

Workshop on Interoperability

# Monetizing Business Assets in Multisided Markets: An Economic Perspective

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# Old models, new models: a few questions

# Two – sided markets



# A classic example of a two-sided market: a matrimonial agency



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# A classic example of a two-sided market: a matrimonial agency



- The agency needs to attract many female members to be attractive to the males - but also needs males to be attractive to the females
- Sometimes this means charging very different rates to reflect the different ease of attracting the two sides (ex: night-clubs)
- The ***network externality*** here is indirect (each side values the presence of clients on the other side), and the elasticity of demand has to be calculated taking this indirect externality into account

Each side of the market is what is being sold to the other side

# Examples of two-sided markets and their clients



- Computer operating systems
- Newspapers and TV stations
- Credit card issuers
- ISP
- E-market places
- Real estate agencies
- Smart phones



# What does this imply for pricing?

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Getting both sides on board may call for aggressive cross-subsidy strategies : Divide and conquer

Pricing may have to be low

for *both* sides in the initial phase of launching a business  
for *one* side in the mature stage

Asymmetric pricing structure to reflect different elasticities:

The price charged to one side of the market is lower the more responsive is its demand *and* the more valuable it is to the other side of the market.

Free access on one side may be optimal

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# Pricing both sides

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$$price(i) = cost - v^j(i) + m(i)$$

$v^j(i)$  = value of a member of side  $i$  for side  $j$

- depends on factors such as size, value and nature of interaction
- may be affected by the platform

$m(i)$  = mark-up

- depends on elasticity of demand, competition, « multi-homing »
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# Some implications



- It's not easy to tell whether a firm's current pricing strategy is viable in the long run
- It is hard to tell the difference between an inefficient firm or project and one that is making short-term losses for long-term gains
- Platforms strategies may differ a lot even on the same market:
  - they may be selling content for very different prices by competing with different strategies (free vs pay media, credit vs debit)
  - different vertical integration strategy (Apple /Microsoft /Linux)
- Example: Evidence now suggests that pay-TV and free-to-air compete quite closely in some markets: DTV/basic satellite packages



# Single-homing vs multi-homing



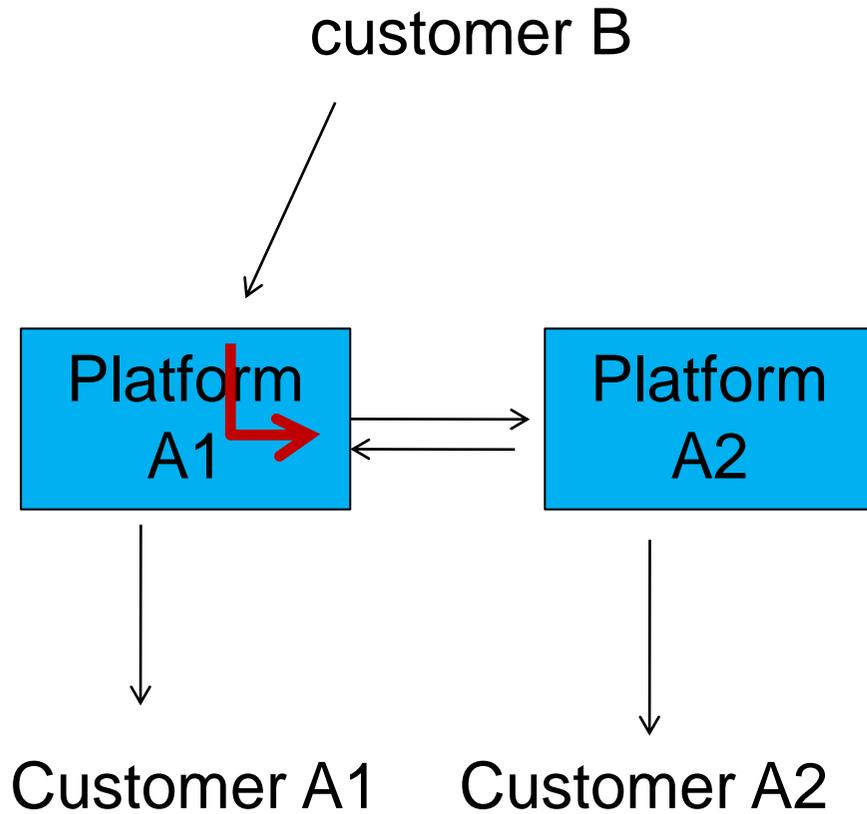
- The advantage of an established platform over a new rival depends on how easy it is for customers to “multi-home”:
  - Not easy for computer operating systems, banks, newspapers
  - Easy for TV channels, credit cards, realtors, search engines
  - Easier for online shops, auction houses than for bricks-and-mortar ones - what does this tell us about the future of Ebay?
- Allowing one side to multi-home shifts competition toward the other side
  - Compete to “capture” clients on the side with single-homing
  - “Resell” these clients to the multi-homers
  - No competition for multi-homers: they buy the access to the clients on both platforms

# Example: Media Players

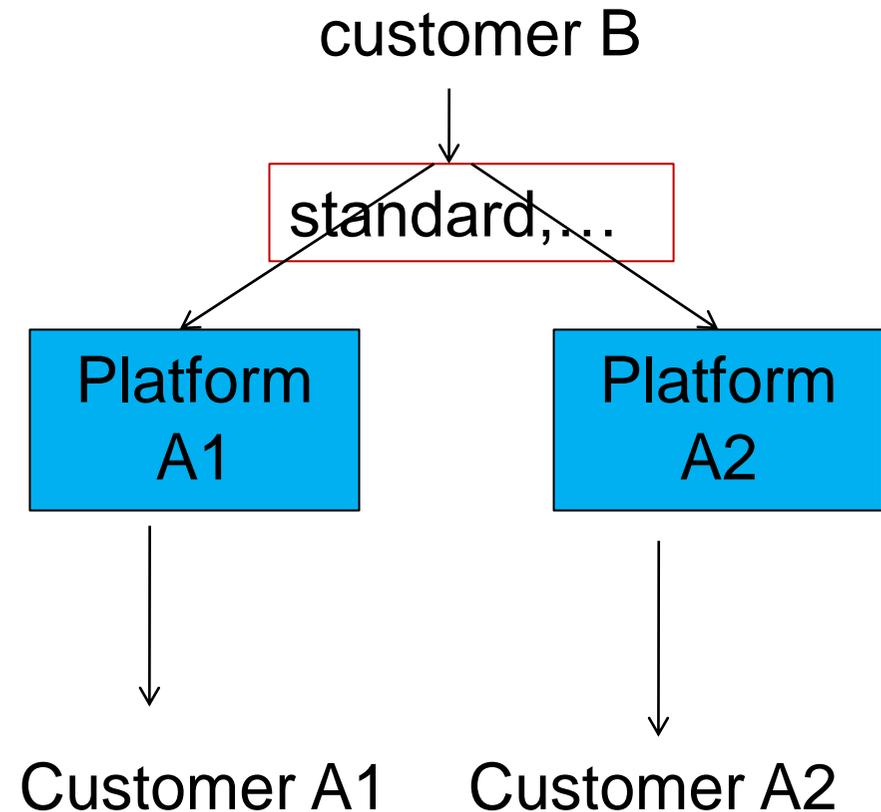
- Media players are not like PC operating systems; many, even most users «multi-home»
- The costs of multi-homing are small
- The difference between players lies not so much in their intrinsic performance characteristics as in the exclusive content that is recorded for them – this is a strategic choice variable of the firms involved
- The fact that many players are given away for free does not mean they are being squeezed out of the market – they make their money on the content side



# Compatibility vs multi-homing



Full compatibility



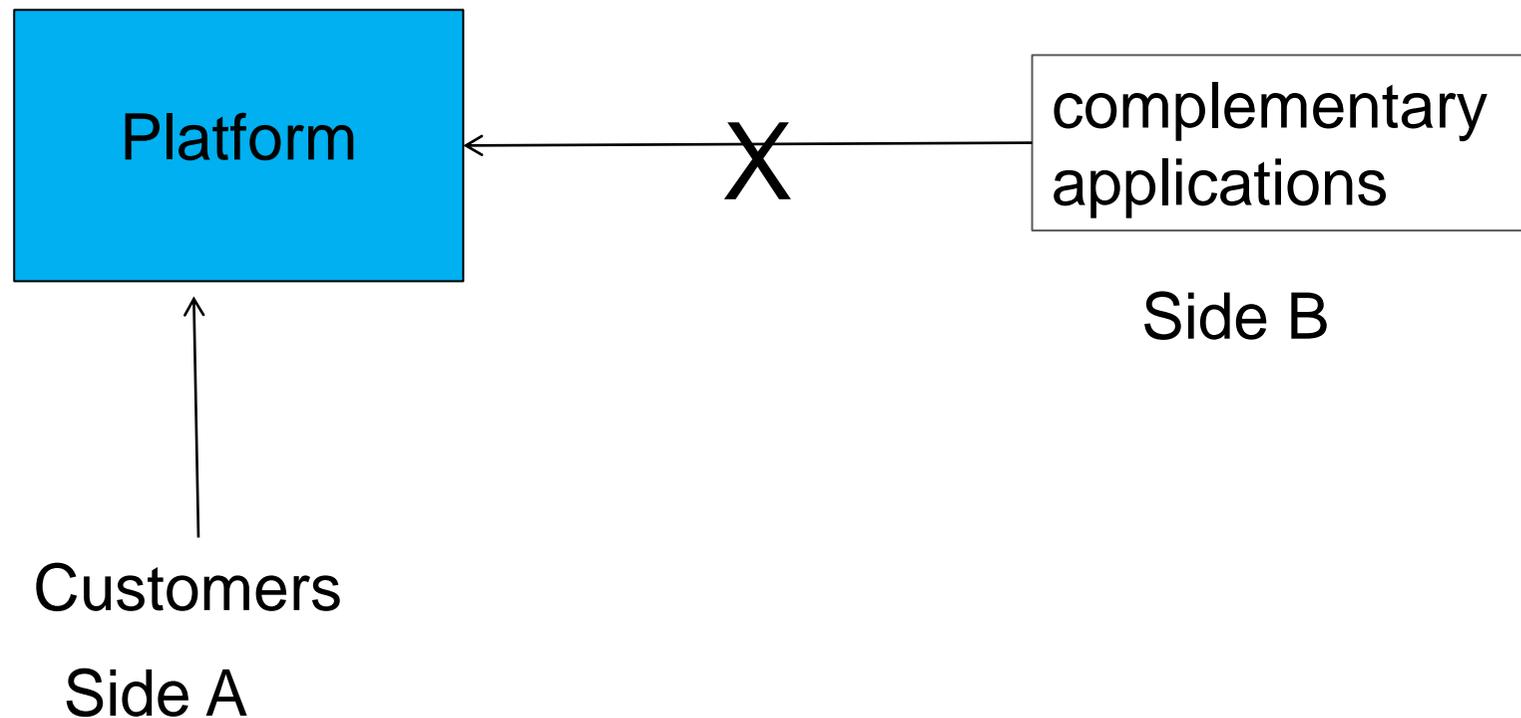
Multi-homing: one-side compatibility

# Compatibility and Two-Sided markets



- Examples
  - Standard adoption, Interconnection with or without access charges, Interchange fee
- Competition between incompatible platforms is intense and not inefficient
  - Divide and conquer strategies intensify cross-subsidy
  - Loss of network externalities or tipping
- Platforms may prefer to achieve total or partial compatibility
  - Eliminates network effects and shifts competition toward value creation through product differentiation
- Multi-homing may not substitute for compatibility

# Lack of interoperability as restriction of access to the platform



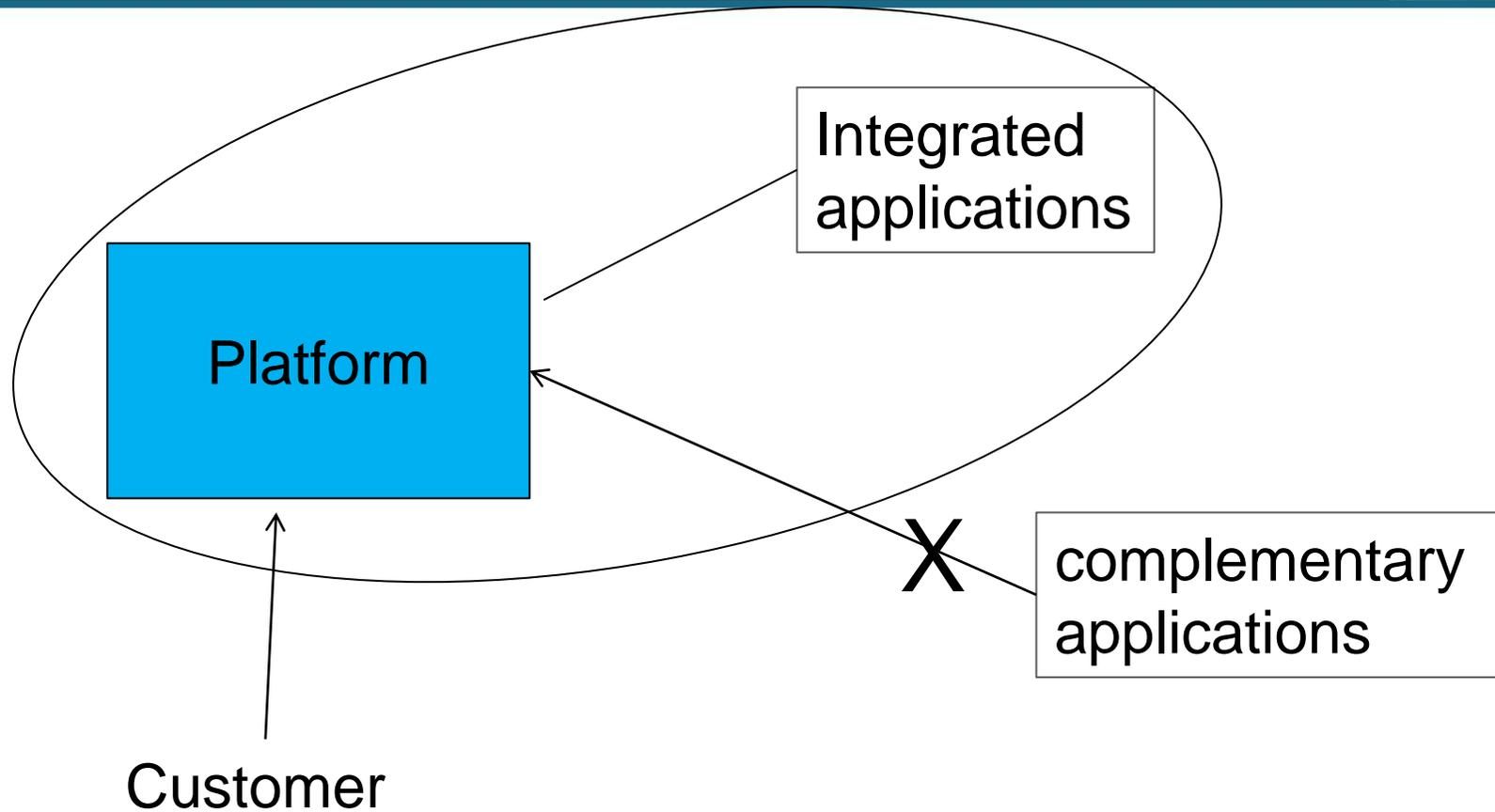
# Restricting access on one side: non-integrated platforms



- Less incentive to degrade quality than one-sided firm
  - The participation on side B creates value on side A
  - The quality of access side B affects the perceived quality on side A
- Market power: the Spence effect
  - The platform care about prices and thus only about “marginal consumers” and ignores the benefits for the captive demand
  - May lead to excessive or insufficient quality on side B



# Lack of interoperability as tying



# Tying and foreclosure

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- Lack of interoperability as a form of tying of complementary goods
  - Microsoft, Apple Ipad
- Chicago argument: all the value can be captured by the platform
  - No incentive to reduce access to the platform
- Standard market foreclosure arguments don't apply to platforms (complements)
- But there are new motives for excluding independent producers on side B:
  - Protecting the **platform** against entry of other platforms, but conditions for this to occur still not well understood

# Tying without foreclosure



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- The traditional value of tying
    - Lowering the combined demand elasticity so as to enable higher pricing
    - More effective marketing of goods (discrimination)
  - Bundling goods with platform (Ipod 1<sup>er</sup> gen, integrated platforms, freebies...)
    - Better coordination between sides (chicken and egg)
    - At infant stage, then dis-integration/unbundling
  - Tying platforms (smart phone, OS/Browser, credit/debit card...)
    - More efficient use of the platforms
    - May boost participation if multi-homing with beneficial effects

# Exclusivity

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- Exclusivity as a factor inducing single-homing: premium content
  - Raise value on the other side
- Exclusivity as a factor in product differentiation
  - Without exclusivity a piece of content can supplied by firm A can be substituted closely by the same content supplied by firm B:
  - Exclusivity obliges the competitor to produce different content of its own

# Media



## The New York Times

- Pay-tv and newspapers both face fierce competition from free content
- Newspapers have the advantage of content short shelf-life but haven't been able to monetize it – why not?
  - Very little scope for exclusivity – there's too much competition in generation – from blogs for opinion and from each other for news
- Contrast with pay-TV – exclusivity deals with sports leagues, Hollywood studios
- There will be a shake-out in news-gathering and a return to exclusivity, but it will take time; in the meantime pay-TV broadcasters are getting rich

Finally, remember that there is always room for a new approach to an old business...



Thank you for our attention!

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