Competing in the Age of Platforms

Platform companies have disrupted countless markets and, when successful, have become the most valuable companies in the world. To appreciate their impact, one need only consider how Amazon has transformed the retail industry.

When Harvard Business School Professor David B. Yoffie and his colleagues looked at the Forbes Global 2000 back in 2015, they identified 43 companies that qualified as “platform” companies. The definition they used was, a “company with at least 20% of its revenues coming from businesses dependent on network effects.”

A “network effect” occurs when something becomes exponentially more valuable as more people have it or use it. Think about the potential connections in Facebook’s network when it only consisted of college students compared to the potential connections with well over two billion users.

In this brief, we will take a closer look at what makes platform businesses different from other businesses, why some have succeeded while most have failed, and what business leaders can do to compete in a world increasingly dominated by platforms.

WHAT IS A PLATFORM?

In the book The Business of Platforms: Strategy in the Age of Digital Competition, Innovation, and Power, Harvard Business School Professor Yoffie and co-authors Michael A. Cusumano and Annabelle Gawer write that platforms, in general,
“connect individuals and organizations for a common purpose or to share a common resource.” They go on to emphasize:

“[Platforms] bring together individuals and organizations so they can innovate or interact in ways not otherwise possible, with the potential for nonlinear increases in utility and value.”

David B. Yoffie
Harvard Business School Professor

While today we associate platforms with tech companies, platform businesses have been around for quite a while. Take, for example, the ubiquitous credit card. As more businesses accepted them, the value of having a credit card increased, leading more consumers to use them. This, in turn, drove more businesses to accept them.

This example highlights a critical aspect of platform businesses: They bring together multiple sides of a market. Credit card companies brought together consumers and retail businesses. Companies such as Amazon, eBay, and Craigslist bring together a broad range of buyers and sellers. And companies like Apple and Microsoft bring together end users with application developers and hardware manufacturers.

To generate the network effects that make platforms so powerful, platform businesses must solve what Yoffie et al. describe as a chicken-or-egg problem.

Putting it simply, to generate network effects, you need to attract users to the platform. When these users represent different sides of a market, the business must decide: Whom do we attract first? Credit card companies had to find businesses to accept them before they were valuable to consumers. Facebook had to become the social media platform of choice for individuals before it could become valuable to advertisers. Uber had to sign up drivers before it could be valuable to people looking for a ride.

Yoffie’s research into platform businesses also found that platforms tend to fall into two categories:

1. Transaction Platforms: Where the main value offered is a connection between users. Social media platforms tend to fall into this category, and so do companies like Amazon and Alibaba.

2. Innovation Platforms: Where the main value is connecting application developers, for example, to users. Google created an innovation platform when it opened up Android for mobile application development.

Some platform companies, based on their success, choose a hybrid route. That is, they may start as a transaction platform, like Facebook, but then, again like Facebook, invite developers to create applications (games, for example) for the platform, thus increasing its value for users.

Thanks to the dominant role that platforms play in the market today, it is quite understandable that business leaders would ask themselves if they could develop a platform of their own. Unfortunately, as Yoffie and others are quick to point out, most platform businesses, even those that seemed to have first-mover advantage (remember MySpace and Friendster?) have failed.

This leads to the question, “What distinguishes the winning platforms from all the rest?”

HOW PLATFORM BUSINESSES WIN

Based on his close examination of platform businesses, Yoffie offers three lessons that characterize winning platform strategies.

Lesson 1: A Good Platform Beats a Good Product

“In a platform market,” Yoffie writes, “having the best platform is more important than having the best product.”

Case in point: The Apple Macintosh was in many regards a better personal computer than its Windows-based competitors. Microsoft, however, had the better platform for developers. As soon as consumers could get more applications, games, etc., on Windows machines, Microsoft had won.

With the introduction of the iPhone decades later, Apple became a major platform player again. Indeed, Microsoft was unable to get a successful phone off the ground. Nevertheless, Apple eventually lost out to Google/Android in the battle for market share when the Android development platform proved more attractive than iOS.

Lesson 2: Solve the Chicken-or-Egg Problem

When it comes to solving the chicken-or-egg problem described above, winning platforms successfully choose the correct side of the market to attract or subsidize.

This problem is a true challenge, and getting it wrong can be fatal. eBay was defeated in China because it stuck to its model of charging sellers to join the platform. It lost out to Taobao, a subsidiary of Alibaba, which chose to allow both buyers and sellers to join the platform for free.
EXECUTIVE INSIGHTS

On the other hand, getting it right can bring with it a whole new set of challenges. Uber, quite understandably, has focused on driver acquisition. After all, the value of Uber increases as getting a ride becomes easier, a direct function of the number of drivers on the platform. However, it has had to spend so much money on these efforts, it has yet to turn a profit.

**Lesson 3: Choose the Right Business Model**

Finally, winning platforms identify a sustainable and scalable way to make money. As it turns out, the two types of platform businesses—innovation platforms and transaction platforms—offer quite different paths to profitable revenue growth.

Innovation platforms can capture value in a couple of ways. For example, they can increase the willingness of consumers to pay for the platform, either by adding new features or by encouraging the development of in-demand applications by the ecosystem. We’ve seen this approach taken by Apple and gaming console developers, among others. The other alternative is simply taking a cut from sales of products or services built for the platform.

Transaction platforms have more options when it comes to capturing value. They can do so through matchmaking, reducing friction in transactions, complementary services and technology sales, and advertising. EBay and Amazon Marketplace are examples of platforms that make matches between buyers and sellers (extracting value from successful matches). PayPal reduces friction in transactions by facilitating payment in a secure and reliable way. OpenTable offers restaurants a table management system in addition to their reservation services. And, of course, Google pioneered the practice of capturing value through advertising in myriad ways.

The winning platforms have succeeded by developing novel ways to generate and capture value. And in many ways, their success has made them virtually unbeatable. So, if you are not (or not yet) a platform company, how can you compete in this world?

**HOW PLATFORM BUSINESSES WIN**

Faced with the immense, market-defining power of platforms, business leaders need to figure out where they can best fit into it. To that end, they have three options:

1. **Participate Directly in a Platform Ecosystem**
   The first option, and the most viable for many, is participating directly in a platform ecosystem. Building apps or complementary services for a particular platform is one way to do this, and countless companies have found success taking this route. The challenge here is making sure that the platform owner doesn’t end up creating a competing product. When Microsoft developed and released its Office suite, it wiped out a host of competing software vendors.

   Selling products through the platform, be it Amazon, eBay, or Alibaba, is another approach. Indeed, in some industries, these platforms have become the de facto marketplace. However, this approach faces the same threat as the development approach: There is little to stop Amazon, for example, from selling a competing product once they realize you have a hit.

   Platform owners need to avoid the temptation of competing directly with platform participants because it can naturally discourage participation. At the same time, as we have seen countless times, that temptation can be difficult to resist.

2. **Buy an Existing Platform**
   The second option for business leaders involves getting into the game by buying an existing platform. While out of reach for most companies, this has been the strategy pursued, with mixed results, by Walmart in its fight with Amazon.

3. **Build Your Own Platform**
   The third option, of course, is to try to build your own platform. As with the second option, this approach calls for deep pockets, time, and enough white space to justify the investment. This was the path chosen by GE when they released their Industrial Internet of Things (IIoT) platform, Predix. Unfortunately, the complexity of this undertaking has proven quite daunting, and the platform has failed to take off as hoped.

As for their recommendations, Yoffie and company are quite explicit: “Small or new firms are generally better off building their platforms on top of existing platforms, rather than trying to go it alone.”
ADAPTING TO THE PLATFORM-BASED MARKETPLACE

While the incredible success of winning platforms has filled many with dreams of joining their ranks, as we have discussed, that is far easier said than done. As a result, the majority of business leaders need to consider how they can best adapt to a marketplace increasingly dominated by platform businesses. It may not be the case that these businesses are too big to fail. In fact, the current global situation is putting many to the test. However, for most industries, they are too big to ignore.

Adaptation here calls for careful analysis. Business leaders must carefully assess the threats posed by platforms in their space. This threat will be much different if you are a product reseller as opposed to a product manufacturer. The former may see threats in transactional platforms, while the latter will see them as opportunities.

Leaders have to ask themselves, “How can I use these existing platforms?” For some companies, these platforms may represent new channels for reaching customers. For others, these platforms may call for a reassessment of current business models and strategies.

Even if many companies need to adopt an approach that boils down to “If you can’t beat ‘em, join ‘em,” this is far from the end of the world. Remember, platforms succeed, first and foremost, due to network effects. They need to encourage and enable different sides of a market to thrive. This means that the dominant platforms are robust and evolved enough to support innovative new approaches and novel uses for what they offer. The real challenge for business leaders lies in uncovering these new approaches.

This is not to say that there is no room for newplatform players. There still exist niche markets where no dominant platform has yet emerged. This leaves the door open for forward-thinking leaders to reimagine their markets and develop the unicorns of the future.

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