

# The AI Hype Trap: A Critical Look at AI Businesses

## Briefing Doc

This briefing document critically examines the current state of AI businesses, particularly in the context of Generative AI (GenAI). It argues that despite significant hype, high valuations, and the demand for "AI Product Manager" roles, most AI businesses are fundamentally "terrible" due to brutal unit economics and unsustainable models. The document contrasts AI business models with traditional Software-as-a-Service (SaaS), highlighting the challenges and providing guidance for Product Managers to cut through the hype and assess the real value and sustainability of AI products, companies, and job opportunities.

## Main Themes and Key Insights:

### 1. The Illusion of "AI Product Manager" and the Pervasive Hype:

- The "AI Product Manager" title is in high demand, sounds exciting, and commands higher salaries, contributing to a significant "FOMO" (Fear Of Missing Out) effect.
- The ease of launching AI apps and the narrative of quick success ("vibe coding a product, raising rounds, and talking about 'changing the world'") fuels this hype.
- However, beneath the surface of investor decks, self-serving podcasts, and VC-fueled valuations lies a "sobering reality: Most AI businesses are terrible."

### 2. Brutal AI Unit Economics vs. Profitable SaaS Models:

- SaaS Success: SaaS thrives on "near-zero marginal cost per new user," leading to "wildly profitable growth" and "70–90% margins." Variable costs scale with growth and are often covered by the customer, and LTV (Lifetime Value) typically exceeds CAC (Customer Acquisition Cost) by 3x+.
- AI's Fundamental Flaw: AI apps "flip that model." "Every new user creates new costs," including "API calls, Compute time, Model licensing, Output moderation."

- Lower Margins: This results in significantly lower margins, "30–60% margins at best," with examples like Anthropic's Claude at around 55%. The source also notes that "some of that margin may come from 'dead subs' – paying but inactive users."
- Escalating Costs with Growth: Unlike SaaS, where growth leads to higher profits, in AI, "growth - more cost. Sometimes exponentially."
- Examples:
  - "GitHub Copilot cost Microsoft \$30 per user/month on average (and up to \$80 for power users) while charging just \$10."
  - "MidJourney had to cap image generations."
  - "Even OpenAI had to meter ChatGPT Plus because active users cost more than they paid."

### **3. The Conversion Problem: Low Paid User Adoption:**

- Despite massive user bases for popular AI products, conversion rates to paid subscriptions are "shockingly low."
- "ChatGPT wants 1 billion users by EOY. Today: ~700–800 million users. Sounds impressive. But only ~10 million pay for ChatGPT Plus. That's ~2% conversion."
- Even "the rosier estimates put it at 5–7%," which is "abysmal compared to the average SaaS product."
- Crucially, "free users aren't free. Compute costs money."

### **4. The Hype Cycle Trap and Inevitable Commoditization:**

- Generative AI is currently at the "peak of the hype cycle," a stage "not correlated with long-term benefits," as seen with "Blockchain. Crypto. Augmented reality."
- "Mass reach today comes more from media hype than product value."
- "Even foundational AI companies are deeply unprofitable. Their current economic models can't sustain themselves."
- Like other transformative technologies (mobile, social, streaming), "eventually LLMs will commoditize." This will lead to "drastic changes in their pricing" to maintain market share and fuel profitable growth.

## 5. Where AI Businesses Could Work (AI as an Accelerant, Not the Product):

- Viable AI businesses are emerging in industries with "complex workflows" like HR, sales, accounting, legal, finance, and healthcare administration.
- These businesses focus on "automating contract and invoice matching," "connecting CRM and contract systems," "streamlining back-office document processing," and "clinical documentation improvement and medical coding."
- The key characteristic is that "they solve a real, painful problem where AI itself isn't the product, it's the accelerant." These may not be "billion-dollar moonshots," but they have the "potential to be real, sustainable businesses."

## 6. A PM's Playbook: Cutting Through the Hype: Product Managers must ask critical questions across three key areas:

### Evaluating the Success of Your AI Product:

- Conversion: Are users converting at healthy rates? (Are you burning money on free users?)
- Margins: What is the actual cost per additional customer? Are you scaling revenue or losses?
- Retention: Do users stick around after the initial hype?
- Value without AI: Does the product solve a real problem regardless of AI? "If it's value is solely based on the fact that's it AI, you probably have a hype play." Products that are "just a wrapper on GPT with no defensibility" are in trouble.

### Evaluating Your Employer's AI Investments:

- Clear vision and strategy: Can leadership articulate how AI will deliver profitable results?
- Grounded business model hypothesis: Is there a focus on sustainable unit economics?
- Defensible value: Does the company possess proprietary data, workflows, integrations, or patents? "Or is it just reselling OpenAI's API?"
- Pragmatism over hype: Are AI features truly solving customer problems or merely "bolted on to hit investor buzzwords?"

### Evaluating an AI PM Job Opportunity:

- Target market and positioning: Is AI truly enhancing a solution to a painful customer problem, or is it the sole value proposition?
- Customer acquisition and conversion: Are customers actually paying, or is it a "free-user bonanza?"
- Customer retention: Are there "repeatable, sticky use cases?"
- Margins and costs: Does the company understand and account for the costs to serve new and existing users, ensuring sustainable margins? (Dodging these questions is a "red flag.")
- Funding dependency: Is the funding based on "viable economics" or "AI hype and investor FOMO?" What is the path to profitability?

#### **7. The One Question to Ask:**

- "AI is incredible technology. Here to stay. But incredible technology does not automatically make a great business. Nor a sustainable job."
- The winning companies and Product Managers "won't be the ones with the best vibe coded prototypes, the flashiest demos, or 'we raised \$100M' headlines."
- They will be the ones asking the "unglamorous question: 'Where is the repeatable, profitable value?'"
- The document concludes: "Because in the end, hype burns cash and kills jobs. Value builds businesses and sustains communities."