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MOST COMPANIES THAT serve as intermediaries between buyers and sellers face a fundamental strategy decision: Should they be resellers (like supermarkets), acquiring and then reselling products or services? Should they operate as multisided platforms (like eBay), connecting buyers and sellers without controlling or owning the offerings being sold? Or should they blend the two models?

The past decade has seen a multisided-platform (MSP) bubble. One reason, undoubtedly, is the success of eBay—and of Rakuten and Taobao, eBay's counterparts in Japan and China, respectively. Another is that multisided platforms look financially more alluring than resellers. These marketplaces usually take a cut from each transaction, which goes almost straight to the bottom line. As a result, their operating costs are low and their percentage margins are high. Because resellers must buy and then sell their offerings, they typically have higher revenues but also higher capital and operating costs and lower percentage margins.

The attractions of multisided platforms have enticed many companies, large and small, to try to apply the model in cases where the reseller model would have had a better chance of succeeding. For instance, all attempts since the early 2000s to create an eBay-style marketplace for patents have been shut down, redirected, or scaled back



ILLUSTRATION: EBOY ARTS, INC.

and limited to brokerage and technology-consulting services. Zappos, the online shoe retailer, started off in 1999 as a marketplace but by the mid-2000s had turned itself into a pure reseller, stocking inventory and taking full control of transactions with end users.

Whether you're the founder of a start-up, a manager in an established business, or an investor, this article can help you evaluate which model—or mix of models—will work best.

A firm's position along the continuum between pure reseller and pure multisided platform is determined by how much control the company takes over transactions (see the sidebar "How Companies Use Different Sales Models"). To what extent does the intermediary control pricing, product presentation, and the other factors that influence buyers' purchasing decisions? To what extent does it take responsibility for fulfilling orders and delivering products?

Choosing the Right Model

Determining whether more or less control over buyer-seller transactions will allow your firm to create or extract significantly more value involves the consideration of four factors.

Scale effects. High-demand products are sold more efficiently by one large reseller than by many small sellers. The reseller can capitalize on economies of scale in purchasing, infrastructure investments (in warehouses and distribution centers, for example), delivery, customer support, and so on. These advantages, however, don't apply to low-demand—or "long-tail"—products. That is why Amazon acts as a reseller for high-demand products but as a multisided platform for long-tail products, which are available on the site from independent sellers.

Aggregation effects. Some products and services have much higher value to buyers when bought together than when purchased separately from independent sellers. In those cases, resellers generally do better than multisided platforms—the latter may not even be viable.

For instance, most patents on technology products such as smartphones have little, if any, value on their own for potential buyers or licensees, because individual patents can be invented around, countered with related patents, or invalidated in court. This is one of the main reasons that multisided-platform business models for patent intermediation (Ocean Tomo's live auctions, for example, and online marketplaces such as yet2 and Tynax) have failed to

gain much traction, while Intellectual Ventures and other patent aggregators—which buy patents, bundle them, and then sell or license the bundles—have thrived.

Resellers are also in a much better position to exploit complementary relationships between products. Having iTunes function mostly as a reseller has allowed Apple to employ a "give away the blades to sell the razor" pricing strategy with the iTunes-iPod combination. The company set very low, uniform prices for music (99 cents or \$1.29 per song) and realized huge margins on the sale of iPods. That strategy would not have worked if iTunes had been closer to the multisided-platform end of the continuum, giving record labels control over music sales and pricing.

Why didn't Apple employ the reseller strategy with its App Store? Whereas there are only a handful of powerful record labels, there are thousands of app developers. Consequently, Apple would have incurred exorbitant costs trying to deal with all of them and gained little by taking control of app sales: Fierce competition among developers keeps prices extremely low (28% of iPhone apps are free; the average price of the rest is \$4), increasing the value of the iPhone to users and allowing Apple to extract big margins from its sale. As a result, serving as a multisided platform makes a lot more sense for the App Store.

Even when complementarities are limited, a reseller that aggregates products may be able to extract more value from buyers through strategies such as bundling and loss-leader pricing, which independent suppliers cannot achieve. For instance, ESPN might not be an obvious complement to the Discovery Channel, but by selling those channels together as part of the cable bundle, Comcast can obtain much higher revenues from subscribers and advertisers than if it sold them separately. Costco, Target, Walmart, and other retailers lure customers into their stores with prices at or below cost on certain goods (for example, gas at Costco and high-definition TVs at Walmart), which they more than make up for with higher margins on other products. Again, controlling products—especially their presentation and pricing—is necessary to achieve this.

The buyer and seller experiences. Multisided platforms generally create value by matching buyers with the right sellers and vice versa, and then enabling them to transact. In some contexts, however, one side might not want to deal with multiple agents



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Idea in Brief

Multisided platforms—marketplaces that allow buyers and sellers to transact directly with each other—have emerged as a powerful business model.

But the breathtaking rise of marketplaces like eBay has lured managers into copying them in cases where they should have operated more like traditional resellers, which buy and then resell products or services. The result has been a wave of failures and restructurings.

The lesson: Managers and investors should consider where on the continuum between pure reseller and pure multisided platform a company belongs and understand that it may take one or more moves to get there. This involves assessing which model will best allow the business to exploit scale and aggregation effects, offer a better buyer or seller

experience, and resolve market failures such as uncertainty about product quality or the reliability of sellers or suppliers.

After establishing the business, managers must remember to reevaluate its position as the competitive landscape changes. Otherwise, the business could be disrupted.

on the other side, which makes the reseller model preferable.

Zappos's shift from multisided platform to reseller was driven by that realization. At the beginning, Zappos relied entirely on partnerships with shoe manufacturers that held inventory and fulfilled customer orders directly. But the company soon discovered that buyers were more likely to complete transactions and come back for more if they were offered a great retail experience: guaranteed fast delivery, an extremely favorable and universal return policy, reliable and standardized information about product characteristics and availability, and so on. The realization that it could not provide this experience if it continued to operate as a marketplace led Zappos to build its own warehouses and take complete control over interactions with end users. Its successful strategy made it an attractive acquisition target: In 2009 Amazon bought the company for nearly \$1 billion.

Sometimes the need to provide a good seller experience calls for the reseller model. Consider Gazelle, a leading online reseller of used electronics products. Gazelle buys items from individuals through its website and resells them through various channels, including export wholesalers and eBay, where Gazelle has earned the prestigious Power-Seller designation. It may seem ironic that the company makes a profit buying from users and reselling on eBay. But Gazelle's key insight was that individual, one-off sellers are at a tremendous disadvantage on multisided platforms: They lack the expertise, credibility, and time to compete with the professional sellers in these marketplaces. In this context, the value proposition of resellers like Gazelle is transaction convenience and speed in exchange for a lower price than sellers might have obtained through an eBay auction.

That said, some multisided platforms manage to achieve the holy grail of providing great experiences

for both buyers and sellers. For example, oDesk has created a leading online marketplace for virtual work that allows employers to find, hire, monitor, and pay individual workers. In stark contrast to traditional staffing agencies, oDesk is able to satisfy the needs of both sides without taking direct responsibility for either party or for their agreements.

Market failures. Left to their own devices, marketplaces sometimes collapse. The most obvious cause of a market failure is uncertainty about product quality or about the reliability of sellers or suppliers.

Many multisided platforms have solved this problem without moving to a reseller model. Ebay, for example, instituted a feedback system for buyers and sellers. Airbnb, which allows house and apartment owners to rent rooms to complete strangers, provides not only a reputation mechanism similar to eBay's but also several other features that keep both sides honest. For instance, it releases the renter's payment to the owner 24 hours after the renter has checked in and confirmed that the location is as described. And it returns the renter's deposit after the owner has retaken possession and confirmed that no serious damage occurred.

It would be a mistake, however, to conclude that such market-based mechanisms are always sufficient to ensure quality and reliability. Sometimes it is necessary to move closer to a reseller model by exerting more control over transactions. This was the painful lesson learned by SellaBand, Bandstocks, and Slicethepie, which all hoped to disrupt record labels by creating platforms where fans would be able to interact with and fund their favorite bands. Too many poor-quality bands led investors to lose interest, however, and all three companies failed (although SellaBand was resuscitated by a group of outside investors with a model closer to that of the traditional record labels). As SellaBand's former CEO told us, "If you want to be successful in this field [music

How Companies Use Different Sales Models

Companies can take various positions on the continuum between a pure reseller model (buying and then reselling products) and a pure multisided-platform (MSP) model (providing a marketplace in which buyers and sellers transact directly with each other). Here are examples of how companies in three industries have done that. In some cases, they have changed their positions over time.



RETAIL AND E-COMMERCE

Online marketplaces such as eBay and Taobao have always been pure multisided platforms: They have never exerted much control over buyer-seller interactions or owned the goods sold through their sites. In contrast, supermarkets, Walmart, 7-Eleven, and other retailers (online and offline) have largely been pure resellers. An important exception is when a retailer sells shelf space to a marquee supplier such as Coca-Cola and gives it control over pricing and the layout and stocking of the shelf.

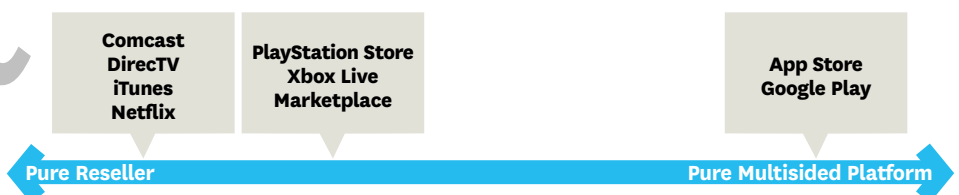
Amazon started off as a pure reseller: From its founding in 1994 until the early 2000s, it bought and resold products in its own name. The company then started moving toward the MSP end of the continuum, allowing third-party merchants to sell products directly to Amazon users. In 2011 those sellers accounted for 30% of unit sales on Amazon. Within a given product category, Amazon may operate as a pure reseller, a pure multisided platform, or something in between—for instance, fulfilling orders but letting merchants control prices and the relationship with buyers.



DIGITAL CONTENT

Cable and satellite services (such as Comcast and Dish Network), iTunes, and Netflix are resellers: Users' contractual relationships are with those services, not with the content providers, and the companies control pricing and delivery to users. Apple's App Store and Google Play, a marketplace for Android apps, are near the other end of the spectrum. In those marketplaces, users buy apps from third-party developers, not from Apple or Google. They are not pure multisided platforms, however, because Apple and Google exert

some control over the quality and distribution of the apps—more than eBay does over the offerings in its online marketplace, for example. Other digital content services lie somewhere in between: When users buy movies and games on Xbox Live Marketplace and Sony's PlayStation Store, their purchase contracts are with Microsoft and Sony, yet game publishers and movie studios maintain control over pricing.



CAR SHARING

Traditional car-rental companies (such as Avis and Budget) and Zipcar are pure resellers: They own fleets of cars, which they rent out to consumers. In contrast, newer services such as Getaround, Lyft, RelayRides, and Uber simply facilitate transactions between car owners and car users. None of these services owns a fleet, and the car owners set their own rates except in the case of Uber, which imposes some standard rates. With Uber and Lyft, users can get a ride from professional drivers (Uber) or private individuals (Lyft).

With Getaround and RelayRides, users can rent cars from private individuals.



crowdfunding], you need to take some kind of control over what happens on your site because of the potential friction in goals and expectation between the two different parties.”

Another potential market failure that multisided platforms cannot address is when one side has an information or bargaining advantage over the other. Fearful of being exploited, the weaker party is unlikely to participate. The reseller model can help solve this. Intellectual Ventures (IV), the world’s largest patent aggregator, has raised more than \$5 billion and spent in excess of \$2 billion acquiring more than 30,000 patents. IV typically acquires patents from universities, small companies, and individual inventors and then resells or licenses them, mostly to large operating companies.

In addition to the benefits of aggregation mentioned above, IV creates value by correcting (to an extent) the huge power imbalance between small patent owners and large operating companies. Lacking the expertise and resources to bargain successfully or engage in litigation, small patent owners have traditionally been able to obtain only meager, if any, payment from large operating companies. The central pillar of IV’s strategy is successfully negotiating with companies on behalf of the many small patent owners that are its suppliers—and in the process making a sizable profit. Again, a multisided platform could not achieve this, which is why virtually all attempts to create patent marketplaces have failed. IV has already become the most influential patent intermediary in the technology sector.

Start-Up and Growth

The considerations above are sufficient for most companies to decide where to position themselves on the reseller-MSP continuum. But a company can’t always get there immediately. Sometimes companies that should ultimately be multisided platforms need to start out as resellers and vice versa.

The catch-22 problem. Suppose you are a start-up or a large company entering a new industry and have determined that the multisided-platform model is best for you. The problem is that buyers will not join your platform if you don’t have enough sellers; neither will sellers if you don’t have enough buyers. Sometimes you can solve this by focusing on a small niche and growing from there, as eBay did with collectors of PEZ Candy dispensers. If you are unable to find such a niche, resorting to the reseller



Buyers will not join your marketplace if you don’t have enough sellers; neither will sellers if you don’t have enough buyers.

model for an interim period might be a wise move. Amazon adopted exactly this strategy: It bought and resold books and other products and established a substantial base of buyers before it tried to attract independent sellers.

Karma—a start-up that launched a mobile application in early 2012 that allows users to select, buy, and send presents from a variety of sources—is taking a similar approach. The core of its value proposition is the ability to provide gift recommendations based on data gleaned from users’ social networks. Currently, Karma buys items from manufacturers and retailers and resells them for a small profit. But the pure reseller model is probably not optimal in the long run: For most gift categories, the large retailers and manufacturers that supply the items to Karma have superior scale; Karma doesn’t have to take possession of the items to create a great experience for buyers; and because the gifts are typically well-known items from branded producers, consumers aren’t going to be concerned about quality or reliability. Nevertheless, the company may have had no choice but to act as a reseller at the outset in order to prove the value of its concept to manufacturers and retailers. In addition, the control offered by the reseller model gives Karma more leeway in experimenting with ways to serve buyers. Once it figures out the best way to do that, it can start shifting toward a multisided-platform model.

Limited capital. If your business should ultimately be a reseller but needs to grow fast in the short run and lacks the resources to do so, operating as a multisided platform, which enjoys lower capital and operating costs, might be a good interim solution.

Gome, China’s largest electronics retailer, employed that strategy. Since its founding, in the early 2000s, Gome has sold or rented space in its stores to suppliers, which operate as de facto independent concessions. This means that products in Gome stores are organized by brand, not by category, and 80% of the salespeople are employed by the manufacturers. Given that this model doesn’t provide a great customer experience, it’s hard to imagine that it can succeed in the long term. But the company lacked the resources to achieve its goal—to be the first to open electronics stores in all major Chinese cities—if it operated as a traditional retailer. Indeed, Gome has expanded at a much faster rate than its competitors. Although it has been struggling financially and has recently closed some underperforming

Creating a Marketplace Is Harder Than It Looks

Connecting buyers and sellers without ever owning the product is a seductive business model: Capital and operating costs are low, and margins are high. However, being a reseller often proves to be a better choice. If you answer yes to any of the questions below, then reselling (or a hybrid approach) is probably a better bet for your company.

1

Are there significant economies of scale to be exploited?

2

Can your company create and extract much more value by bundling or by selling complementary products?

3

Do buyers derive significant benefits from aggregation?

4

Is your company able to create a better buyer or seller experience by taking control of transactions?

5

Do buyers need to be protected from sellers or vice versa?

6

Does one side have a disproportionate information or bargaining advantage?

stores, the issue seems to be a lack of capable senior managers, not the company's business model. In fact, Gome's closest competitor in China, Suning, uses the same model and is thriving.

Disruption and Disintermediation

The framework we've offered above is also useful for identifying disruption opportunities or, if you're an existing intermediary, threats.

In the typical disruption scenario, emerging marketplaces displace incumbent resellers. Indeed, the multisided-platform model has become particularly powerful and widespread with the rise of the internet and mobile-communication technologies. New marketplaces are created every day, which makes it easier for buyers and sellers to interact directly, bypassing traditional middlemen. EBay rendered collectibles stores obsolete. ODesk and similar sites are displacing staffing agencies. Amazon's Kindle and other online self-publishing and distribution platforms are challenging book publishers. Peer-to-peer car-sharing services such as RelayRides and Getaround are challenging established car-rental companies as well as Zipcar (all of which function as resellers, buying their own cars and renting them to users).

It would be a mistake, however, to assume that all resellers are subject to disruption by online or mobile-based multisided platforms. Li & Fung, the world's leading middleman for apparel fabric, has functioned as a reseller since its founding, in 1906. Although a well-designed online platform could provide a convenient one-stop shop, it would lack the advantage that Li & Fung achieves by aggregating demand from many clients: the power to obtain lower prices from suppliers, make faster deliveries, and help suppliers better utilize their capacity.



In the typical disruption scenario, emerging multisided platforms displace incumbent resellers.

Similarly, the proliferation of internet-based video marketplaces such as Hulu, YouTube, and Xbox Live Marketplace, through which users buy content directly from providers, has not rendered cable and satellite aggregators obsolete. Aggregators use bundling to extract much higher revenues from viewers and advertisers than content providers can by selling their products independently through online marketplaces; the aggregators then share those higher revenues with content providers.

We are beginning to see a reverse disruption scenario, in which upstart resellers are challenging established multisided platforms. Gazelle is an example. This suggests that successful multisided platforms inevitably create opportunities for resellers to aggregate demand or supply in specific markets or to offer a better experience for a segment on either side of the market.

MULTISIDED PLATFORMS have emerged over the past decade as some of the most powerful and valuable business models around. It is important, however, not to overestimate their attractiveness relative to the more traditional reseller model. Before jumping on the multisided-platform bandwagon, managers and investors should carefully consider where on the reseller-MSP continuum an intermediary belongs and understand that it may take one or more moves to get there. They must then be diligent about reevaluating that positioning as the competitive landscape changes. Otherwise, they may wake up to discover that their seemingly secure business has been upended by a disrupter from either end. ♥

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Andrei Hagiu is an associate professor in the strategy unit at Harvard Business School. **Julian Wright** is a professor of economics at National University of Singapore.