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From Netscape to eHarmony: The High Risk of Platform Markets

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The High Risk of Platform Markets

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by Dylan Minor

Platforms are market structures that bring together complementary partners. Think eBay, which pairs buyers and sellers online, or credit cards, which similarly connect consumers and the companies with which they want to do business. Platforms enable all sorts of relationships: Apple's iOS joins mobile software programmers and iPhone users; myriad online dating services couple potential life partners. In short, any company that matches two sides of a market is a platform.

Everyone uses platforms, and company fortunes are made and lost through them, but the dynamics of how platforms operate and how winners emerge remain little understood—even among those organizations whose very existence depends on them.

Indeed, central to the strategy of any platform business is the imperative to simply survive. A quick survey of business history shows how easily platforms come and go. Facebook handily displaced MySpace. Internet Explorer eliminated Netscape and enjoyed a run of dominance, but now is threatened by Google's Chrome. Yet those companies with staying power can grow to dominate industries in ways that can veer toward monopolistic—and earn supernormal profits. It's a concept known as tipping.

When a platform market tips, a single winner emerges: Google in search, Microsoft Windows in business computing. Not all markets tip to a single winner quickly, but when they do, the effects are dramatic. Winners gain an outsized share of revenue and profit, and those that achieve long runs of supremacy learn to use their advantage to build greater and greater strength.

The tipping phenomenon hinges on a business's ability to convene many users—and often a wide variety of them—on both sides of its market. Microsoft's Xbox 360 game console would not be very successful if it had only one gamer using its product and one developer creating programs. Nor would it enjoy enduring success if it had 1 million software developers but only one gamer. A platform strategy needs many users of both types. Further, the platform increases in value to potential users as it attracts more of each type. The more sellers on eBay, the greater the selection of products for buyers. The more buyers, the more attractive the market for sellers. It's a system that can quickly feed on itself and lead to tipping.

But how that winning firm is selected is an inherently difficult question. Indeed, it is hard to discern whether a platform-based market is in the process of tipping until we actually witness that it has tipped. To address this challenge, my colleagues and I ran a series of economic experiments in which subjects representing both sides of a market were given the option to choose among multiple competing platforms. Subjects received initial financial incentives for choosing each platform that increased as more of each type of user gravitated toward a given platform (to represent the rising value of the platform based on participation). But we also informed subjects that one platform was superior in its ability to match users.

Prior to the experiment, it was not obvious that all users would eventually migrate to the superior platform, because—as is found in practice—we also instituted switching costs. For example, once someone becomes a Facebook user, the cost of transferring from Facebook to a new social network is, at a minimum, the cost of learning how to use the new platform. There is also the cost of giving up all of one's connections. Hence, the challenges faced by Google+.

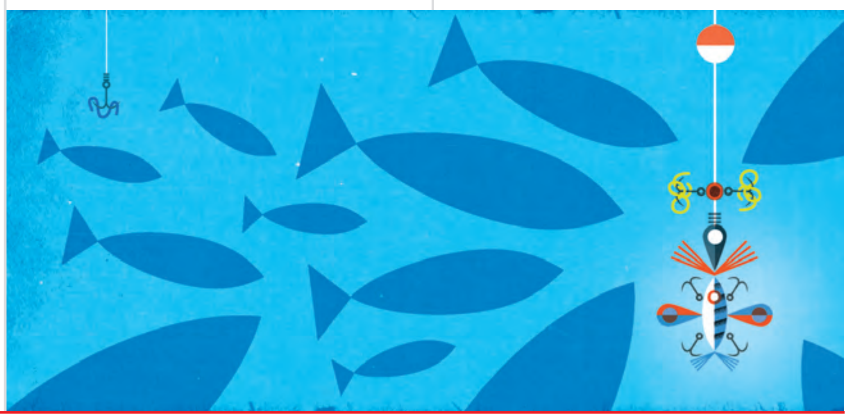

Illustration by Matthew Hollister

We found, however, that despite allowing for switching costs, over time users ultimately all choose the superior platform. This suggests that the winner will be decided by the platform that can provide the most value to both of its user types. This result persists even when we allow an inferior platform to have a head start—to gain dominant market share and lock in customers who want to avoid switching costs. Perhaps, then, there is hope yet for Google+, assuming it can deliver the kind of step change in user experience that Facebook delivered in comparison with MySpace.

How does a platform business achieve a better value proposition than its rivals? The primary factors are increasing the quality of matches between complementary users and charging the most competitive fees. Examples of the first variable include eHarmony's promise of a superior pairing through its advanced user profiling process or eBay's user-generated ratings of sellers and buyers.

With respect to fees, there are a host of options. The two main classes are one-time charges to "join" the platform and those based on usage (such as transaction fees, service charges, and pay for placement). One could also charge fees based on match quality. Although less frequently employed, this strategy offers interesting potential. For instance, when the band Radiohead used its online delivery platform to provide downloads of its album *In Rainbows* in 2007, users paid whatever they wanted according to what they perceived as its value (or the quality of the match between album and fan).

Sometimes it makes sense to forgo fees on one side of the platform to bring users to the other. Consider a nightclub that is attracting a disproportionately large percentage of men. It could waive entrance fees for women or offer other incentives such as drink specials in order to attract more women. We know this as "Ladies' Night."

Once a platform market tips, the winner can consider modifications to its fee strategy. Netflix used to offer unlimited video streaming as a benefit for subscribers of the company's DVD rental services. However, after amassing an enormous user base, it now charges separately for streaming.

Despite the long history of tipping, some platform markets seem impervious. The gaming console market appears to be stable with three platform companies: Nintendo's Wii, Microsoft's Xbox 360, and Sony's PlayStation 3. Under what conditions can firms coexist in a platform market, escaping the doom (or missing the riches) of a single, surviving market leader?

We repeatedly found one condition that allowed multiple platforms to coexist for the long run or at least give the appearance they were doing so: heterogeneous consumer tastes within a given market. Dating sites provide a strong example: eHarmony, JDate, ChristianMingle, and Cougar Life each aspire to connect two sides of the romance market, but each serves a different preference among a diverse customer base. And in the gaming market, some users are seeking graphically intensive war games, while others want physically active yoga programs. Where different platforms serve different sectors of the market, multiple platforms can coexist.

Of course, that's only at one level. When you define most seemingly heterogeneous markets one layer deeper—where customers with similar tastes reside—you'll find most platforms do, in fact, tip. Thus, one essential element of success is accurately defining the market you intend to dominate: Is it video-game consoles or video-game consoles for sports enthusiasts? The former serves a heterogeneous market, the latter a homogeneous one.

This prompts other questions: How can you identify a platform market that is attractive to enter, and under which conditions is it appealing? If you seek to enter a market serving a relatively homogeneous set of customer needs—such as computer operating systems or credit card platforms—you must come equipped with a competitive advantage that allows you to provide a match between users (or an improved pricing scheme) that can overcome switching costs. When a market has not yet tipped, this can be a successful strategy. If the current market has already tipped to a dominant platform, however, it will be considerably more difficult to simultaneously pull enough users on both sides of the market away from the current winner. Imagine an entrant wanting to displace eBay. Few sellers would want to join a new site with no buyers, and few buyers would join a site with no sellers. The

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value proposition would have to be overwhelming.

Entering markets serving more diverse customers could prove more promising, as there are multiple possible submarkets to enter (or create), and the power of any dominant player in a submarket will likely be less than that of a dominant player in a homogeneous single market. It's much easier, for instance, to provide a new, compelling twist on a dating site than to provide a new search engine.

The growth rate of technology-based businesses ensures that platforms will become an increasingly prevalent mode of operating in the marketplace, which raises important questions for your business strategy. Are you competing within a platform marketplace? Consider all the facets of your business. Even if your core business is not platform-based, supporting elements could be. If and where you are engaged in platform markets, could you be "tipped out" by a stronger player? Are you primed to dominate? Is the market homogeneous or heterogeneous? Can you define new segments? How do competitors stack up?

Unless your platform business has a distinct and recognized advantage, long-run success is unlikely. But those firms that provide a superior match between users in the most economically efficient fashion can become the sole dominant player in their industry, enjoying monopoly-like profits with a diminished threat of competitive entry from others. +

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