From Netscape to eHarmony: The High Risks and Big Rewards of Platform Markets

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The Promise and Peril of Platforms
Companies competing in platform-based markets take high risks. They can dominate for years or be swept away in an instant.

By Dylan Minor

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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 they wish to do business with. 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 them, company fortunes are made and lost through them, and yet 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 simply how to survive. A quick survey of business history shows how easily platforms come and go. Facebook handily displaced My Space. 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 super-normal 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 only had one gamer using its product and one developer creating programs. Nor would it enjoy enduring success if it had 1,000,000 software developers but only one gamer. A platform needs many of both types of users. Further, the platform increases in value to potential users as it attracts more of each. 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 if 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). Further, we allowed one platform to be superior in its ability to match users, thus providing higher overall payoffs to its 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 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+.

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

So, how does a platform business achieve a superior value proposition? The primary factors are to increase the quality of matches between complementary users and to charge the most competitive fees. On the first variable, consider 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 onetime charges to “join” the platform and those based on usage (transaction fees, service charges, pay for placement, and so on). One could also charge fees based on match quality. While 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 based on their perceived value (or the quality of the match between band and fan).

Sometimes it makes sense to forego fees on one side of the platform to bring users to the other. Consider the nightclub that is attracting a disproportionately large percentage of men. It could waive entrance fees or offer other incentives like 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 their DVD rental services. However, after amassing an enormous user base, they now charge separately for streaming.

Despite the pervasive 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 found one recurring condition that allowed multiple platforms to coexist for the long run or at least give the appearance they are doing so: when consumer tastes within a given market are heterogeneous. Dating sites provide a strong example: e-Harmony, 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. In the gaming market, some users are seeking graphically intensive war games, while others are seeking physically active yoga programs. Where different platforms serve different sectors of the market, multiple platforms can co-exist.

Of course, that’s only at one level. When you define most seemingly heterogeneous markets one layer further down—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 begs another question: How can one identify a platform market that is attractive to enter, and under which conditions? If you seek to enter a market serving a relatively homogeneous set of customer needs—computer operating systems or credit card platforms—you must come equipped with a competitive advantage that allows you to provide a match between
users (and/or 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 attract 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 such a new site with no buyers and few buyers would join a site with no sellers. The 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 in a homogeneous single market. It’s a lot easier to provide a new compelling twist on a dating site than 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, raising 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 well be. If and where you are engaged in platform markets, are you ripe to be tipped out? Primed to dominate? Is the market homogenous or heterogeneous? Are there new segments you can define? 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 industries, enjoying monopoly-like profits with diminished threat of competitive entry from others.