

Beyond Pricing: Platform Rules

Competitive Strategies Within and Between Platform Markets

Lecture 3

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Two-sided markets are markets in which one or several platforms enable interactions between two or multiple user groups (e.g. ads and readers) and try to get them “on board” by appropriately **charging** and **governing** users on each side of the platform





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Platform strategy revolves around much more than pricing. Careful governance of complementors and end-users can increase the overall value created by the ecosystem as well as the value captured by the platform.

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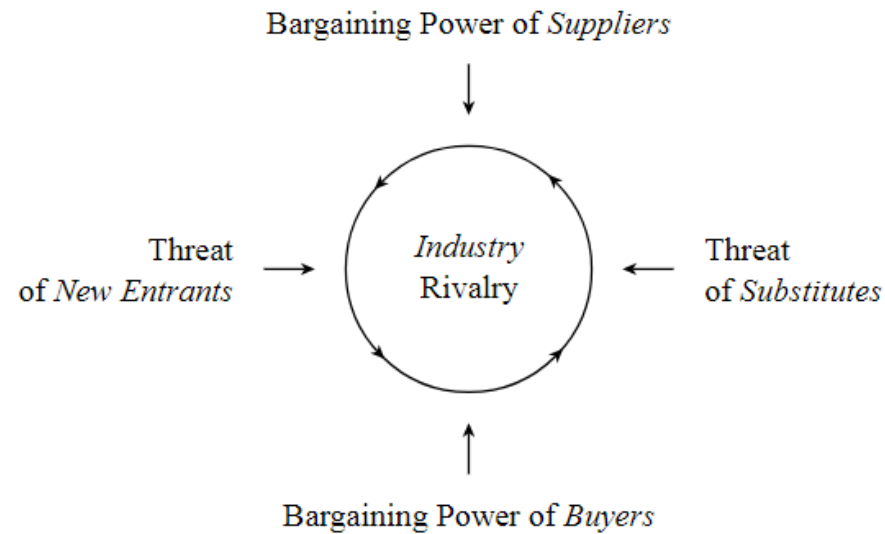
Assumptions underlying Porter's five forces

- Industry boundaries are fixed and industry is well-defined
- Market entry is costly, especially when profits are high
- Zero sum, it's a battle for a **variable slice** of a **fixed pie**:
 - Five forces all compete for the same pie, eating away at firm's share
 - All firms operating in same stage of the value chain are competitors
 - Suppliers and customers are sources of value slippage
- The best (i.e. differentiated, lowest price) product wins the competition
- First-movers are best positioned due to learning and scale advantages
- Macro-level factors (e.g. governments) do not affect value capture

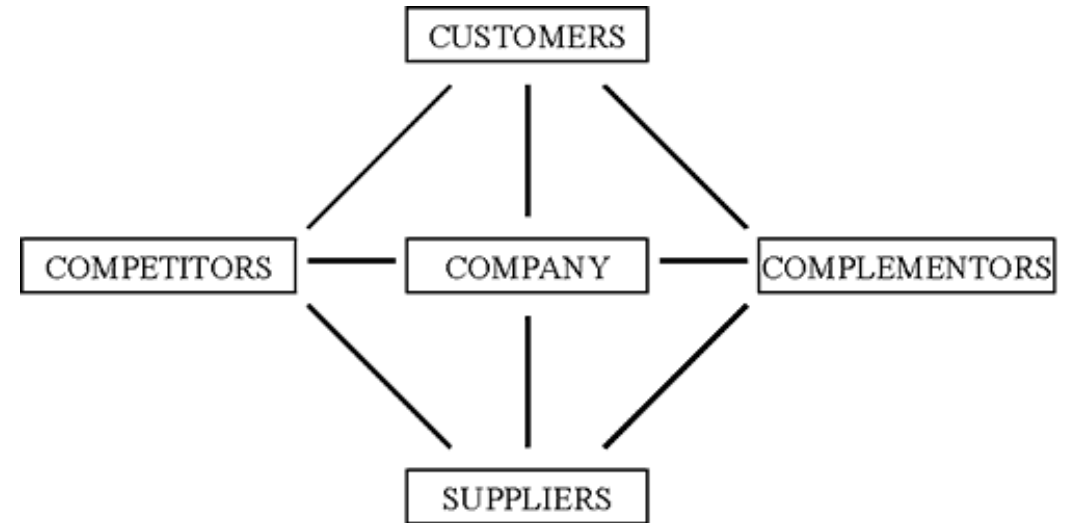
Competition in the digital economy

- Industry boundaries are fluid and platforms often span multiple industries
- Market entry is cheap, opportunities for hit-and-run entry
- Positive sum, it's a 'battle' for a **variable slice** of a **variable pie**:
 - Complementors are an important source of value creation
 - Competitors can help to legitimize and establish industry
 - Customers and suppliers can be a source of value creation
- It's not always the best product that wins the competition
- First movers do not always win, learning and scale have become less important
- Macro-level factors (e.g. platform governance) strongly affect value capture

From competition... to *coopetition*



Porter's Five Forces framework (1979)



Brandenburger and Nalebuff's value net framework (1996)

Beyond pricing: Platform rules

- Value in platform ecosystems is co-created such that partners produce complementary goods that increase the overall value of the platform (Adner & Kapoor, 2010; Ceccagnoli *et al.*, 2012):
 - On the one hand, platform owners rely on complementors, suppliers, and consumers to enhance the overall value of the platform
 - On the other hand, however, platform owners compete with these partners over who is going to capture the value that's created
- Beyond pricing, platforms have to decide on the level of architectural openness and the rules for intra-platform competition
- Platform rules also significantly affect complementor competition

Apple Introduces 14-day no Questions Asked Refunds for
App Store & iTunes in EU Countries (Dec, 2014)

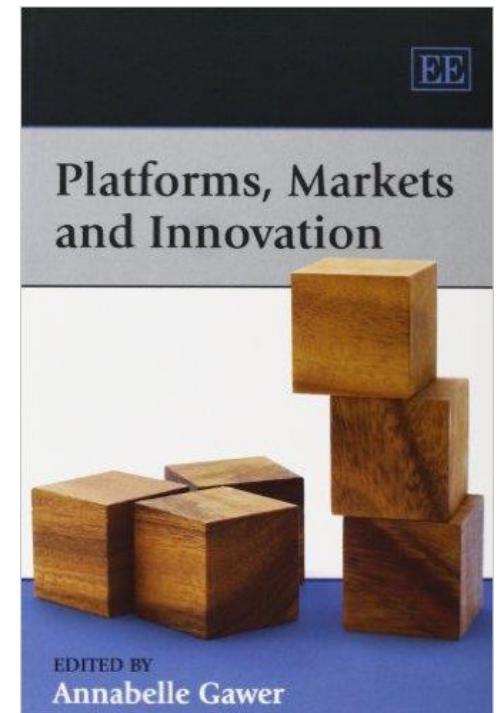


Available on the
App Store

Platform governance strategies

Six platform ecosystem governance strategies that affect the platform's overall value creation *and* value capture (and subsequently the competitive dynamics faced by complementors):

1. Platform openness
2. Selective promotion of complements
3. Competing with complementors
4. Platform absorption (vertical integration)
5. Platform and category exclusivity
6. Backward compatibility



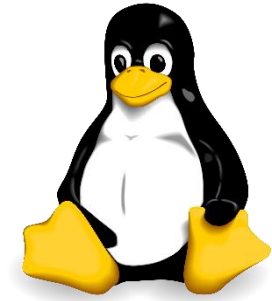
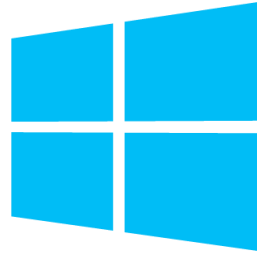
Platform openness

“A platform is “[wholly] open” to the extent that: 1) no restrictions are placed on participation in its development, commercialization or use; or 2) any restrictions ... are reasonable and non-discriminatory, that is, they are applied uniformly to all potential platform participants.” – Eisenmann et al., 2009; 1.

Proprietary platforms are those based on technology that is company-owned and protected through patents, secrecy, or other mechanisms. A platform is “wholly proprietary” when its owner prevents all others from legally producing or augmenting it. – Schilling, 2009; 9.



Wholly open
complementor architecture



Wholly closed
platform architecture



Wholly open platform
architecture



Wholly closed
complementor architecture



Opening the platform

- One of the most crucial decisions platforms face (Schilling, 2009):
 - Horizontally: Tradeoff between *appropriability* and *adoption* (West, 2003)
 - Vertically: Tradeoff between *control* and *diversity* (Boudreau, 2010)
- When to open up the platform architecture?
 - If the market is too large to cater by a single firm
 - If a costly standard battle looms and should be avoided (margins)
 - If participants can offer valuable innovations/diversity
 - When demand-side users are heterogeneous (e.g. Android)
 - If quantity of complements is preferred over quality in complements
 - If (innovative) new entrants need to be deterred



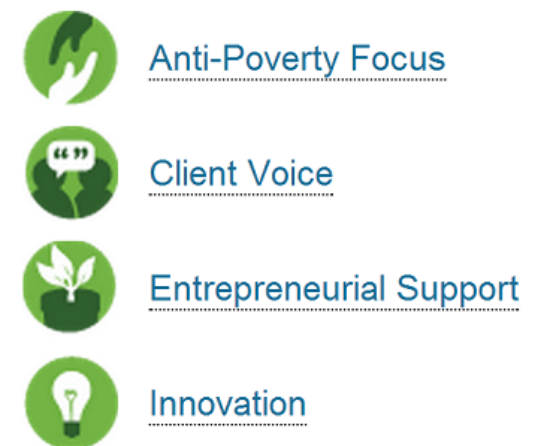
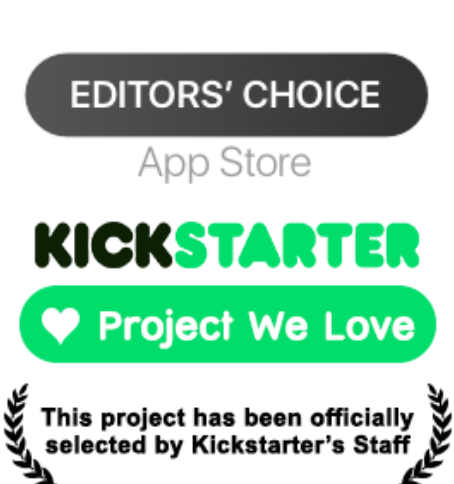
Closing the platform

- When not to open up the platform?
 - If the platform owner lacks strong appropriability mechanisms
 - If fragmentation (standardization) of the platform architecture is to be avoided (preferred) – in case of strong network externalities
 - If the platform owner is a significant producer of complements
 - If the platform owner has a clear technological trajectory in mind
 - If participating firms in a platform consortium are at risk of 1) free-riding (e.g. lack of promotion or innovation), of 2) causing ‘political paralysis’
 - If quality in complements and platform architecture are important



Selective promotion of complements

- Most platforms selectively promote complements and complementors through storefront features, certification (badges), algorithmic recommender systems, and otherwise
 - Selection oftentimes is obscure, non-random, and highly sought after
 - Affects performance of both affected and unaffected complements
 - Promotion can lead to (intended) shift in complementor behavior



Platform promotions are powerful...



“Ed Sheeran 'owes career to Spotify’” -

<http://www.bbc.com/news/entertainment-arts-30436855>

...but they do not affect all complements equally!

'IF YOU LIKE...' ARE BENEFICIAL FEATURED CATEGORIES				
Average Download Increase per Category, Apple App Store, U.S.				
Category	Start Date of the Feature	End Date of the Feature	Average Download Growth	Example App
If You Like... Candy Crush	14 / 02 / 2014	20 / 02 / 2014	279%	Puzzle Craft
If You Like... Minecraft	21 / 02 / 2014	27 / 02 / 2014	175%	Tiny Tower
If You Like... The Room	28 / 02 / 2014	06 / 03 / 2014	255%	The Silent Age
If You Like... Badland	07 / 03 / 2014	13 / 03 / 2014	395%	Sea Stars

“Apps featured by Apple or Google get 6 times the downloads and 9 times the revenue – or nothing.”

www.venturebeat.com

Selecting Complements for Promotion

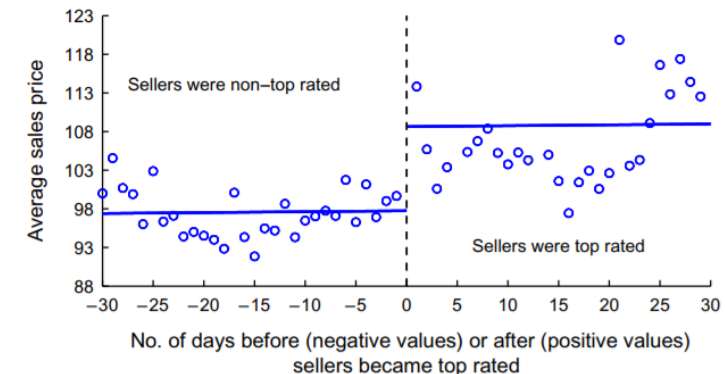
- Platforms are limited in how many complements they can promote
 - Promoting too liberally risks dilution and hurts endorsement's legitimacy
 - Storefronts have limited space (even digital ones!)
- Complements are competing against each other
- Complements create value in different ways
 - Through their individual performance
 - Through their contribution to the overall ecosystem (depth and breadth)
- Complements reap different marginal returns from promotion
- Complementors differ in their bargaining power



Promotions can affect sales

- Promotions typically have a large effect on complement performance
- Analysis of eBay's Top Rated Seller program further shows that:
 - Badged sellers benefit more in categories with fewer other badged sellers
 - Badged sellers benefit more in categories with more competition
 - Badged sellers benefit more if their prior reputation is unknown
- Besides increasing complement sales, platforms care about maximizing own share of extra income:
 - Reputation increases complementor bargaining power
 - Exclusivity avoids spillover to competing platforms

eTRS certification
leads to **higher prices**



Promotions can affect behavior



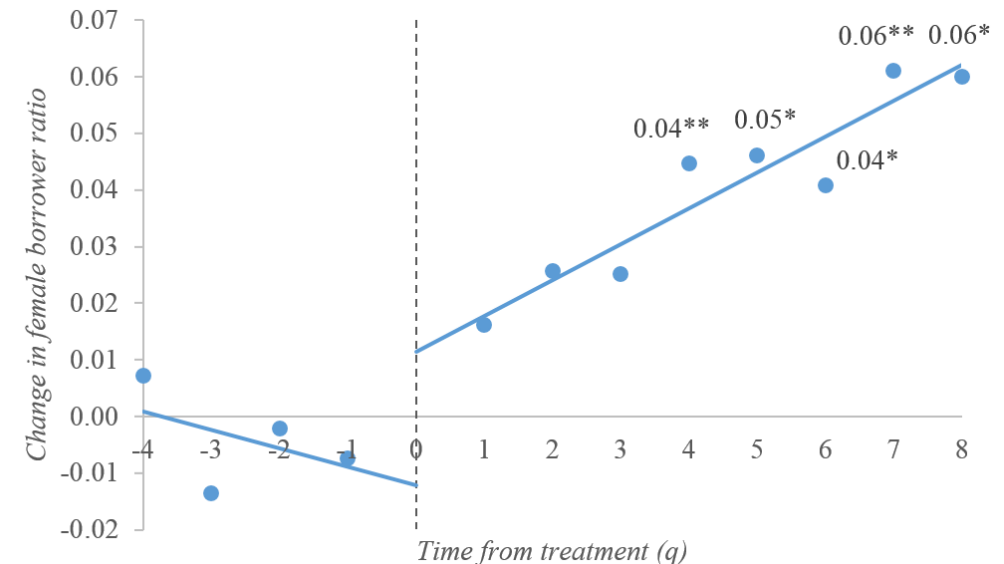
- Platforms as ‘market orchestrators’, promote to impact behavior
- Microfinance platform Kiva introduces Social Performance Badges
- Strong emphasis on women borrowers in platform’s quest to reduce poverty (On average women reinvest 80% of income in wellbeing of their children)



Family and Community Empowerment badge:

“In order to serve families and communities, a Field Partner should be reaching women. In most markets, serving women means offering loans without material guarantee requirements or otherwise reaching out to poorer clients with fewer assets.”

Kiva Field Partners who received the *Family and Community Empowerment* badge **increased their share of female borrowers by up to 6 percentage points** per quarter compared to otherwise comparable Field Partners without badge.





Competing with complementors

- Entry into complementor space by the platform
- What is the motivation behind platforms' entry into complementary goods markets (Wen & Zhu, 2017; Zhu & Liu, 2016)?
 - Target most successful areas to increase platform *value capture*?
 - Target less successful areas to increase overall *value creation*?
- Affects competitive dynamics within the platform:
 - Complementors stand little chance against platforms and likely experience less incentive to innovate and compete after platform entry
 - Platforms control the platform, have superior market knowledge, and have greater resources resulting in better quality/lower costs

Case in point: Amazon



Table 1 Percentage of Products Sold by Amazon in Two Sample Product Categories

Category/subcategory	Total no. of products	% sold by Amazon	% sold by Amazon among top 100 best sellers
Electronics	2,024,750	7.0	64
Accessories & Supplies	407,149	10.5	62
Camera & Photo	410,312	10.1	76
Car electronics	16,731	23.3	90
Computers & Accessories	997,543	4.9	73
GPS & Navigation	8,453	21.9	89
Home audio & Theater	10,433	24.2	71
Marine electronics	593	41.1	83
Office electronics	39,214	6.7	77
Portable audio & Video	48,678	15.1	47
Security & Surveillance	11,320	15.9	66
Televisions & Video	14,753	6.4	75
Tools & Home improvement	2,460,108	5.8	88
Sports & Outdoors	3,695,634	3.1	76
Jewelry	1,287,098	3.2	34
Toys & Games	798,977	5.9	66
Shoes	344,710	16.7	72

Source. Data collected from Amazon.com during April 2010.

Source: Jiang, Jerath & Srinivasan, 2011; 758

What markets does Amazon enter, and why?

- Amazon is more likely to enter categories that are popular and rated highly;
- Amazon is more likely to enter categories with high prices and low shipping costs;
- Avoids categories where its prime or super saver shipping programs are costly;
- Amazon is more likely to enter categories that are offered by many sellers already (sourcing the product is easy and cheap);
- Amazon's entry forces smaller sellers out of the market (unable to compete)
- Overall, evidence supports the view that Amazon enters complements markets to increase **value capture (Zhu & Liu, 2016)!**

Platform absorption (vertical integration)

- Integration of complement-functionality into platform architecture
- From complementary goods to structural platform features:
 - Efficiency gains for users from buying bundle instead of components
 - Increasing the value of the system (platform + complements)
 - Quality assurance/improvement through technical integration
 - Increased margins/lower prices when complements are 'money side'
 - Imperative when threatened by complementor 'envelopment'





 Windows Azure

 Yammer
For Enterprise Social Networks

 Office

 Windows Server

 Lync

 skype

 Internet Explorer 10

 SkyDrive

 bing

 Outlook

 XBOX



 Windows Phone

 Windows



NOKIA

Platform exclusivity and category exclusivity

- Platform exclusivity: ‘Denying’ a complementor access to rival platforms (single-homing network externalities)
 - Has the strongest impact on platform sales when platform is young and there is uncertainty about market shares (Landsman & Stremersch, 2011)
 - Without exclusive content, the established platform grows more dominant over time due to same-side network effects (Lee, 2013)
 - New platforms must ‘buy’ exclusivity while established platforms ‘demand it’
- Category exclusivity: Granting privileged access to a complementor
 - Decreasing competition among complementors will foster innovation and quality and therefore profits for the platform (Boudreau, 2012)



Backward compatibility

- Increases the value of a next generation platform to non-adopters by unlocking cross-side network externalities early on
- Backward compatibility in video games (Gretz *et al.*, 2015):
 - Backward compatible video game consoles sell better early on
 - Offer most value to non-adopters but reduces perceived switching costs
 - However, cannibalizes sales of previous generation
 - Fosters increased competition between current-gen complementors



How governance strategies affect value

1. Platform openness

- Increases the overall value of the ecosystem
- May jeopardize both platform *and* complementor ability to capture value (consumers benefit)

2. Selective promotion of complements

- Increases value creation for affected complements
- Selection likely strongly driven by platform value capture motives (consumers also benefit)

3. Competing with complementors

- Can be driven by both value creation (i.e. rounding out the platform) and value capture motives
- Early evidence suggests value capture motive

4. Platform absorption (vertical integration)

- Likely benefits consumers through quality gains and elimination of double margins
- Detrimental for complementors. Some value creation but mostly shift in value capture

5. Platform and category exclusivity

- Increases value only for some complements
- Limits other complementors and consumers in their options. Shifts value from competing platforms

6. Backward compatibility

- Increases the overall value of the ecosystem
- Shifts value away from previous generation platforms. Mostly benefits consumers and platform

Value creation platform governance strategies focus on augmenting the overall value of the platform for all stakeholders (i.e. the platform, complementors, and end-users) – *it increases the size of the pie*. **Value capture platform governance strategies**, on the other hand, focus on augmenting the value that the platform owner receives at the cost of the other stakeholders (i.e. complementors and end-users) – *it increases the platform owner's slice of the pie*.



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Thank you!



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