

Exercise Set 4 – Model answers

1. Describe, shortly, how the following exhibit network effects:

(a) WhatsApp group.

E.g. this suffices: Each additional user in the group adds a possibility for all the other users to communicate with her/him. A finer detail is that this effect can be negative, neutral, positive, or heterogeneous.

(b) The use of open source software, e.g. R or Python.

Even for use, there is a direct effect that results from the use of the same software making it easy to share code and development effort with others, quite similar to having a common language. The developers in these platforms benefit from the other developers as they can build on the large collection of ready packages. There are also positive indirect effects: users benefit from the community of developers and the developers benefit if they can develop something that is going to be widely used. This indirect benefit for the developers can come through pure altruistic motives or just through increased reputation (e.g. Linus Torvalds), but the developers of successful packages can also benefit through having something to show in the job market.

2. Is a typical retail store, e.g. your local supermarket, a platform? Why?

Typically we would not consider a retailer to be a platform as it is only serving one side of the market (shoppers) and is just procuring stuff from wholesale markets. This was wrong by many.

Considering the difference between a market place and a grocery shop may be useful. On a market place, a merchant may rent a slot to be able to have a desk to sell from. If the merchants cannot sell their stock, that is a risk for them. Each transaction is between the merchants and the buyers. The role of the market place is to facilitate the trade between the merchants and buyers. The market place sets the prices for sellers (the rent) and buyers (free access). The sellers set the prices for their products. A market place is a platform.

Things are different for a grocery shop. The shop owner purchases the goods on sale from the wholesale markets. If the goods are not sold, the shop owner carries the risk. Buyers make transactions with the shop only, not the wholesale market or individual producers of goods. The retail shop sets the prices for goods on sale, but does not influence wholesale market prices. The shop is in retail business.