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Matchmakers

The New Economics of Multisided Platforms

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Introduction

MANY OF THE BIGGEST COMPANIES IN THE WORLD, INCLUDing Alibaba, Apple, Facebook, Google, Microsoft, News Corp., Rakuten, Tencent, and Visa, are *matchmakers.* So are many of the most exciting and valuable start-ups, such as Airbnb, BlaBlaCar, Didi Kuaidi, Flipkart, Lending Club, Pinterest, Spotify, and Uber. What these businesses have in common is that they all connect members of one group, like people looking for a ride, with another group, like drivers looking for passengers.

Matchmakers are very different from the businesses that have been the staple of college economics classrooms and MBA lectures for decades. They operate under a different set of economic rules. Traditional manufacturing businesses, for instance, buy raw materials, make stuff, and sell that stuff to customers. But matchmakers' raw materials are the different groups of customers that they help bring together, not anything that they buy at all. And part of the stuff they sell to members of each group is access to members of the other groups. All of them operate physical or virtual places where members of these different groups get together. For this reason, they are often called *multisided platforms.* They're places where all of these different groups can meet.

If you've ever taken an economics course, you have heard a lecture on how traditional firms manage their production and set their prices to maximize profits. When it comes to matchmakers, that lecture was dead wrong, in critically important ways. That's because the classic economic models don't account for the fact that the demand by each group of customers served by a matchmaker depends on the demand by other groups of customers it also serves. For instance, the American Express card connects consumers and merchants; consumer demand for the card depends on how many merchants have decided to accept it, and merchants' demand in turn depends on how many consumers have decided to use the card. Let's be clear: ignoring the interdependence of matchmakers' demands was a big mistake. Economic textbooks and business school courses made claims that just didn't apply to a large and growing part of the economy and, if followed, would have led matchmakers into bankruptcy if they were able to even get off the ground in the first place.

Economists, including the two of us, have been doing a lot of work to understand how matchmaker businesses work. We've made immense progress since 2000, when the difference between traditional and matchmaker businesses was first discovered. Once you understand the economics behind them, many of the seemingly counterintuitive strategies that matchmakers use—like actually paying customers to participate—make perfect sense. It's those insights that we share with you in this book.

Discovering the error in applying the economics of traditional firms to matchmakers was timely and perhaps inevitable. The use of this business model exploded around the time economists made this breakthrough. The mash-up of technologies—from software to the web to mobile broadband—made it cheaper to start matchmakers and vastly increased the power and reach of this business model.

But we think that to really understand the matchmakers—and we'd argue that you must, because you're increasingly surrounded by them, participating in them, or competing against them—you need to grasp the basic types of multisided platforms that have been around for a long time. What's so fascinating to us is how all the "new" business models that receive so much hype today have striking similarities to businesses in the past—from the lending exchange in Athens around 300 BCE to newspaper classified ads around 1750 CE to credit cards in Manhattan in 1950 CE. We can learn a lot simply by understanding the fundamentals that have endured over thousands of years and that are now being powered by technology and other innovations that make matchmaker businesses more vibrant and much more scalable.

We're going to share with you a lot that we have learned since 2000, when we first started working on the new economics of multisided platforms. Over the last fifteen years, we've written three other books on this subject and, together or separately, many widely cited articles that report our research. Most importantly, we've had the opportunity to work closely with many of the most significant multisided platform businesses in the world—including Ariba, American Express, Google, Microsoft, PayPal, Tencent, and Visa.[1] We've also served as advisers to many start-ups and have even started one that is doing quite nicely.

This book uses case studies to help you understand a kind of business that you will almost certainly interact with as a customer, investor, executive, entrepreneur, or regulator, and that you might even want to start yourself some day. We're going to explain the new economics of multisided platforms, how it differs from traditional economics, and how it explains what many successful and important businesses do. And help readers who have taken courses on business economics unlearn much of what they've been taught. We're also going to show you how matchmakers are transforming economies worldwide and how they are killing some established industries, creating some new ones, and forcing the reinvention of others. And that these powerful engines of commerce are making life easier and better for billions of people.

Matchmakers has three parts. Part I (chapters 1–3) presents an overview of the new economics of multisided platforms and shows how this business model with ancient roots has been turbocharged by modern technologies. Part II (chapters 4–10) provides a deep dive into key concepts that matchmakers must deal with in building, igniting, and operating their businesses. Finally, part III (chapters 11–13) describes how turbocharged, multisided platforms are creating new industries, destroying old ones, and forcing existing