Every startup in Silicon Valley wants to be the next Facebook, with its one billion users, or LinkedIn, which just sold to Microsoft for $26 billion. And why not? Their business model is a beautiful thing: platforms (also known as two- or multi-sided markets) are asset-light and make money by sitting between different parties, controlling the market and taking a piece of every transaction. Consider Care.com, which connects parents and babysitters who would otherwise have trouble finding one another, and just as importantly, ensuring the reliability of the other party. If Care.com’s owners earn
a hefty commission, they’re doing so by making the world a better place, one babysitter match at a time.

But a platform isn’t simply a matter of connecting brick-and-mortar businesses to consumers via the web. You need to do something to make it so that your platform actually makes the buyer-seller relationship work notably better – or even creating markets where none could have existed without the platform’s nurturing hand. Which means that not every industry is susceptible to takeover by platforms.

You wouldn’t know that from looking at Silicon Valley, where platforms have been funded to solve any and all problems, including some where traditional markets are working just fine, and others where the platform doesn’t make things work all that much better. Consider, for instance, the startup that promises to do your laundry by connecting you to local Laundromats or get you food in real time by connecting you with local chefs. Laundry and cooking may be tasks that software engineers would rather not do themselves, but platforms haven’t made these chores any easier to deal with. They’re what our friend Pierre Azoulay, an economist at MIT’s Sloan School of Management, calls “the internet of things your mom won’t do for you anymore.”

Why aren’t these “platforms” valuable? Because a valuable platform is a “place” where groups meet to trade or otherwise transact in ways that would be difficult without the mediating hand of the platform. This includes ensuring that the right types of participants show up: Care.com, for example, allows sitters to provide third-party verification of their bona fides and – like so many other online platforms – enlists users themselves to maintain quality control. Parents rate sitters, and vice-versa, with the hope that a five-star rating provides at least some peace of mind to anxious parents.

What makes the platform model desirable is that once the market maker has inserted itself in the middle to create trade that wouldn’t exist in its absence, a cut of each transaction is theirs for the taking. If you think of a platform as a playing field, the owner is selling tickets to any player who wants to get onto the field, no matter which side he or she is playing on, or how many teammates have already joined. A company running a platform probably doesn’t care which team wins (in the sense of one side, or player, benefitting the most from the platform). It just wants to sell tickets to a lot of players and make sure the game is played on its turf. To do so, you have to ensure that the players you let onto the field actually enhance the platform’s value, so both sides stick around to play. (Your local little league team versus the New York Yankees isn’t a matchup that anyone really wants to see.) This service becomes more valuable with market “thickness,” so the bigger you get, the more indispensable you become and the less feasible it is for competitors to muscle in on your business.

As for the “things your mom won’t do for you anymore” startups, what problem are they trying to solve? What friction are they reducing? It’s really not much trouble to drop off your laundry or dry-cleaning at the place down the street, and then pick it up yourself. If you don’t like the hassle, it’s not much work to find one that delivers. That is, information costs, search costs, and transaction costs
are all pretty modest. As for services that connect hungry consumers with nearby chefs, those entrepreneurs discovered that while customers are relatively easy to sign up, the other side of the market – the chefs – are much more expensive. So expensive in fact, that it makes more sense for them to hire chefs to work in the companies’ kitchens. Which means that it’s not a platform anymore; it’s a vertically integrated firm, with all of the associated costs.

So what’s a hard problem that platforms should work on solving? Consider an example ripped from the history of economic thought: buying and selling used cars. As anyone knows who’s been through the process, one party has a lot more information than the other. Sellers can put one over on an unaware buyer for lots of reasons: they know if they’ve driven the car hard over dirt roads and gotten oil changes only occasionally. They know if they’ve had an accident that they repaired without reporting it. And so on.

Buying a used car from someone you don’t know and who makes no guarantees is already fraught. There’s a reason that authorized dealers who do eight-point inspections can charge more: they’re charging for trust and peace of mind. This is why George Akerlof, a Nobel Prize winning economist, focused on the market for used cars when he wrote his groundbreaking 1970 paper, “The Market for ‘Lemons,’” on asymmetric information: the differences in what buyers and sellers know about what’s being sold is so very obvious.

Solving this problem was exactly what eBay, the auction site, had in mind when it launched eBay Motors under the entrepreneurial eye of Simon Rothman. eBay used the now-familiar mechanisms of seller and buyer ratings, as well as an outside evaluation of the cars by services like Carfax. But its real advantage was serving as a clearing house for rare and hard-to-find collector models.

It’s still too early to tell whether platforms like eBay Motors will solve the larger problem of information asymmetry in the wider used car market. Many of its sales are simply used car dealers advertising the cars that you’d find on the lot, replacing the classified section of your local newspaper or Craigslist with a better interface. And many of the fixes they’ve employed bring them closer to pre-internet (in-person) used car transactions. Beepi, an eBay Motors competitor, allows buyers to inspect vehicles on delivery – and reject them within 10 days at the company’s expense if not fully satisfied.

But, at least, if the used car entrepreneurs of cyberspace succeed, they will in fact be solving a real problem. Dwell on that the next time an entrepreneur tells you how they’re going to hit it big with Dogwalkers.com.

Ray Fisman is the Slater Family Professor in Behavioral Economics at Boston University, and the coauthor of The Inner Lives of Markets


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