

## Summary of Speaker and Presentation

INSER hosted a talk by Dr. Geoffrey Parker, Associate Professor, Economic Sciences, A. B. Freeman School of Business, Tulane University today entitled "Platform Envelopment." In this talk Prof. Parker describes the research presented in his most recent paper: "Strategies for two-sided markets." Thomas Eisenmann, Geoffrey Parker and Marshall W. Van Alstyne. *Harvard Business Review* 84.10 (Oct 2006): p92(10).

According to Professor Parker "Products and services that bring together groups of users in two-sided networks are platforms." Competing platforms, then, are products or services that compete for market share. For example Xbox 360 and PS3 are two examples of competing platforms.

Another set of competing platforms are the iPod and Zune. According to Prof. Parker Zune is an example of a "me too" product – it is a similar product that does not provide any more functionality than its competitor. In this case the Zune was a big failure in terms of market share because it could not compete with the already dominant iPod.

Blue Ray and HD DVD are competing platforms that are still in competition. In the end somebody will win and receive a big payoff. The loser will potentially lose millions in R&D and marketing costs. It is still possible in this case that there will be a compromise and the two platforms will exist side-by-side. In fact LG has already manufactured a DVD player that is capable of reading both formats. If this becomes the standard for all DVD players no one will win big because the two platforms have to share the market.

This contest for platform envelopment is not new. Prof. Parker pointed out that the telephone and the telegraph existed side-by-side for several decades. Eventually the telephone took over the telegraph market by offering all the same functionality as the telegraph *plus* additional features. Thus the telephone "enveloped" the telegraph.

It is important to remember that platforms mediate transactions. Even something as basic as a VISA or Mastercard credit card is a platform. These cards are competing platforms that mediate transactions between consumers and merchants in a network called a Platform-Mediated Network. Ebay is another example of a Platform-Mediated Network.

Professor Parker then described the two-sided network model and its four network effects. A two-sided network is a network where a platform has two distinct types of users. The platform can then have different relationships with each set of users. There are two types of effects that result from this, "same-side" network effects and "cross-side" network effects. Both effects can be either positive or negative. Thus balancing the two sides in a two-sided network leads to four possible effects. Since a two-sided network responds differently than a one-sided network this leads to three essential challenges for platform providers: pricing, winner-takes-all dynamics, and envelopment.

One important implication of a two-sided network is that one set of users can subsidize the cost of another. For example, Google has two sets of users, advertisers and searchers. Advertisers pay money to place ads on the site while searchers use the site for free. Thus the advertisers subsidize the user group so that searching remains free. This is called a cross-side network effect. Same-side effects occur when users some aspect of one side of the network increases or decreases users on that same side. For example, Playstation saw this type of effect happen once its PS2 gaming platform reached a certain level of popularity. PS2 became even more popular because it was easy for friends to trade games, encouraging more people to favor the PS2 over other platforms. Platform providers must examine these issues carefully to determine pricing of products.

Platform developers are often involved in battles to secure platform supremacy. The battle between VHS and betamax is an excellent example of this concept. In such battles the platform provider seeks to completely dominate the market in a winner-takes-all strategy. As mentioned above the costs are high and inevitably one company loses substantial investments in R&D and marketing. Professor Parker explained the various issues involved in such a battle.

The final challenge involves envelopment: one platform taking over an adjacent platform. This happens because adjacent platforms often have overlapping user bases. Bundling effects come into play. Mobile phones are an example of bundling – they now act as MP3 players, cameras, and PDA's in addition to phones. Adjacent platform, especially those owned by large corporations, can bundle additional services into their platform and price them comparably to the existing platform. The existing platform may not have the resources to compete with this new product. The existing platform must adapt to the change, leave the market, or sell to its competitor.

The attempted envelopment of Real Networks by Microsoft provides an excellent example of this process. Real Networks originally offered streaming media and player for free to users while charging the content providers. Microsoft decided to enter this market. They also subsidized the users but bundled their player with other services such as server functions. The content providers switched to Microsoft because they needed server applications anyway. As content providers switched to Microsoft so did users, which is an example of a cross-side network effect. Real Networks survived this attack by switching its subsidy-side: they made user pay a small monthly fee and provided software free of charge to content providers. In addition to changing business models platforms under threat of envelopment can team with a larger corporation or sue the enveloping corporation under anti-trust laws.

### Question and Answer Session

Q. Will Apple bundle subscription services?

A. I don't know how they are going to get away without bundling.

Q. But Apple also seems to be hedging its bets by saying you don't want to use digital rights management...

A. I'm not sure that DRM is that significant in the public arena. It is probably only an issue at a place like a university where people have a very high speed connection and the inclination to search for music. But for the general public stealing music is not a problem. One possible outcome for the future is that as people have access to very high-speed connections these will substitute for storing music. People will be able to access music on demand rather than save it on a device. They will essentially allow companies to take over the archiving and cataloging of their music.

Q. What do you mean by organizational issues in terms of envelopment?

A. When you do envelopment you have these new features that you have to organize. You have issues similar to a merger where you have to integrate these multiple systems and make them work together.

Q. Does this mean that the market will become more concentrated?

A. I think it will depend on the maturity of the market. Mature markets will have lots of market share so envelopment is more likely. Envelopment is less likely in newer markets. Integration is more likely to occur very early on. Platforms can always disaggregate later if necessary. What eventually happens is that you have integration followed by strong complement markets forming followed in turn by integration again.

### Summary of Audience

The audience consisted of about 15 people, both students and faculty. Students included both undergraduate students in the Informatics program as well as graduate students representing Library and Information Science.

