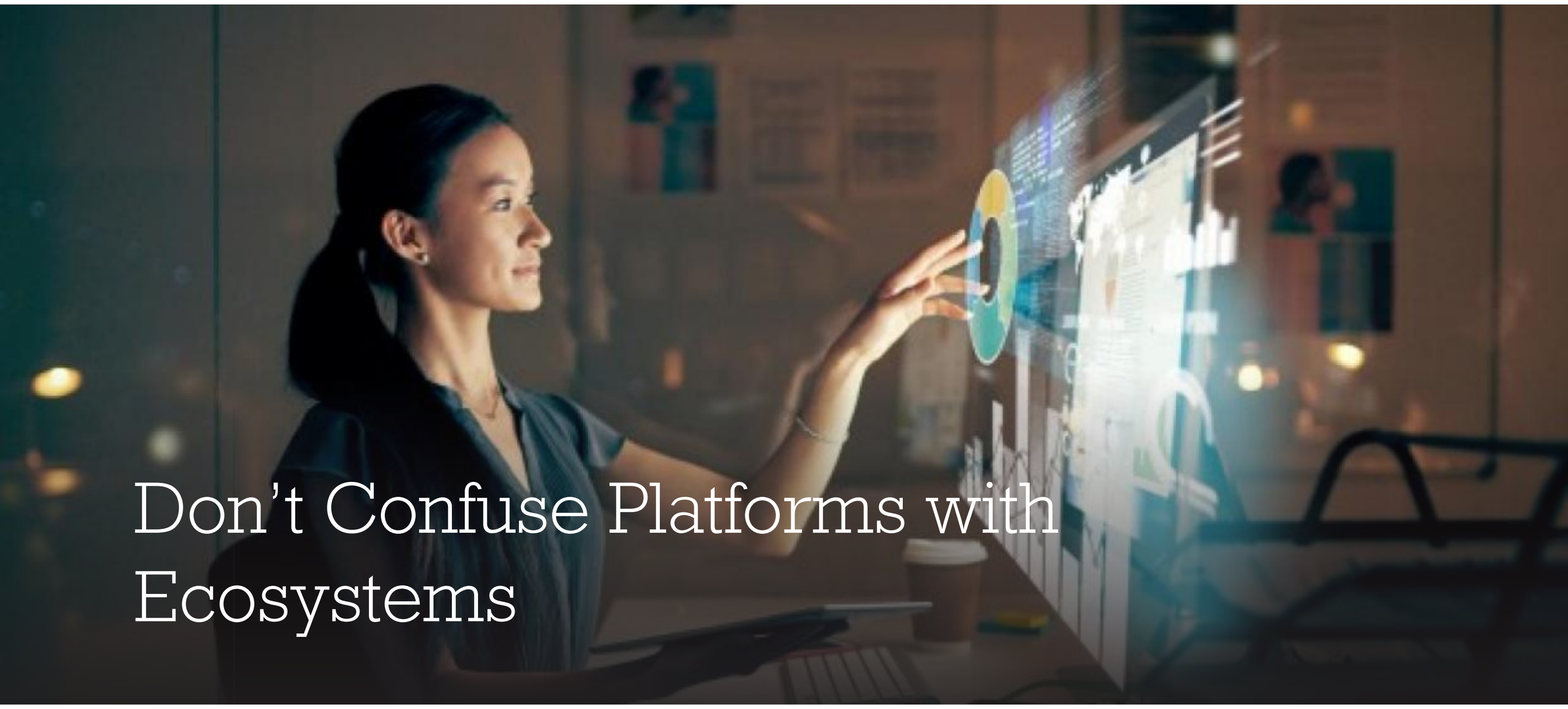


Don't Confuse Platforms with Ecosystems

A beginners' guide to high-value business models.

What's even worse than ubiquitous business buzzwords? When those buzzwords are also used interchangeably. Case in point: the terms "platform" and "ecosystem". Although often conflated, these words mean different things. Treating them as synonymous denotes either a lack of knowledge or imprecise thinking. But there is more at stake here than appearing smart. The distinction between platform and ecosystem has broad strategic implications that can make the difference between success and failure in today's digital world.

The Merriam-Webster dictionary defines a platform as "a vehicle used for a particular purpose". A platform is an asset or business that removes friction from a market. The oldest examples of platforms are village markets that facilitate transactions between buyers and sellers. They do so by reducing the costs of transacting at scale by attracting a large number of buyers and sellers.

Transactions that take place in a platform share an attribute of similar nature, e.g. a purchase, and the platform facilitates this via the provision of scale. For example, Which.co.uk is a platform aggregating groups of similar offers, e.g. credit cards and loans, attracting consumers to credit card companies or lenders through the promise of convenience and the ability to better compare products. A platform generates value by facilitating the third parties' transactions and not by taking part in the transactions themselves.

An ecosystem is a group of firms **linked through non-generic complementarities**, or investments in mutual adaptation. Ecosystem members have to coordinate to **create a unique value proposition** for the consumer. This value proposition would not exist without an underlying ecosystem.

People value convenience in satisfying a broad range of needs, all closely related within the context of a specific customer journey. For example, living a healthy lifestyle means that customers may want to go to the gym, buy sports equipment and shop for healthy food, etc. US-based Vitality is an ecosystem that offers a range of possible deals with incentives for health-conscious consumers. However, Vitality is not just a healthy lifestyle provider; it is primarily an insurance business that offers customers coverage priced according to their health.

Is it a platform or an ecosystem?

The figure below illustrates how platform and ecosystem features can exist in a business model in four different permutations:

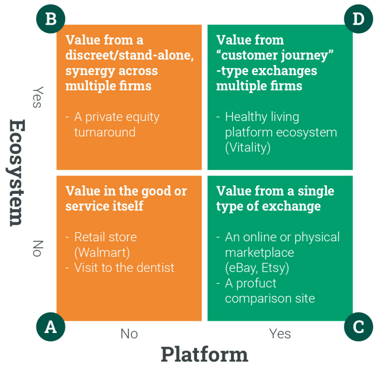
Quadrant A: The business model is neither a platform nor an ecosystem. Value is generated along a standard industry value chain. A reseller doesn't provide platform services. For example, when someone buys books (either with cash or consignment) and then resells the books to the customer, this is not a platform business. In this case, one side of the platform – the buyer – doesn't get to interact directly with another side – the supplier. In other words, Walmart as a discount store is not a platform.

Quadrant B: The business model is an ecosystem, but not a platform. The cross-organisational collaboration generates the value. When a private equity (PE) firm buys a target, it brings not only the capital, but also management capabilities and consulting services from different small firms. Some of these may be available in-house (inside the PE firm), whereas others are engaged temporarily by the PE or the target, in order to create value from the underperforming asset. For example, the PE might bring in external executives to sit on the board of the target in exchange for future shares (and not for the ongoing salary). In this case, there are minimal formal relationships between the advisors (who typically represent boutique firms or self-employed individuals) and the PE firm. As the needs of the target evolve, the composition of the board, its leadership team or the consultants evolves as well. The PE acts as an "orchestrator" of multiple small ecosystems of expertise around each acquisition.

Quadrant C: This business model is a platform without being an ecosystem. It enables transactions between two parties with the value being generated by the transactions themselves (regardless of the nature of the underlying exchange). eBay and Airbnb are examples of a platform, which connects buyers and sellers directly. Etsy connects craftspeople and their customers. The Apple Store, on its own, is also a platform.

Quadrant D: This business model comprises both a platform and an ecosystem. It brings buyers and sellers together for transactions across different related businesses offering a shared solution, within the context of a defined value proposition, e.g. living a healthy lifestyle (e.g. Vitality), travelling for young professionals in Southeast Asia (e.g. UOB Mighty) or digital entertainment across different types of content and devices (e.g. Apple). All of these interactions are facilitated through the exchange of customer data, allowing hyperpersonalisation, rewards and increased convenience.

As stated above, Vitality connects insurance policyholders with a range of discounted health and fitness options, including gym memberships, sporting goods, healthful snacks, etc. Towards the stated goal of "incentivising healthier behaviours", Vitality works as both a lifestyle platform and a business ecosystem encompassing independent but complementary providers. Through patronising the platform, users can not only achieve their wellness goals but also lower their insurance premiums. This should create a healthier pool of policyholders and reduce payouts for Vitality's insurance partners.



When platforms and ecosystems intersect

Valuations of established platform and platform-based ecosystem businesses are higher because of several factors:

- First, their assets are lighter compared to assets typically required to produce and deliver goods and services in scenario A. Platforms connect two parties without having any part in the goods or services that they are exchanging.

- Second, the lock-in of customer and seller helps platforms to develop efficiencies (e.g. ease to contact a supplier, compare prices, distribute a solution) and thereby may result in potentially lower costs for both customers and sellers. This win-win situation attracts all parties to the same platform.

- Third, once a platform achieves a critical mass, it has a strong bargaining power to set conditions of participation in the platform or in the ecosystem. As they become the places to be thanks to their scale, they can exercise complete control over their captive environments.

Platforms do have an Achilles heel: the risk of low switching costs. If someone can get coupons for shopping at McDonalds from both Groupon and LivingSocial, these two platforms will compete with each other for customers, thereby undermining the benefits of their lock-in. Yet if a platform is a part of an ecosystem, a customer is more likely to stay because of a higher personalisation of services or loyalty programmes. In this case, the value is derived not from the individual transactions, but through the overall customer experience. All the Asian super apps, such as Tencent's WeChat, are based on these principles. There are multiple platforms inside Alibaba's ecosystem that cater to different customer journeys.

Therefore, the ultimate end goal for a platform creator should be the extension of their business into a bigger ecosystem. However, since ecosystems are difficult to build from scratch, an aspiring Mark Zuckerberg or Jack Ma needs to start from a platform business that solves a unique customer pain point, perfect it and then build an ecosystem around it. Ideally, it should be in a space where customers experience a pain point, but the existing solutions are either absent or poorly executed.

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