David Youngberg

Econ 280—Bethany College

**Lecture 18: Platform and Network Goods**

1. Mover Advantages
   1. So far, we’ve learned that sometimes the first mover has an advantage over the second mover and sometimes the opposite occurs.
   2. Let’s now discuss two specific goods, one of which clearly illustrates the power of mover advantages.
2. Network goods
   1. A *network good* is a good whose value to a consumer increases as the number of consumers who use it increases. In other words, consumers externalize a benefit to other consumers.
      1. Dating sites, social networking sites, some software, online gaming, standards of measurement, and trade hubs are all examples
      2. Note this doesn’t change the *cost* of the good. This isn’t about any cost saving techniques. This is merely about how value changes.
   2. A network good is an example of a coordination game.
3. Properties of network goods
   1. Network goods are usually sold by monopolies or oligopolies.
      1. Because the value increases the more people use it, network goods tend to concentrate around one or a few products. Thus one or a small number of firms will dominate the market.
      2. This doesn’t mean the monopoly is stable over time. Once, MySpace was bigger than Facebook. But then, MySpace was the monopoly.
   2. The “best” product may not win
      1. Again, we saw this in our coordination game: we can get locked into inferior products very easily.
      2. Internet Explorer is one such example. Everyone learns internet browsing on IE and so every computer has IE. We are lock into it, even though IE is far, far, far inferior to Google Chrome.
   3. Standard wars are common
      1. Because the winning company will likely develop into a monopoly, companies compete over what will become the industry standard. (E.g. Blu-ray versus HD-DVD.)
      2. This war plays out by getting different 3rd parities to sign up for one standard or the other until one side hits a critical mass.
4. Contestability
   1. A market is *contestable* if a rival firm could credibly take away business from an incumbent firm.
      1. It does not actually have to occur. It only *could* occur. The threat must be credible.
   2. In general, contestability increases as:
      1. Fixed costs of market entry are low, relative to potential revenue.
      2. There are few or no legal barriers to entry.
      3. The incumbent has no unique, hard-to-replicate resource.
      4. Consumers are open to the prospect of dealing with a new competitor.
   3. All firms are interested in limiting contestability in the market. But because, in network goods, firms compete for the whole market, they are particularly interested in limiting that contestability.
   4. One way they do that is by increasing *switching costs*—or the costs to switch to another product.
      1. Facebook lets you load as many photos as you want for free, but it does not make it easy for you to take those photos to Google+.
      2. Media put on your iPad or iPod isn’t easy to move to other products.
      3. Firms with customer loyalty programs make it hard for you to switch to other firms because you then give up “points” you’ve accumulated. (These programs are also a form of price discrimination.)
5. Platform goods
   1. A *platform good* is a good which increases in value for one type of consumer when a person of another type consumes it.
      1. Platform goods are sometimes called a two-sided market.
      2. In theory, there is nothing which stops platform goods from servicing more than two groups, but two is the most common and intuitive.
   2. This is a particular form of network goods. But instead of ***any*** person joining increases the value for everyone, one type of person joining increases the value for the other type.
      1. Examples: night clubs (connecting men and women); malls (connecting shoppers and retailers); and travel reservation services (airliners and customers)
      2. The more one group joins, the more valuable the good is to the other group. Men don’t go to night clubs where there are no women (unless, of course, it’s a gay night club).
   3. Typically, both sides pay to consume the platform good but price discrimination plays an important role here.
      1. Some groups will have a more elastic demand curve for others. Since platform goods are usually services, and the different groups are usually easily identifiable, price discrimination comes up a lot in platform goods.
      2. And because more of one group makes the other group more valuable, the manifestation of price discrimination is particularly extreme: some users get the good for free.
      3. We discussed this earlier: it is a cross-subsidy.
6. Example: Malls
   1. Malls are all about connecting retailers with customers.
      1. For customers, going to a mall is really convenient as it’s easy to go from store to store. The more stores, the better the mall.
      2. For stores, malls are great because there’s a lot of foot traffic. It’s easy for customers to duck into a shop and buy something.
   2. Stores have to pay rent to mall. That makes sense: they are taking up space.
   3. But so are customers. They take up space, use the bathrooms, make messes at the food court, use benches and play areas. But customers don’t have to pay (at least not directly).
   4. It’s because a customer’s demand for mall goods is more elastic than the stores’ supply for mall goods. Thus the stores’ rent subsidizes the customer.
   5. And stores are happy to do this: again, the more mall visitors there are, the more valuable their mall location is.