Strategies for Two-Sided Markets (p209)

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Synopsis

Products or services that bring together groups of users in *Two-sided markets/networks* are platforms. The platform incurs costs in serving both sides and can collect money from each although one side is often subsidised. Unlike traditional businesses, where at some point growth leads to ***diminishing returns***, with **two-sided network effects** the value to any given group depends greatly on the number of users on the network's other side.

Fuelled by the promise of increasing returns competition in two-sided networks can be fierce as network leaders invest more in R&D, or lower prices, to drive out competition. As a result mature two-sided network industries are usually dominated by a handful of large platforms; extreme cases produce a *winner-takes-all scenario*.

Platform providers that have vanquished immediate competition may face significant competition from large companies in adjacent markets who have the ability to offer a multiplatform bundle.

Two sided network dynamics

The following positive effects exist; note that negative instances of these may also exist.

Same-side effect	Increasing the number of users on one side attracts more users on the same side
Cross-side effect	Increasing the number of users on one side attracts more users on the other side

Key Challenges

1) Pricing the product

In competitive industries prices are largely determined by marginal costs, resulting in thin margins. Where barriers to entry are high the price ceiling is set by customer's willingness to pay, allowing for more substantial margins.

With two-sided networks a price has to be decided for both sides, by factoring in the impact on growth and willingness to pay. Typically the side which is attracted by a large user base **subsidizes** the other, promoting *strong network effects*.

Factors impacting pricing;

- Ability to capture cross-side networking effects
- User sensitivity to price
- User sensitivity to quality
- Output costs
- Same-side network effects
- Users' brand value

2) Winner-Takes-All Dynamics

The prospect of increasing returns to scale may encourage platform sharing to reach critical mass.
Conditions encouraging a single platform solution;

i. *Multi-homing costs** are high for at least one side
ii. Network effects are positive and strong - at least on side has high *multi-homing costs**
iii. Neither sides users have strong preference for special features
    I. Smaller niche providers can produce differentiated platforms otherwise

As a minimum the winner will require cost or differentiation advantages. Additional elements that can provide a competitive edge are,

a. Existing relationships with prospective users
b. Reputation / brand
c. Capital investment

First-mover advantage may exists, although late movers can avoid the errors of innovators. Racing to acquire users is a mistake if the business is not readily scalable or has insufficient funding /

resource to support explosive growth.

Multi-homing costs are those associated in establishing and maintaining platform affiliation. Businesses can seek to influence switching costs through *"sticky features"*.

3) The Threat of Envelopment

There is a constant danger of envelopment from adjacent platforms, who may provide your functionality as a multiplatform bundle - normally at a lower total price.
This blurring of market boundaries is known as **convergence**.

Competitive responses

i. Change business models [see Seizing the White Space] such as,
   a. Switching the money side (revenue model)
   b. Offer services as a system integrator
ii. Seek partner support of a larger firm
iii. Increase stickiness [note: better to have implemented this beforehand]
iv. Sue, using antitrust laws / anticompetitive behaviour of subsidised offerings

Further Reading

- Wikipedia: Two-sided_networks