favor of these companies is that the critical mass of customer-users needed to make their platform viable needs only to meet the minimum number of users to result in meaningful social networking for them⁵. In the Free model of social networks, for instance, the revenue generating side of the platform necessitates a much higher critical mass of customers to make the platform

⁴ Pew Research Center, Internet & American Life Project Omnibus Survey, Jul 2013

⁵ The advertiser/marketer side of the platform does not exist for a Primium social networking platform



viable. These products provide opportunities to come up with offerings such as Family and Friends packages, helping to drive adoption. It is possible that the same users can be active in current platforms as well as privacy-respecting platforms, but for different types of social interactions.

For access providers – building Primum revenue streams

Access providers – communication and internet service providers – are witnessing a commoditization of access, and are seeking to broaden their revenue streams. Primum provides access providers with an alternative way of building product-based revenue streams.

For instance, Dutch telco KPN partnered with Silent Circle, a US-based encrypted communications provider, to offer encrypted calls and text messaging to its customers in Netherlands, Belgium and

Access-to-Primum-play

- Seek products with high interoperability – helps counteract the user-side network effects and customer lock-in enjoyed by the incumbents, even piggybacking on them.
- Avoid products involving many-to-many interactions – side-steps typical winner-take-all dynamics.
- Enter into exclusive partnerships to bring Primum offerings to market – differentiates from competition.
- Build on trust – leverages higher levels of trust enjoyed by local access providers over a global digital intermediary.
- Focus investments on infrastructure and technology to complement Primum-only players – brings economies of scope for more efficient operations, leading to higher value appropriation.
- Bundle Primum offerings with access – encourages higher adoption of Primum offerings among existing customers/ attracts new customers.

Germany⁶. Access providers possess two key advantages that complement the capabilities of Primum-only players. First, they provide the channels to reach a large customer base, as well as infrastructure that can be leveraged. Second, they can readily provide compliance with the 'host-data-in-user-country' requirement that many regulators and governments are pushing for. KPN is bringing both to Silent Circle in this recent partnership, while building a new revenue stream for itself.

For incumbents – adapting to Primum

For incumbents, the potential for industry disruption, rather than the current market growth should be the motivation to round out their product portfolio with Primum offerings, especially in products with high interoperability and one-to-one/one-to-many interactions. The more the incumbents wait, the greater the chance of challengers entering and dominating the Primum space, given the lower strength of incumbent advantage. In many cases, Primum offerings can be readily configured by adapting current paid-for offerings sold to institutions and enterprises. The key challenge for incumbents to overcome may be internal to its organization – balancing the current dominant units driving its Free business model and strategic inertia towards new ideas – the classic innovator's dilemma.

Incumbents in products with low interoperability and many-to-many interactions can face a serious challenge from privacy-respecting platforms of new entrants. Given the strong user-side network effects, challengers will take time to build their competing platforms from the ground up. At the same time, the winner-take-all dynamics in these markets implies that once a challenging Primum-based platform attains a critical mass it can grow fast and possibly unseat current platforms from their market-leading position. The competitive dynamics for these product markets are less predictable.

⁶ Loek Essers, *KPN strikes deal with Silent Circle to offer encrypted phone calls*, PCWorld, 19 Feb 2014

Incumbents are best placed to pre-empt competition by building their own Premium offerings and platforms, accommodating a short-term cannibalization of user base in Free/Freemium in order to sustain long-term market dominance. With Premium offerings in their portfolio, incumbents are also better placed when facing regulatory ire/consumer backlash around privacy concerns.

Conclusion

In recent discussions many have derided privacy, claiming that upright citizens with nothing to hide have no need of secrecy. Lamenting this narrow interpretation of privacy as secrecy, UCLA economist Jack Hirshleifer described it as autonomy within society, with autonomy meaning independence from control by others⁷. Premium thinking follows Hirshleifer's view on privacy. The key proposition is that the latent demand from privacy-conscious customers is sizable enough for a distinct, albeit niche, segment within the broader market for digital products and services. The increasing focus on regulating user data markets is providing the much needed push here. Both incumbents and challengers have opportunities to define and grow this market segment and can potentially rewrite the rules of the game.

⁷ Jack Hirshleifer, *Privacy: Its Origin, Function and Future*, Conference on the Economics and the Law of Privacy, University of Chicago, Nov 1979

Picture by Mikel Martinez De Osaba / dreamstime



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