Capgemini Consulting

DIGITAL LEADERSHIP

An interview with

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A Platform Strategy: Creating New Forms of Value in the Digital Age

Transform to the power of digital

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Every Company Can Be a Platform

What is a platform for those that are new to the concept?

A platform is a nexus of rules and infrastructure that facilitates interactions among a network of users and third-party participants. As users create value for other users, a network effect expands the community, unleashing the power of a platform. Take Facebook, AirBnB, Alibaba and Uber. These seem like disparate companies, but all have a strong foundation: a platform business model.

Even a weak platform will outperform a strong product every time. If you are using a traditional product strategy, just adding new and better features won't work. This occurs because you won't be able to evolve fast enough with just your internal team.

Executives often think of companies like AirBnB as being 'platform-born'. Do traditional organizations even have a chance given the radical change that would be required to be a platform company?

There is a huge variety of hybrid business models. Traditional companies can continue to operate the old business model and add a platform business model on top. It's a mistake to think that you need to transform the entire business straightaway. One of the most famous examples is Apple. It still produces phones and, therefore, it still has to manage traditional product designs and supply chains. That part of Apple continues to operate as a traditional business. But, Apple has added a platform dimension. This includes the mobile phone operating system iOS and the iTunes market ecosystem.

> *Even a weak platform will outperform a strong product every time.*

Also, imagine if hotels such as Marriott, Intercontinental, or Hyatt had added a platform to their existing business. There is no reason they could not have done this, since the business models are not in conflict. However, they moved too slowly.

Let's say you are one of these hotels and are competing with AirBnB, what would you do?

One thing they could do is start to join the platform and put their spare rooms on AirBnB. However, they would then become beholden to the platform in the same way that publishers have become beholden to Amazon, which is a dangerous position to be in. The other thing they could do is buy the number two player and scale that, enter a partnership with Intercontinental and Marriott, or create an industry consortium and share the capability on a similar platform. Those are the kinds of levers that they can try. Starting from scratch as an individual player would be difficult at this point because AirBnB is just too far ahead. In a market with network effects, incumbents have too few users bringing them useful sources of supply.

> *Traditional companies can continue to operate the old business model and add a platform business model on top.*

Besides Apple, are there examples of traditional companies that have adopted a platform successfully?

My favorite examples are Nike and McCormick Spice. Originally, you might think of Nike as a sports apparel or shoe company. However, adding data sensors and a community was an ingenious move. They developed the Nike FuelBand to track health and sports activity, which allowed groups to track and improve their sports performance together. Nike is now trying to become the operating system for sports gear and clothing. Whether Nike succeeds, or a competitor like Under Armour, this will be done by connecting your tennis racket, your bike, your clothing, your watch, and other apparel.

McCormick Spice – a US-based company that manufactures spices and herbs – thought, "How am I going to build a platform on salt and pepper?" In a brilliant maneuver, they added information, taste recipes and communities. They effectively developed a recommender system and have become a 'Netflix for food'. The platform allows them to even design new consumer packaged goods, expertise they can sell to packaged goods manufacturers, grocery stores, and even restaurants.

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Prepare for a Winner-Takes-All Market

What are the advantages and risks of launching a platform strategy?

In the Internet era we are seeing a rise of giant firms that is analogous to the conglomerates of the industrial era, but for the opposite reason. The industrial era was driven by giant supply-side economies of scale, leading to huge market concentration. This occurred in electrical utilities, steel production, oil refining, auto manufacture, railroads and many others. These firms became so large, they are the reason we have antitrust law. In the Internet era, we are seeing similar market concentration. Google has 91% market share of search in Europe; Android represents 80% market share in mobile; Microsoft has a 90% share in desktop operating systems; Facebook has 1.6 billion people on its platform; and Alibaba has 70% of all logistics transactions in China and 80% of all ecommerce transactions. None of these firms are known for having industrial scale capital facilities. Instead, their market concentration is driven by demand-side economies of scale and not supply-side -- that's a giant network effect at play!

If you generate network effects and figure out how to generate demand-side economies of scale in your industry, then you will be on track for one of these winner-takes-all positions. If you are too late, you lose the option to create a platform because competitors will have created one around you. Then, you will have to then bump up against their network effects and you may be too late to penetrate.

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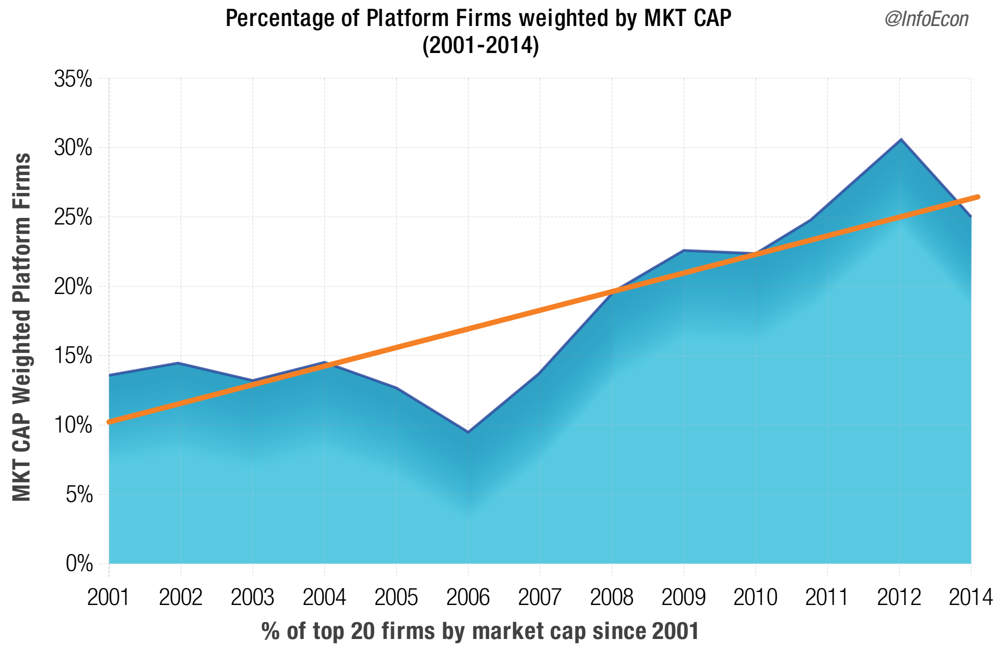
Platform Firms are Becoming More Important in our Economy



Source: Van Alstyne, Marshall, "Platforms: How Change in Industry is Driving Change in Strategy", MIT Platform Summit 2015

Besides a high-level strategy, do platforms affect day-to-day tasks for a company?

You must manage a company in the Internet era differently than how one used to manage a company in the Industrial era. Functions such as marketing, strategy, logistics, finance, IT, and human resources used to be handled inside the firm, but now must be managed with external versions of these same activities (see figure on the next page).

Take operations and finance as examples. Marriott and Hyatt have property that they own. Airbnb doesn't own property, but property is traded outside the firm. Finance used to value the assets owned by the company. But how are you going to value AirBnB or Uber based on their assets if they do not own them? Instead, you must value the transactions that third parties bring to the platform as well as the feedback that pulls more transactions onto the platform. So valuation methods must shift from owning capital to attracting and husbanding capital. Notice that Airbnb and Uber have done something remarkable. They have shed even the variable costs of production. This allows them to scale at a staggering pace. If your industry is going to be transformed by platforms, you are going to have to understand these complementary scales.

Competition in your Blind Spot

How does this change competition for companies?

In the Internet economy, it can feel like competition comes out of nowhere. Swatch and Timex are suddenly competing with Samsung. Ford is suddenly competing with Google in self-driven cars or with Uber in a way that they never anticipated. The United States Postal Service is used to competing with FedEx and not Facebook. However, it now finds itself competing with Facebook because its core business model is based on bulk mail for ads and ads are vastly more effective on Google and Facebook.

How do these new players keep coming in and taking over an existing business? Incumbents keep looking at product features, overlapping product features and overlapping services, but that's the wrong way to view competition in the Internet economy. The right way to view competition is, "do you have overlapping users?". Consider that it is far easier to add a product to a platform than to add a platform to a product. If an adjacent platform can add your product or service to its user base in a way that feels free, you will be out of business. Amazon sells Amazon prime, which is free shipping. But then it's easy to add free video as well and cut into the cable business. If the market is "multisided," meaning that it offers many different kinds of interactions across different kinds of users, then it can give away one type of interaction in order to provide another one for free. For example, LinkedIn facilitates professional-to-professional interactions but it charges recruiters for the recruiter-to-professional interaction. This clobbered Monster's business that focused on recruiting alone and had a much smaller network. Players inside the traditional industry will probably be in the same position you are, so it is easier to anticipate their moves. However, it's harder to anticipate the moves of companies coming from an adjacent platform. It's those firms you really have to start worrying about.

Network Effects & Inverting the Firm Changes...

Finance
Shareholder Value → Stakeholder Value
Incorporate network effects

Human Resources
Internal Employees → External communities

R&D
Experts & Specialized departments → Crowdsourcing & Open Innovation

Strategy
Entry Barriers & Inimitable Resources → Ecosystem husbandry & Long Tail

Marketing
Push → Pull, Outbound → Inbound

IT
Back Office (ERP) → Front Office (CRM) → Out-of-Office (Social & Big Data)

Operations & Logistics
Uber: biggest taxi company, no taxis,
Airbnb: biggest accommodations but no real estate
Facebook: biggest media firm but creates no content
Alibaba: biggest merchant but has no inventory

Source: Van Alstyne, Marshall, "Platforms: How Change in Industry is Driving Change in Strategy", MIT Platform Summit 2015

What's an example of a firm using its platform to compete in an adjacent ecosystem?

As another example, Alibaba's strategy team is starting to offer microloans. They will be in a position to offer microloans better than banks because they can observe accounts receivable, transactions history, and how frequently people pay for things.

Not only will they be able to vet loans in a new and interesting way, but will also have a different incentive structure. Traditional lending institutions must make money from the loan itself, but Alibaba can make its money from subsequent transactions. This means it can afford a lower-priced loan than a bank. By the time banks see what's happening, they are already check-mated because it's too late. Alibaba will already be a dominant player. It's far easier for Alibaba to add microloans to their transactions platform than it is for banks to add a transactions platform to their loans. At that point, the banks wouldn't want in, because they won't be able to recover unless they can somehow participate in the downstream transaction ecosystem.

As technology becomes more connected, the size of overlapping users is increasing. How can companies distinguish which users they should cater to?

Look at who is closer to the relationship. Apple is really good at reaching customers through AT&T systems. They took over the customer relationship and then multi-homed across both the Mac and Windows operating systems using iTunes. Apple built a layer on top of the network and took control of the relationship so users affiliate with Apple more than with AT&T. It's really who gets to control the customer interaction, who can reach through and do that in a better way. Those are your biggest threats.

> *“If an adjacent ecosystem platform can add your product or service to its user base in a way that feels free, you will be out of business.”*

How can traditional companies, such as telcos, ever enjoy as strong a relationship with their customers as firms like Apple?

They need to do a better job of becoming more than just pipes and tap the network effects in their data. They need the transaction data and preference data for starters. For example, telcos have some opportunities because they already have businesses and consumers on board. Now the question is, “Can we design marketplaces and innovation ecosystems where we are the market as opposed to someone sitting on top of our backbone?” Their problem is that they have effectively been pushed down the stack. They have been commoditized and they need to reach up through that stack and see what kind of services that they can provide closer to the customer. Alternatively, they may be able to participate by acquiring certain existing platform companies, operating over the top, and then growing through them.

Firms Should Fear Firms Outside their Immediate Industry

	Isn't afraid of...		But should fear...
Publishing	Houghton Mifflin Harcourt	Mc Graw Hill	Amazon
Broadcast	NBC	CBS	NetFlix
Electronics	Toshiba	Philips	Nest (Google)
Delivery	United States Postal Service	FedEx	Facebook
Cars	Toyota	Ford	Uber, Google
Watches	Swatch	Timex	Samsung

Source: Van Alstyne, Marshall, “Platforms: How Change in Industry is Driving Change in Strategy”, MIT Platform Summit 2015

Embrace a Platform Mindset Built on Fairness and Community

How do you know which area of your business could benefit from a platform?

Start with your key value proposition. In Lean Startup you had a minimum viable product. The exact analog here is your minimum viable platform. What is the minimum viable platform, what is the minimum interaction that's going to create the most value for your external users? You need something that's going to attract people. From there, then layer on further interactions to get new data and create incremental network events. Again, this is using consumer data to create value for other consumers. At the same time, ensure that new interactions add value rather than interfere with existing interactions. As you layer on new interactions, you must address the intricacies of each of those interactions with fair governance of interactions taking place on the platform. It's very, very complex.

What do you mean by governance? Is an example of governance, "I am Apple, I take 50% of all revenue of Apps more or less?"

We like to define governance as a combination of three things: 1) who gets to participate, 2) how do you create and divide value, and 3) how you resolve conflict. You have highlighted one element of it: do they keep 10%, 2% or 70%? But participation and conflict issues also matter. If firms always decide in their own self-interest, as opposed to deciding fairly in the interests of ecosystem partners, participants won't participate or invest.

My favorite example is Intel Architecture Labs (IAL). Intel created a separate division equal in stature to its other product divisions in order to represent the voice of ecosystem partners. Wisely, this representative voice of ecosystem partners meant that projects launched by partners couldn't be killed or absorbed by Intel. If you do not look after the health of the ecosystem, or manage cannibalization in such a way that the ecosystem wins and not just internal product divisions, you won't get ecosystem partner investment. A platform strategy fails if every time someone invents something really valuable, the first thing you do is take it away.

The norm in traditional managerial practices is if value is seen, then try to take it all. Why is this different for companies with a platform strategy?

The simple argument is that 5% of a trillion-dollar market is much more valuable than 95% of a million-dollar market. For example, SAP and Salesforce explicitly think about what percentage of the total ecosystem value they take. It's not 95%, it's much lower. So the real question is how much ecosystem value does a firm create and what governance mechanisms allow you to take value at a slow and steady rate that keeps the ecosystem healthy and growing. How do you look after the ecosystem partners, especially the small ones, so that they continue to invest and grow?

> *What is the minimum viable platform, what is the minimum interaction that's going to create the most value for your external users?*

One of the biggest mistakes I see firms make is asking, "How are we going to monetize?" as the first question instead of "What's the best platform design?". If this occurs, your monetization strategy will put friction on your network effects. Then, your competitor will design a better platform, take your users and then monetize later. Rupert Murdoch made this very mistake when he acquired MySpace. He immediately thought of ads, based on his news experience, and he drove users away, killing the platform. MySpace has never recovered.

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What skills do executives and a workforce need to ensure platform success?

It takes people skills in community management. They tend to be much more socially aware and understand the interests of ecosystem partners. When something goes wrong, you fix it quickly and openly and manage the external relationship so that the community continues to participate. To ensure platform success, you have to be comfortable managing without controlling and that's not traditional management practice.

The Platform Revolution: The Near Future for All Industries

Is there any industry immune to integrating platforms into their strategy?

Most industries will be affected, but the order of transformation will take place in proportion to the amount of value created by information and by the external community. Media and software industries are obvious transformations. Services industries will also follow. Even though there is a lesser proportion of value that's being created by information and by community, there are pockets where a platform approach has been valuable even in heavy industries.

A good example is Red Lake Mine, a mining company that is more than 50 years old. The analysts thought that its mines were maxed out and its stock price began to dwindle. The CEO opened up its mining data and offered open innovation challenges. A few thousand people around the world took on the challenge and identified new veins of gold in mines, tripling the amount of extraction in the next couple of years. One might imagine a heavy industry as one immune to platform transformation but even here it is possible. Energy is another industry that, despite its huge capital costs, will undergo platform transformation. In this case, the need to manage spare capacity and trade on production surplus will force the transition.

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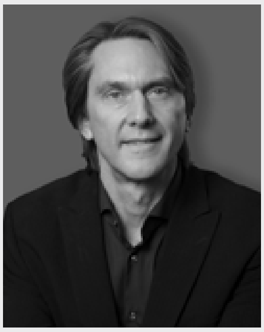
Do you need a long-term vision, strategy and investment program to integrate a platform strategy? For example, General Electric, a traditional appliances company, invested in Predix, its software platform, which is seen as having great potential. However, GE also invested for four years in building a team of 1,500 software engineers.

Platform design is art. After Johnson Controls built PANOPTIX systems for buildings, they eventually pulled back. They weren't able to convince developers to come and join their ecosystem. There are a variety of different failure points because it's such a complex problem with so many different moving parts. You must manage the cannibalization in a judicious way. You must manage the interactions among your growing ecosystem partners. You must manage value being created externally and you must also manage external quality control and fraud prevention. That's hard and that's not what firms are used to doing. All these activities must realign and adjust, and it's a long-term investment to get it to work.

Strategy in platforms is like playing three-dimensional chess. You have to look at the strategic choices of your ecosystem partners just as much as you look at 3D choices of your own platform internally. Conceiving all those multi-party interactions and getting it right gets complicated and it's not going to happen by accident.

> *"There are pockets where a platform approach has been valuable even in heavy industries."*



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Marshall Van Alstyne – a research scientist at MIT and tenured professor at Boston University, Questrom School of Business – is one of the world's foremost scholars of information business models. He co-developed the theory of Two-sided Networks, a major contribution to understanding the impact of network effects.

Marshall is co-author of Platform Revolution (published March 2016), which analyses how seemingly disparate companies, from PayPal to Alibaba, have upended entire industries by harnessing a single phenomenon: the platform business model.

Capgemini Consulting talked to Marshall to understand how these companies are unlocking hidden resources and creating new forms of value.

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