How to Build a Successful Platform Business

Companies that successfully construct networked market places that attract participation and create value for participants, follow three core principles.

How is it that major business segments are being disrupted and destroyed by upstarts with none of the traditional resources businesses have typically needed for growth? Uber is set to replace the taxi business without owning a single car, Alibaba has become the "world's biggest bazaar" without owning a shred of inventory and Facebook attracts 1.3 billion regular readers who login to browse news, photos and videos, yet it doesn't produce a single piece of content.

The answer is the "platform", a business model that uses technology to connect people, organisations and resources in ecosystems to exchange, goods, services and ideas. The list could go on; Amazon, YouTube, eBay, Upwork and Pinterest are others, but crucially, each is unique and caters to a specific market or industry.

Platforms are powerful because they eliminate gatekeepers, unlock new supply and demand and create community feedback loops. Uber, for example, performs a matching service that serves as a virtuous cycle. More demand is met by more opportunistic drivers, which increases geographic coverage, which leads to faster pickups, which encourages more customers to join the platform and more people to sign up as drivers. Driver downtime is lowered and so are prices, which leads to more scale.

This network effect represents a new economic phenomenon. In the 20th century industrial era, monopolies came about thanks to supply economies of scale, largely from increases in production efficiency. Today, monopolies are created by "demand economies of scale", which are led by technological improvements on the demand side to create bigger networks that create valuable for their users. Such platforms make money by charging a cut for exchanges and are therefore built to scale.

Building a platform

Many traditional companies are now scrambling to make platforms for this very reason. These traditional companies, which we call "pipelines", create a good or service and channel it to customers. But as Apple demonstrates, firms needn't be one or the other. They can be both. In any case, there are some key principles to consider.

First, every platform should start with the aim of enabling interaction between participants, the producer and the consumer. It is the exchange of value that attracts users to the platform. The platform also needs to enable the creation of a value unit. For example, for Airbnb, the service listing information is the value unit created by the seller and then served to buyers based on their search query or previous interests. This is the basis for exchange.

This is often facilitated by filters, which are algorithmic software tools that ensure users receive only the most relevant and valuable information.

Second, while "interaction" is the why of platform design, attracting users and encouraging interactions is the how. Three functions in particular must be performed very well to encourage a high volume of valuable interactions: Pull, facilitate and match.

To pull consumers, platforms have to solve a chicken-or-egg problem: users won't come to a platform unless it has value and a platform won't have value unless it has users. One powerful tool to encourage users to come and use the platform is the feedback loop, such as the example of Uber above. Platforms must also keep users' attention once they become members. For example, Facebook realised that its users found the platform valuable only after they had a minimum number of connections. So the company shifted its efforts away from recruiting new members and towards helping existing ones find friends.

To facilitate, platforms may need to roll out creative tools to smooth interactions. Canadian photography platform 500px does this by enabling photographers to host their entire portfolio on the platform for easy viewing and exchange.

Successful matching is the icing on the cake. Platforms accomplish this by using data about producers, consumers, the value units created and the goods and services exchanged. The more data a platform has and the effectiveness with which it is used by algorithms can ensure effective filtering and greatly aid interaction. All these three functions are essential to a successful platform and feed each other.

Thirdly, successful platforms scale by layering new interactions on top of the core interactions. Take Uber and Lyft for example, that started experimenting with new ride-sharing services that complement their personal taxi business model. UberPool and Lyft Line allowed two or more passengers traveling to the same place to find one another and share a ride, reducing their costs and increasing the fare for the driver. Uber is also now helping drivers finance car purchases by acting as a middle man to guarantee car loans for its drivers.

Iterate to remain

Adding new features and functionalities can increase a platform's usefulness and popularity, but it can also make it complex. One way to manage complexity is to change the core platform slowly while making changes at the periphery to cater to certain groups of customers. Amazon Web Services, for example, the most successful platform in cloud-based storage, focuses on optimising a handful of basic operations, such as data storage, computation and messaging. Other services used by just a handful of AWS customers are restricted to the periphery.

If you're launching a new platform, or seeking to grow an existing one, attention to the above principles can maximise your chance of success. Sometimes, platforms cannot be entirely planned. Most of the activity is controlled by users. Therefore, a careful allowance for serendipitous discoveries and close monitoring of user behaviour are fruitful ways of finding new value, which then have to be fed back into the platform.

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