A Guide to Marketplaces

Third Edition

versionone

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versionone

Version One Ventures is an early stage fund investing in mission-driven founders across North America. Founded in 2012 and with $100M+ in AUM across four funds, we have backed over 60 technology companies. We invest in marketplaces and SaaS as well as emerging technologies and industries such as crypto/blockchain, bio/healthcare, energy/climate, AI, and robotics. Version One is based in San Francisco and Vancouver, and is led by Boris Wertz, Angela Tran, and Max Webster.

To learn more about Version One, please visit www.versionone.vc

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PREFACE TO THE THIRD EDITION

Five years ago, we published the first edition of ***A Guide to Marketplaces***. At the time, we were working with a diverse group of marketplace startups and found there to be little content focused specifically on building marketplace companies.

Fast forward to 2020. Marketplaces are still a very important part of our portfolio, but much has changed. Marketplaces have evolved from products to services to information. We've seen the growth of managed marketplaces that take on additional parts of the value chain. After decades of waiting, B2B marketplaces are finally ready to have their moment. And we're excited by new crypto-native marketplace structures that were not possible in a pre-blockchain world.

Additionally over the past five years, our work with marketplace founders and startups has continued to inform our understanding of the challenges and opportunities that marketplaces face. Max Webster joined our team in early 2020, bringing his experience in decentralized energy markets and crypto/blockchain. And there has been an upwelling of great content on how to get a marketplace started. As a result, we realized it was time to refresh this guide.

In the third edition, you'll find an updated section on seeding initial supply and demand as well an entirely revised chapter on marketplace types, with new sections on B2B marketplaces, API-as-a-marketplace, and decentralized marketplaces. We've also refreshed existing concepts with new examples and references throughout the guide.

The first and second editions of the guide have been downloaded more than 50,000 times. We have received countless thank you emails, comments, and requests from founders and others. We have appreciated each and every note and we hope you find the third edition as useful as the first two.

We want to thank Jonathan Hsu, Li Jin, Julia Morrongiello, Andrew Parker, Bala Subramaniam, Connor Watumull, and Mike Williams for their invaluable feedback during the creation of this edition. This guide is a work in progress and we welcome any suggestions on how to make the content more relevant and helpful in your journey.

INTRODUCTION

The web changes everything. In just 30 years, the Internet has become so ubiquitous that it's hard to remember how things were done before.

Nowhere is this more true than with how goods and services are exchanged. Not too long ago, the marketplace was a purely local affair. Artisans and farmers brought their goods to the local marketplace to be sold. But when the marketplace moved online, it shattered the very notion of local and global. You're now able to buy anything and everything with just a few clicks, and vendors have unprecedented access to a global audience.

Let's take books as an example. Used and rare books were once limited to tiny backstreet sellers. If they were lucky, book-lovers might happen upon a prized out-of-print edition while browsing the aisles. Moving the process online brought about a radical shift. You just need to type in an author's name and title, and scores of choices will pop up from booksellers all over the world. If there's a book out there, it can be found. You can buy a hard-to-find copy of a used hardback from someone in San Francisco, read it, then sell it to someone else living in Dublin.

Boris Wertz saw this transition first hand. Back in Germany in 1999, he launched an online marketplace for books, JustBooks. In 2002, JustBooks was acquired by AbeBooks and by 2008, AbeBooks was doing several hundred million dollars a year in transactions between buyers looking for rare prints, limited runs, and used textbooks and the sellers who had them. AbeBooks was subsequently acquired by Amazon in 2008.

The online marketplace is a true example of a green-field opportunity. Whether it's rare books or home repair services, an online marketplace brings buyers and sellers together in ways that were never possible before. It creates new buying and selling opportunities. And, unlike an e-commerce site, anyone can build a marketplace with minimal capital requirements since there's no inventory to buy, build, or manage.

As a result, the marketplace business model has attracted countless entrepreneurs. When a marketplace works, it works really well. There's high potential for long-term profits at scale. And once a marketplace achieves widespread popularity, it's hard for others to compete. That's why you probably can name only one online auction site.

But, as many entrepreneurs find out, it's hard to get the virtuous cycle of supply and demand to reach liquidity. You need to ramp up both sides in near unison. If there are buyers but few sellers, the buyers leave. Yet if there are no buyers, how do you convince the sellers to sign on?

After AbeBooks was acquired by Amazon, Boris moved into investing, first as an angel investor and now with Version One Ventures, with Angela Tran joining in 2013, followed by Max Webster in early 2020. Over the past decade, Version One has invested in great marketplace companies, such as CryptoKitties, DemandStar, Dolly, Drover, Headout, Indiegogo, MagicBus, Nexus Mutual, Opyn, Patch, Roost, Shippo, SuperRare, Top Hat and Uniswap. We have learned from, and helped, many passionate entrepreneurs looking to break down the walls for how goods and services are bought and sold in their particular space.

What follows are some of the insights we've learned while observing, funding, and building marketplaces for more than two decades. There's no single way to build and scale a marketplace, but we hope this guide provides some insight to help you in your journey. Now let's get to work.

— *Angela, Boris and Max,*
October 2020

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INTRODUCTION TO MARKETPLACES

WHAT'S A MARKETPLACE?

Let's start with the basics. An online marketplace is a type of e-commerce site that connects those looking to provide a product or service (sellers) with those looking to buy that product or service (buyers). These buyers and sellers may have had trouble finding each other before, so the marketplace creates efficiency in an otherwise inefficient market. As Bill Gurley wrote:

> "The core reason that Internet marketplaces are so powerful is because in connecting economic traders that would otherwise not be connected, they unlock economic wealth that otherwise would not exist. In other words, they literally create 'money out of nowhere.'"

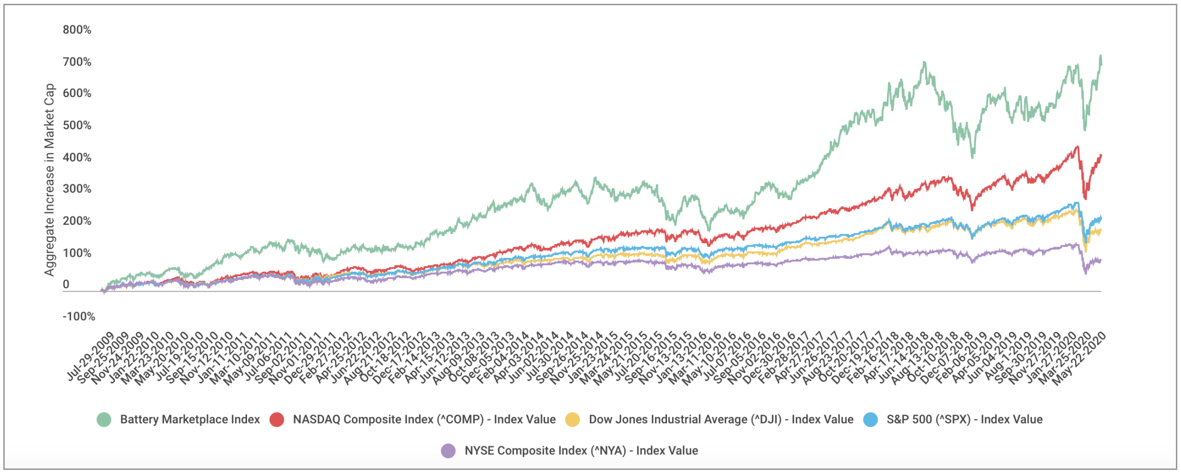
eBay's launch in 1995 sparked the first wave of product-focused marketplaces, and Uber's success in 2010 brought a second wave of marketplaces for services and combinations of product and service marketplaces (such as food delivery). Today, we're approaching a third wave of information marketplaces fueled by blockchain technology. And, B2B marketplaces, as well as SaaS-enabled marketplaces, are picking up steam.

With the explosion of marketplaces, there are now sites to connect bands with music venues, homeowners with snow plowing services, and students with used textbooks. The impact on day to day life cannot be overstated. From the way we order food, book a trip, or find a babysitter, it's hard to imagine life without online marketplaces.

Marketplaces now represent some of the world's most high-profile consumer businesses and generate a large amount of value for investors, as reflected in Battery Venture's Battery Marketplace Index. The index tracks the world's largest marketplace companies — companies must be listed on one of the major global stock exchanges and have a market capitalization of $500 million or more.

As shown in the following chart, returns for the index companies have outpaced the NASDAQ by a significant margin over the past seven years: nearly 205% for the marketplace index vs. approximately 156% for the NASDAQ.

Battery Marketplace Index



Source: [Battery Ventures]

While marketplaces spread across diverse market segments, there are two common elements to every online marketplace.

1. Marketplaces aggregate many sellers and their inventory.

What sets a marketplace apart from a standard e-commerce site is that the goods and services are supplied by a third party. In most cases, the marketplace platform acts as a type of digital middleman.

The independence of suppliers is an increasingly grey area when it comes to service marketplaces. Most on-demand service marketplaces like Uber, DoorDash, and Instacart stress the independence of their workforce, while other startups are taking a more managed approach to gain more control over the customer experience (see Chapter 4 on Marketplace Types).

2. Marketplaces include a transaction element.

A marketplace differs from a listing site by taking care of at least part of the transaction between buyer and seller. A true marketplace like eBay and Uber manages the entire transaction, from listing to payment processing, with the services and goods delivered offline.

For the purpose of this handbook, we're also including those marketplaces where transactions are initiated but not processed on the platform — for example, lead generation sites like Thumbtack where providers send quotes through the platform.

MARKETPLACE TYPES

A marketplace can be categorized in terms of its participants on both the supply and demand side:

- **P2P (peer-to-peer):** This is a grassroots transaction where private individuals sell their goods to other private individuals. For example, the early days of eBay and Airbnb were dominated by private individuals.
- **B2C (business-to-consumer):** As a marketplace gains traction, its seller base professionalizes as two things happen: 1) existing businesses see the opportunity and sign on to the platform and 2) private individuals find success on the marketplace and formalize their activities into a business.
- **B2B (business-to-business):** In these marketplaces, a business entity transacts with another business. Alibaba has become the biggest player in this group by reducing the friction for North American companies to find suppliers in China. We've yet to see the large-scale success of B2B marketplaces across the full spectrum of verticals, but we believe there's a massive opportunity for new B2B marketplaces to transform inefficient supply chain processes, as we'll discuss in Chapter 4.

FAST FACTS: TOP MARKETPLACES

Alibaba
711m buyers (Q4 2019)

eBay
174m buyers (Q1 2020)

Airbnb
750m+ guest arrivals (Q4 2019)

Etsy
2,814,000 active sellers and 47,748,000 active buyers (Q1 2020)

Uber
111m monthly active riders (Q4 2019)

Amazon
5MM+ third-party sellers (Q4 2019)

TWO METRICS FOR ANY MARKETPLACE

We'll discuss marketplace metrics in detail in Chapter 5, but the two key metrics for any marketplace startup to understand are:

1. GMV (Gross Merchandise Value):

GMV is simply the total dollar value of everything sold through the marketplace in a given time period. This is a different and much bigger number than the platform's revenue. Net merchandise value is GMV minus the value of returns (products) or cancellations (services).

- Accurately calculating GMV can be tricky for marketplaces where transactions are initiated on the platform but completed offline.

2. Take Rate:

Take rate is the percentage of transaction value that the marketplace collects in fees. Setting the take rate is typically the cornerstone of a marketplace's monetization and business model.

- The more value a marketplace provides, the more it's able to charge in fees. For example, if a marketplace enables suppliers to find new buyers, then suppliers are more likely to tolerate higher fees.
- The more fragmented the overall market, the higher a marketplace's take rate can be. That's because high fragmentation reduces the negotiation power of marketplace participants.
- Keep in mind that the take rake can be considered a marketplace's direct revenue, with fees from value-add services like promotions, discovery, and platform contributing to indirect revenue. Some marketplaces like Etsy have done an incredible job with ancillary revenue — increasing overall revenue without touching the take rake.
- When transactions are concluded offline, it's hard for a marketplace to track those transactions and monetize based on take rate. In Chapter 3, we'll discuss other monetization strategies for these situations.

SELECTING THE RIGHT MARKET

Bill Gurley of Benchmark Capital wrote the definitive post on which markets are the best fit for marketplaces in "All Markets Are Not Created Equal: 10 Factors To Consider When Evaluating Digital Marketplaces."

While Bill laid out ten factors, we believe six to be the most essential:

1. High fragmentation

It's much easier to start a marketplace when there are a lot of uncoordinated suppliers and buyers. When there are just a few suppliers, they'll likely resist the arrival of a new intermediary in their market and won't want to share in the economics — resulting in a low take rate for your marketplace. For example, travel marketplaces have had more success with hotels, not airlines. In addition, a marketplace can create the most value in a highly fragmented market, since there's a true need to help buyers and sellers find one another.

2. The buyer-seller relationship: monogamy vs. playing the field

In those markets where buyers are fiercely loyal and use the same supplier every time, the value of a marketplace is reduced. For example, once consumers find a doctor or cleaning service they like and trust, it's easier to stick with the known provider rather than take a chance on, or spend time searching for, someone new. This means there's little need to use the marketplace again. The same dynamic is also true with commoditized products where you source products from the same supplier (e.g. diapers on the consumer side and raw materials for businesses).

3. Higher frequency

Bill Gurley said, "All things being equal, a higher frequency is obviously better." DoorDash, OpenTable and Uber are high frequency use cases, where consumers rely on the marketplace as a utility. When evaluating frequency, it's important to differentiate between how often a buyer uses a service and how often they use the marketplace. For example, you might need a babysitter every day, but you only look for a new babysitter every two years (back to point #2).

4. Total Available Market (TAM)

As with any new business opportunity, a proper TAM analysis is imperative. How big is the total available market and how much can you capture? Keep in mind that the best online marketplaces create new value; therefore, the current market size does not necessarily paint an accurate picture of the opportunity.

For example, Uber's convenience has greatly expanded the car service market to more users and geographic locations. Gurley gives an excellent analysis on Uber's impact on the overall market size of the car-for-hire transportation market.

5. Transactional: Being part of the payment flow

When buyers and sellers need the marketplace to exchange money, the potential take rate is much higher than when transactions happen offline. Think about it this way: When a marketplace handles the transaction, it pays the supplier their portion of the revenue with the fees automatically deducted, instead of having to send them a bill at a later date. This makes fees much more palatable to most sellers.

6. The ability to expand the overall market and create value

Virtually all marketplaces create efficiency: they make it easier for buyers and sellers to find each other and complete a transaction. But not all marketplaces create value equally.

For example, marketplaces may connect schools with substitute teachers, visiting doctors with hospitals, commercial landlords with retailers interested in setting up pop-up shops. These all certainly increase efficiency, but they might not necessarily expand the market. The likely reason is because there's finite supply and finite demand. In other words, a new marketplace won't create a new crop of teachers or doctors, or schools and hospitals. And in the absence of a new online marketplace, both sides would probably find each other eventually, albeit in a less efficient way.

The best marketplaces can tap into new groups of participants and grow the overall number of transactions. The sharing economy is a great example of creating value. People who never thought they'd be landlords or hotel proprietors are now hosts on Airbnb. People who never thought they'd transport people for money are now drivers on Uber. These platforms empower whole new groups of people to become sellers.

> More sellers = more participation on the platform = more liquidity = more transactions = more overall value.

You don't need to hit all six criteria (or all ten on Bill's list) to build a good marketplace. But the better you score, the higher the overall potential of the marketplace. And underlying all six factors we consider the magnitude of potential value creation.

SUCCESS FACTORS: HOW TO WIN AGAINST THE INCUMBENT

The narrative of the little guy going up against the giant is baked into the culture of Silicon Valley. There's always an incumbent marketplace (even if it's Craisglist), so finding the right business model to break into an existing market is critical for any new marketplace.

Any newcomer should focus on the incumbent's most important weakness and that weakness will be different for each situation. Some of the common strategies are:

1. Lower the take rate.

According to Albert Wenger of Union Square Ventures:

> "I don't see take rates of 20% or more as sustainable in the long run. Why? Because they (a) impose too heavy a tax on marketplace activity and (b) produce too much profitability for the marketplace operator. The first is bad from the perspective of efficiency as it will crowd out some transactions that would benefit from taking place in the market. The second will provide the incentive for competing marketplaces to be created."

For example, Craigslist offered free listings to compete with the paid listings in the traditional classified sections of newspapers. Applying Clayton Christensen's theory of the Innovator's Dilemma, most incumbents find it hard to follow down the market. They brush off an upstart as being too small or too low-end to matter. By the time the incumbent finally gets around to addressing the new innovator, the upstart has already found traction.

However, unseating an incumbent based on lower take rate alone is difficult, since the network effects of the existing marketplace will make it hard for a newcomer to build any momentum. You'll typically need to differentiate in other ways in addition to lowering the take rate.

2. Go vertical.

A startup can unbundle a generalized marketplace and focus on creating the best product for a specific vertical. Many marketplaces have struck gold by picking one thing and doing it extremely well. For example: StubHub vs. Craigslist and HotelTonight vs. Expedia.

This is a strategy that has been spectacularly effective for many verticals and the market map that venture capitalist Andrew Parker created back in 2010 has become the blueprint for tracking the different companies that have chosen to carve out niches from Craigslist. David Haber offered an updated chart at the end of 2012 to demonstrate just how effective the vertical strategy can be.

GO VERTICAL: THE SPAWN OF CRAIGSLIST

Source: The Gong Show, Andrew Parker, 2010

Source: David Haber, TechCrunch, 2012

In some cases, marketplace businesses build traction in smaller verticals before expanding their reach. Geographical marketplaces often nail one location before expanding into new territories. DoorDash began as Palo Alto Delivery. Indiegogo first went after the indie film market before opening up to other categories.

Expanding outward from the niche can also happen organically as sellers start listing items in new categories. For example, Etsy sellers began listing craft supplies and tools and this category has become one of Etsy's largest today.

Keep in mind that category expansion doesn't always work as planned. When Boris was COO at AbeBooks, he thought they could expand the site into new books. Despite a strong selection at competitive prices, the new books category never lived up to expectations and most of the buyers stayed with their existing retailers (mainly Amazon).

3. Develop a 10x better product.

Another strategy is to build a product that is ten times better than the incumbent's. This has been one key to the early success of Facebook Marketplace, OfferUp and LetGo vs. Craigslist (though one could argue, as Albert Wenger did back in 2009, that mere market expansion explains a lot of this growth as well). Or Uber's success against the taxi industry. Think about how Airbnb's fortune changed when they started using professional photography.

Keep in mind that sometimes a 10x better product itself isn't enough. Benchmark's Sarah Tavel wrote that multi-billion dollar businesses build a 10x better product while also recasting incumbent cost structures. In other words, a better product might not be enough if only the very wealthy will be willing or able to afford the service or convenience. She wrote that a 10x better product and saving people money is the undercurrent running through dozens of breakout companies, including Uber, Airbnb, and WhatsApp.

Lastly, these kinds of opportunities are rare and hard to pull off, because the incumbent's network effects often outweigh any product improvements.

4. Offer unique inventory.

A marketplace startup can also focus on the supply side, and identify opportunities to bring unique inventory to underserved markets. This strategy certainly helped Airbnb against HomeAway, as well as Etsy against eBay.

In some cases, you can even create supply that didn't exist before. Prior to Airbnb's success, there wasn't much incentive for people to post their unused space. Not many people would be comfortable advertising a room in their apartment on Craigslist. Now, Airbnb is a primary source of income, or at least a major supplemental source of income, for a lot of folks.

And a new wave of career training startups like Lambda School, Flockjay, and SuperHi have created their own unique supply of well-trained programmers, sales professionals, and creatives to place with a variety of tech companies, offering the potential to become the talent marketplaces of tomorrow.

4. Start with SaaS.

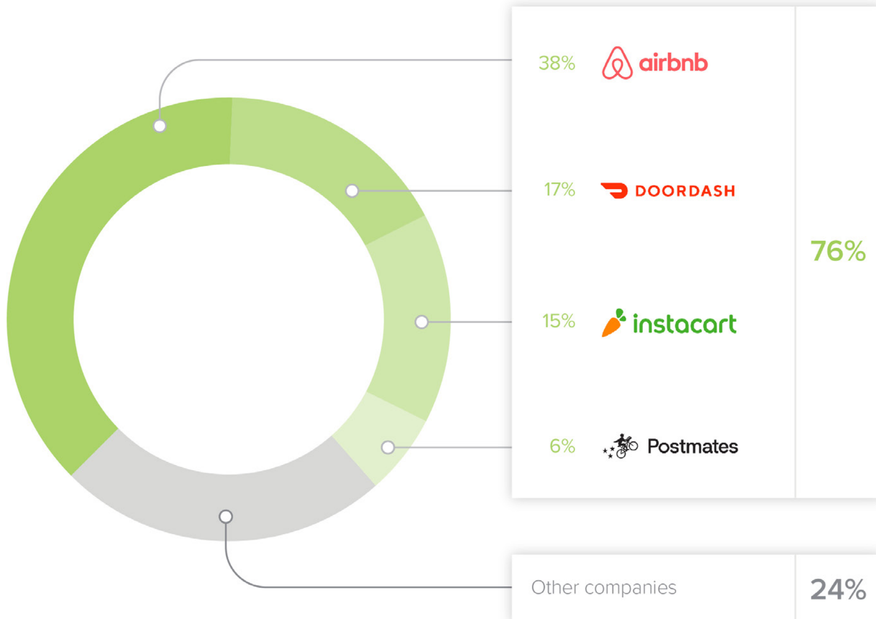
One final strategy is to start with SaaS and expand into a marketplace, as we're seeing now in the Shopify vs. Amazon battle. Shopify began by offering easy-to-use SaaS to democratize starting online businesses. With over a million merchants on their platform, it now makes a ton of sense for them to aggregate this supply into a marketplace with easy discovery for buyers. The newly revamped Shop App is their first attempt at this ultimate goal. Another classic example is OpenTable, which began by offering booking and POS SaaS to restaurants. Once they had enough aggregate supply, they started matching customers with those customer restaurants.

MARKETPLACES AND NETWORK EFFECTS

One of the main reasons why investors and entrepreneurs love marketplaces is the power of their network effects and how it creates a high degree of defensibility for startups.

While network effects can be difficult to unlock, once they are, the upside is incredible — particularly with high frequency/large GMV industries like food and travel. In a16z's Marketplace 100 (a ranking of the largest and fastest-growing, consumer-facing marketplace startups and private companies), the top four companies — Airbnb, DoorDash, Instacart, and Postmates — account for 76 percent of the list's total observed GMV.

Marketplace 100: Four marketplaces account for 76 percent of observed GMV



Source: a16z, https://a16z.com/2020/02/18/marketplace-100/

What exactly are network effects? It's more than just a large number of users — network effects kick in when the value of a product depends on how many other users there are. When a new user/member is added to the network, it increases the value of the product or service to all other users. This increased value can come in the form of cost reduction (in user acquisition as an example), higher liquidity (in a marketplace), stronger community or deeper relationships (in social networks), etc.

Generally speaking, network effects are categorized into two types: direct and indirect.

Direct Network Effects

The simplest network effects are direct: an increase in usage leads to a direct increase in value for all other users. Social sites like Facebook, Twitter, and Wattpad have a direct network effect. If you join Facebook and start sharing content I'm interested in, Facebook becomes more valuable to me

When we think about direct network effects, we consider the roles of the participants. In a marketplace, users are buyers, sellers, or sometimes both. Likewise, in a community or social platform, users can be content creators, content consumers, or both.

In a marketplace, the roles of a buyer and seller are typically distinct — effectively creating two-sided network effects. When there's overlap between buyers and sellers, it's easier to get your network off the ground at the beginning as you'll achieve liquidity more quickly. For example, in Etsy, Craigslist, and Airbnb, we see some overlap between buyers and sellers (or hosts and guests in Airbnb's case).

While overlap helps a marketplace at the beginning, two-sided network effects add to the defensibility of your marketplace over time since there's more fragmentation. For example, with Uber, there's little overlap between drivers and riders.

We also need to consider how network effects fall on the local-global spectrum:

- Local network effects: The value-add of a product may not increase with the overall size of its user base, but is dependent on the size of a smaller subset. In this case, a user's experience might be influenced directly by the number of people and actions of a small subset of users (i.e. connections through the user's personal/professional network or neighborhood). We see local network effects at play with the on-demand economy like food delivery, instant messaging, and social networks.

- Global network effects: These take place with a larger-sized network with few barriers in payment or language. Airbnb is today's best example of global network effects creating a dominant market position. And while Facebook is not a marketplace, Dan Rose had an interesting Twitter thread about Facebook's global network effects power beating out local network effects in Germany. Keep in mind that some marketplaces, like Etsy, will fall between local and global network effects, as there can be shipping and language limitations.

Indirect Network Effects

Network effects can also be indirect. In these cases, when more people use a product or network, it sparks the production of complementary products and goods — thus increasing the value of the original product. A common example is with hardware and software: the more people that use a hardware product, the more likely it is that developers will build software and apps for that hardware.

Indirect network effects can also apply to marketplaces. Developers often build applications and products on top of APIs of existing marketplaces and platforms. For example, Shopify has a very active developer/value-add app ecosystem. In addition, countless services sprout up to support popular platforms — like Airbnb management services (Guestly) and driver rental car options for Uber/Lyft (Drover).

How do network effects differ from virality?

When information can be shared rapidly and widely from one user to another, or when the rate of adoption increases with adoption, we have virality. In other words, the product grows faster as more users adopt it (to a certain limit). Jonathan Hsu, co-founder of Tribe Capital, has called virality a network effect on growth.

While network effects and virality often go hand-in-hand, not all network effect products are viral, and not all viral products have network effects. For instance:

- Marketplaces are not necessarily viral, even though they have network effects. While you can achieve some virality through incentives, the two-sided network effect does not lend itself to adoption of users on one side to come on-board with invitations/interactions from the other.
- News outlets, gaming, and communication products can be highly viral products without strong network effects.

As you build your marketplace, don't fall into the trap of confusing network effects with virality. While virality depends on the type of marketplace, network effects are critical to scaling and sustaining a marketplace. Think about how users benefit each time someone else participates, and in what way: directly or indirectly. Understanding how network effects impact your startup brings you one step closer to building a more defensible product.

In addition, we can't underestimate the importance of network effects data to the success of a marketplace. Tophatter, a mobile e-commerce marketplace with no prior data infrastructure or data background, has been refining its marketplace by making decisions about which products go into the marketplace (e.g. seller-side analytics to determine which items and sellers are good). Their goal is to build a personalized marketplace for each buyer. They built the right data infrastructure to generate and evaluate personalized recommendations for users on the platform.

The result has been a 30% increase in clicks. The company is expecting to make $100 million in revenue in 2017, compared with nearly $40 million in 2016. Much of this growth is due to how data-driven the company is, especially when it comes to recommendations.

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SEEDING, GROWING, AND SCALING A MARKETPLACE

STAGE 1: SEEDING A MARKETPLACE

The earliest days in a marketplace are a tricky time. There's a chicken and egg problem when it comes to supply and demand: customers need supply, and suppliers need customers. But it's nearly impossible to ramp up supply and demand in lock step.

We've found that in most cases it's best to focus on building up the supply first. That's because there's more incentive for sellers to invest their time for greater distribution in the early days. There is zero motivation for customers to come without any inventory.

In the long run, however, aggregating demand is critical for defensibility. As Ben Thompson notes in his seminal works on aggregation theory, in a world with abundant supply, the only real differentiator is the trusted relationship with demand. We've seen this play out with the last two waves of Internet platforms and marketplaces from Google to Airbnb to Uber. Bill Gurley echoed a similar sentiment: "A lesson I have learned many times in my 20 years as a marketplace investor is that aggregating demand is the one & only key."

In this section, we'll cover some techniques for aggregating both supply and demand.

Aggregating supply

Here are five common strategies to help seed supply at the beginning:

1. Identify unique inventory: One of the best types of suppliers to target are those people who don't already sell online. For example, Etsy went after the producers of hand-made goods. These designers and crafters found their unique goods buried within eBay's massive inventory and typically resorted to selling their items locally at craft shows, farmers' markets, etc. Etsy came along and brought these local experiences online.

The advantage of focusing on unique inventory is that it won't take much effort to persuade providers to join once they're made aware of your site. In addition, these types of sellers will typically bring along some of their own buyers, helping you ramp up your customer base at the same time.

2. Convince existing sellers to list on your platform: If your ideal suppliers already have an online outlet, you'll need to be creative and exert more energy to convince them to join your young marketplace. In many cases, this means hitting the pavement (or phones) with direct sales efforts — an example of Paul Graham's advice of doing things that don't scale. For example, in the early days Airbnb emailed Craigslist listers and encouraged them to check out Airbnb.

While researching how some of today's biggest marketplaces drove initial supply, Lenny Rachitsky found that one-on-one direct sales was a crucial lever for about 60% of the companies he spoke to. For example:

- **GrubHub:** "Supply growth was all sales — door to door, walking into restaurants during their downtime, talking to owners. It was very sales driven. What we did was take every excuse they had for not using GrubHub, and removed it as an obstacle." - Casey Winters (ex-growth at GrubHub, CPO Eventbrite)

- **OpenTable:** "On the restaurant side, unfortunately, there were no easy levers early days. It was hire a direct sales force on the street. People on the street knocking on doors, carrying the software. Demo'ing it and showing them how it worked." - Mike Xenakis

- **Etsy:** "The main thing that I believe really worked was recruiting sellers in person at craft fairs and elsewhere." - Dan McKinley

- **Uber:** "Uber Black was initially ops and phone driven. They would call limo companies to pitch them." - Andrew Chen

3. Bring customers to a provider: With service marketplaces, one of the easiest ways to build early liquidity is to approach a provider with a customer opportunity already in hand. A ready-to-go, paying customer is much more compelling than a sales pitch about future potential.

For example, some restaurant delivery startups started out by scraping the web for menus from local area restaurants. Then, when a customer placed an order on their site, the startup went to the restaurant to get the order fulfilled.

There are two challenges with this approach. The first is that the provider's information (e.g. restaurant menu) needs to be available and up-to-date. Then, there's always a risk that the selected provider won't convert and you'll end up leaving your customer high and dry. Even if a different provider fulfills the order, you may not be delivering a perfect experience to the customer.

4. Pay for inventory: An early growth hack at Boris' startup JustBooks was buying books to list so they didn't have an empty site. When Uber launched in Seattle, they paid town car drivers to idle. This generated the supply, and once the customers and money started rolling in, they switched those drivers over to commission.

Buying inventory artificially creates supply, improving the way the marketplace works at the outset. It's an easy way to get inventory in the early stage, but it's not scalable as it obviously gets expensive to buy and manage inventory yourself.

5. Aggregate readily accessible inventory: Another strategy is to aggregate inventory that's already listed somewhere, for example through affiliate programs. This approach will provide the initial scale that you're looking for, but there are several key drawbacks. First, while you may have a lot of inventory, none of it will be unique. Why should buyers come to your site instead of the other sites you're pulling inventory from?

The second problem is that when you aggregate existing inventory, you run the risk of becoming a cross-platform utility rather than your own marketplace with lots of highly engaged users. Fred Wilson discusses this issue with regard to networks, but his words are equally relevant to marketplaces:

> "If the initial utility of an app is to connect to a bunch of networks, collect information, present it, and then let the user engage with one or more of those networks, what incentive is there for the user to engage directly with other users of the app and help build a network inside of it?"

With that said, aggregating existing inventory can be an effective way to kick-start your marketplace early on. That's what our portfolio company Dwellable did before quickly transitioning to their own inventory.

6. Capitalize on referrals and brand ambassadors: You can incentivize your existing supply to refer new supply. Lenny Rachitsky found that one-third of the marketplaces he researched used a referrals program as an early lever to grow supply. He quoted Benjamin Lauzier from Lyft:

> "Referrals and ambassador programs were big for us early on. Double digits of %'s of new supply early on came from these programs. We went after students because our primary audience was younger and millennial...We had tiers of rewards — the top tier was essentially a part-time job. As a reward at the top tier, we gave you a letter of recommendation from the COO of Lyft, which many students valued very highly, and was very cheap for us. Referrals (online program) was more impactful top-line, but Ambassadors (people referring users on the ground) were a key piece to the launch strategy in each city — seeding supply and demand ahead of launch."

Want more examples and tips on growing supply? Read Lenny Rachitsky's guest post, "28 Ways to Grow Supply in a Marketplace," on Andrew Chen's blog.

No matter which approach you use, it's easier to build a strong community if there's a large overlap between buyers and sellers. For example, think about the number of Airbnb hosts who stay with other hosts during their own travels. Likewise, sellers on Etsy also make purchases since they appreciate handcrafted goods. Peer-to-peer marketplaces are more likely to have sellers that double as customers and vice-versa.

Aggregating demand

The reality is that there is no one-size-fits-all solution to aggregating marketplace demand. There are many dimensions to consider including the size and frequency of purchases or geography. The only real answer is to run a variety of experiments (which likely won't scale) and see what works. Here are some examples of successful strategies we've seen.

1. Word of mouth: The single best marketing that any company can hope for is word of mouth. Nothing beats an unsolicited recommendation from one trusted friend to another. And with no upfront costs, this is the most sustainable growth strategy as well.

In order to unlock the maximum amount of word of mouth, you must first confirm that you're actually solving a problem for some segment of society. Once you've confirmed that you're actually making something people want, it's then critical to focus on making that user experience as easy and delightful as possible.

As Sarah Tavel explains, your goal is "to create meaningfully more happiness in the average transaction than any substitute." She outlines several questions to help determine how well you're increasing happiness for buyers:

- How easy or hard is it to find and choose a match?
- How easy or hard is it to place an order?
- What's the error rate (e.g., no response from supplier, not what was expected)?
- What is the economic or time value a buyer gets vs. other platforms?
- How happy are buyers with what they received?

If you provide a seamless solution to a meaningful problem for a defined group of people, they will end up as your best demand aggregators.

2. Referrals and brand ambassadors: Beyond simply hoping that users love your product and will tell their friends about it, many early marketplaces experienced success with paid referral programs. Note that these tactics are also successful on the supply side as covered above. Some classic examples include Uber, Airbnb, Eventbrite, and iStock. These programs are often double-sided so users feel good about referring a friend — sign up for this app and both parties both get $10. What's not to like?

Different companies have had success with different versions of brand ambassador programs. Some, like Uber, used street teams to sign up new customers at busy stores. We've seen that word can spread particularly quickly on college campuses. Max used this college ambassador strategy to create a top sales channel at Bright (the Sunrun of Mexico).

3. Offer value in single player mode: One of the best ways to kick-start demand for any network is to build a tool that offers standalone value to users in single player mode and then expands into even more value once the network grows around it. Chris Dixon lays out some excellent examples here with Delicious (initially offered a cloud service for web bookmarks) and Instagram (initially offered an easy to use set of filters to take beautiful photos).

4. SEO and performance marketing: Once you have a clearly defined customer segment for whom you're solving a clear problem, the challenge becomes finding that customer online. Two of the most direct ways to do that are via SEO and paid performance marketing (e.g. Google and Facebook ads). SEO is an incredible long-term tool, but requires continuous updating. Paid marketing may be the most straightforward of all, but may be prohibitively expensive for sustainable growth. Either way, early rounds of SEO optimization and paid growth may be effective initial steps to start a flywheel.

5. Create a brand and mailing list first: Given that a customer's trust in a brand is the most difficult thing to build, it can make sense to begin building those relationships prior to launching a marketplace. Two of the more effective ways to do this could be through creating a mailing list, blog, or podcast that delivers free and valuable content related to a customer's pain point.

The bottom line is this: if you are building a marketplace, you need to devise an effective strategy for ramping up supply. The next stage is getting to that virtuous cycle of supply and demand.

STAGE 2: HOW TO SPARK THE VIRTUOUS CYCLE TO GROW A MARKETPLACE

The virtuous cycle is the holy grail for online marketplaces. In this positive feedback loop, a high number of quality suppliers attract more customers; then more customers attract more suppliers to join. This cycle continues as a self-sustaining growth engine until both supply and demand reach critical mass to be "winner takes all."

But how does a marketplace create the momentum for a virtuous cycle in the first place?

Identify and double down on the hot spots.

One of the most important things you can do is identify and double down on the things that work in your marketplace. As you start scaling, there will be many matches and transactions between buyers and sellers. But not all matches are created equal. Identify where things are clicking on both the supply and demand side. This could be in certain geographies, audience segments, price points, and user behavior.

Then you'll want to double down on these hot spots, often following Paul Graham's advice to do things that don't scale. Don't worry that the absolute numbers hardly seem worth the effort. At this point you're just trying to get the virtuous cycle going. If the market exists, you can recruit your suppliers and customers manually, then switch over to less manual, more scalable, methods.

> "At some point, there was a very noticeable change in how Stripe felt. It tipped from being this boulder we had to push to being a train car that in fact had its own momentum." Patrick Collison, Stripe

Airbnb is a classic example. Founders Brian Chesky, Nathan Blecharczyk, and Joe Gebbia frequently traveled to NYC to acquire their early users. When they realized that high quality listing photos were key to attracting customers (and differentiating the experience from Craigslist), they rented a $5,000 camera and went door to door, taking professional pictures of as many New York listings as possible. This approach led to two to three times as many bookings on their New York listings.

> "When New York took off, we flew back every weekend. We went door to door with cameras taking pictures of all these apartments to put them online. I lived in their living rooms. And home by home, block by block, communities started growing. And people would visit New York and bring the idea back with them to their city."
> – Brian Chesky, for The Atlantic

Be Patient: marketplaces take time.

With a typical SaaS or e-commerce startup, you probably should reassess your market or model if you don't see signs of traction after six to nine months. However, this timetable is way too accelerated for marketplaces. Considering you need to establish both buyer and seller communities, you will need more time to prove your business. It can take three years for a marketplace to get going.

Looking at a Version One portfolio company, the crowdfunding platform Indiegogo was founded in 2007, but its breakout year didn't come until four years later.

This means that founders need to believe in their idea even when no one else does. But that doesn't mean turning a blind eye to the market. You've got to continually look for small signals that you're on the right track — such as increased word of mouth from early adopters, increased repeat usage from buyers, increased listings from sellers, and positive user feedback.

Just as important, investors need to stay patient. No two-sided marketplace is built overnight.

STAGE 3: SCALING A MARKETPLACE

As a marketplace figures out how to bring buyers and sellers together and builds liquidity, the virtuous cycle starts kicking in. Growth quickly accelerates. The ultimate goal is that a successful startup grows into a big company. But as you begin to scale, you'll need new strategies to keep the forward progress going.

1. Foster trust and safety.

A certain level of trust is required for any transaction to take place. During the early days of your marketplace, you may have a small and passionate community. As such, trust and safety are not significant concerns. However, as a marketplace grows and gains popularity, it will inevitably attract some bad actors. As one TechCrunch commenter wrote back in 2008, responding to an article on Airbnb:

> "If this ever becomes mainstream, the whole thing will come crashing down. The kind of people that *DO* rob, abuse, rape and murder people will start using these systems, and that will spread legitimate fear, corrupting the whole thing. Pray that this remains underground, that's the only way it can survive."

Your job as a marketplace is to fight these bad actors proactively, so both buyers and sellers have confidence in the platform.

Transparency is one of the most effective ways to establish trust and credibility. This can be done with a rating system, user reviews, or testimonials. Some platforms act on this data to weed out the bad users (both buyers or sellers). For example, you'll never see an Uber driver with a rating lower than three stars. Uber filters these drivers out, so customers don't have to sift through driver reviews before getting a ride. On the flip side, riders are also rated, so drivers can feel safe with their pickups too.

Providing some level of guarantee — be it for service quality, delivery time, or payment — is critical for instilling trust on both sides. If your marketing claims you'll be at your customer's doorstep in 15 minutes, you need to make sure you can deliver on that promise. If a buyer never received their item, you'll need to be ready with a money-back guarantee. And, whenever the terms of the transaction are broken (on either side), you need to follow up with a very personal response.

2. Support your power sellers.

In addition to solving trust issues, the next step to scaling a marketplace is to support your power sellers — those sellers who earn a living off your marketplace. This approach may seem counter intuitive for some startups that are typically used to pleasing end users (the buyers). But to be successful at scale, a marketplace needs good supply.

eBay offers an official PowerSeller program where qualified sellers get priority customer support, unpaid item protection, a "top-rated Seller" designation, and other promotional offers. eBay does a great job organizing its local eBay On Location events to connect its sellers, provide additional learning/selling resources, and build a sense of community and identity around being an eBay seller.

3. Develop an ecosystem.

Think about add-on products, services, and experiences that give sellers a deeper connection with your marketplace. These are incredibly effective ways to differentiate the selling experience on your marketplace from other sites, and lock sellers into your site.

The first approach is to develop or offer these add-on products and services yourself. In the early days, Uber connected its drivers with exclusive leasing and financing deals and offered drivers who completed at least 100 trips each month a partner Fuel Card for gas and car maintenance purchases. The card offered a discount at participating gas stations/mechanics and charges were deducted from one's Uber earnings.

The second approach is to support the third-party services that spring up around your site. Marketplaces have a tremendous opportunity to scale into a platform with an entire ecosystem of value-added services and startups.

The success of Airbnb has sparked an ecosystem of value-added services, with startups offering property management services, guest screening, catering, and guest hop services for hosts. We saw a similar ecosystem emerge around eBay, with companies forming to take care of shipping, photos, insurance, and consignment.

Shopify has done an excellent job of understanding the role that third-party developers play in enhancing Shopify's overall value to sellers. In the Shopify App Store, sellers can find third-party apps for selling, marketing, inventory management, customer support, shipping, reporting/analytics, and more.

4. Prevent leakage.

With many marketplaces, there's a real risk that buyers and sellers will settle the transaction off platform, preventing the marketplace from capturing any revenue from the transaction it worked so hard to put together. Charles Hudson provided a great analysis on the role of a well-designed rating system to combat leakage. In order for a rating system to have an impact, suppliers need to value their rating and buyers need to trust the quality of the rating system. For example, with Uber, drivers and riders are matched partly by their ratings and scores. This creates a strong incentive for both the provider and buyer to care about their score and keep the transaction on the platform.

5. Build a moat.

As any marketplace gains popularity, its supply inevitably becomes less and less unique. From Boris' first-hand experience, booksellers once were exclusive to AbeBooks, but then started to list with Amazon after it launched its marketplace. Uber and Lyft drivers typically begin with one service, but often end up driving for both.

Marketplace uniqueness can be diluted even when suppliers don't intentionally leave. For example, Etsy struggles with design copying, including complaints of major retailers mass-producing products that look extremely similar to its handcrafted artisan designs.

When building a marketplace, it's safe to assume that the uniqueness of your supply will fade over time as your suppliers seek out opportunities on other marketplaces and competitors look to grab a piece of the pie that you discovered. In this case, building a moat comes down to protecting supplier and buyer mindshare. Sarah Tavel summarized this perfectly in The Hierarchy of Marketplaces: "Never forget: happiness, not scale, is your moat."

Protecting your supply

Don't give your sellers any reason to seek out other marketplaces. For example, you can:

- Lower listing/transaction fees for unique inventory (see Boris' post Is the Freemium Model the Future of Marketplaces?).
- Tie sellers to your site through reviews that cannot be transferred to other marketplaces. As we mentioned above, you can refer to Charles Hudson's post on Marketplaces, Rating Systems and Leakage.
- Create an innovative model like Uber's Vehicle Solutions program that offers rentals and partnerships to help drivers access a car for an hour, a week, or however long they need.
- And do whatever you can to reduce friction for suppliers at every stage.

3

FINDING THE RIGHT BUSINESS MODEL FOR YOUR MARKETPLACE

Many entrepreneurs come up with a great idea for a marketplace, but then fail to find the right business model that will translate their activity into profits. The challenging part of monetizing a marketplace is that buyers and sellers are looking to complete transactions with one another, and fees introduce friction to the process. Whichever party is charged a fee will naturally try to conduct the transaction off-platform whenever possible.

Finding the right business model depends entirely on the characteristics of your market:

- If customers are comfortable buying products/services over the marketplace with little back and forth, then seller transaction fees (complemented with additional seller services) are most likely the way to go.
- If the marketplace acts purely like the classifieds (no transactions), listing fees make more sense.

In general most marketplaces take fees from their sellers — either through listing fees, lead generation fees, or transaction fees. The primary reason for monetizing the seller is simple: after you've seeded the marketplace with initial supply, demand becomes the limiting factor for marketplace growth. Charging buyers creates friction and limits their participation.

In this chapter, we'll look at several of the most common monetization models: transaction fees, listing fees, end-user/buyer subscriptions, and seller services. We'll also discuss how to find the right pricing/rake scheme.

TRANSACTION FEES VS. LISTING FEES

Let's start with the transaction fee, where the marketplace takes a cut of each transaction generated through the platform. It's the fairest monetization model for suppliers and vendors, as they only pay a fee if and when they sell something.

This model encourages more suppliers to join the platform and thus increases the liquidity of the marketplace's supply for two reasons: first, when you take away the upfront fee it's easier to join, and second, if you only charge when a sale is made, you decrease the supplier's risk of losing money. A transaction fee model also scales nicely: the more sales your platform generates, the more revenue you bring in.

By contrast, listing fees can have the opposite effect. Charging suppliers to list on your site will inevitably discourage some from listing. You might find your marketplace soon hits a ceiling where you can't get any new suppliers to join. In addition, this model is less fair than transaction fees as listing fees hit all vendors equally — no matter how many sales they end up making on the site.

However, there are upsides to listing fees. They assure some level of quality control for a better buyer experience. When sellers need to pay to list, they are more likely to list items with a high chance of selling, as well as invest time in each listing. In other words, you won't have to worry about providers flooding your marketplace with low quality products and listings.

ENHANCED SELLER SERVICES

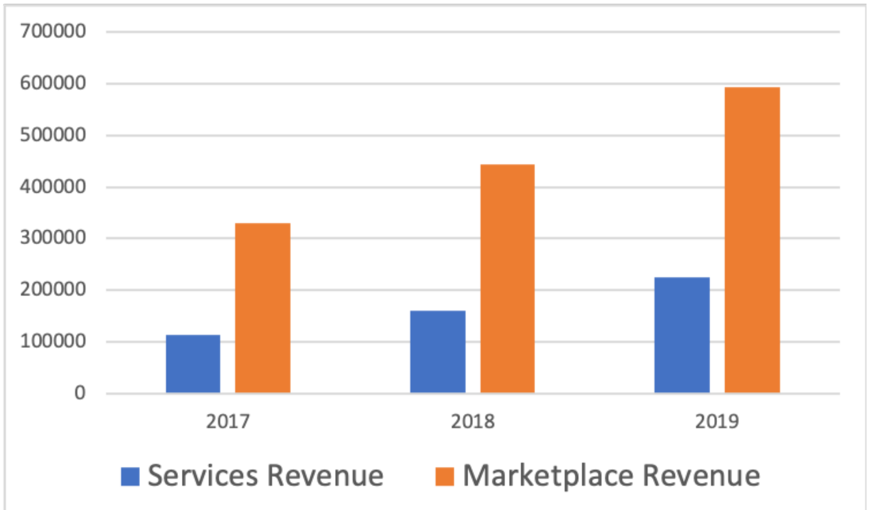
A recent trend has been for marketplaces to monetize by charging for optional seller services. In this case, you can make the base listing free and charge for enhanced services like better placement. The low entry cost encourages more suppliers to list (increasing liquidity), but revenue can be hard to come by since only a small percentage of suppliers will choose to pay for the better placement.

Such a freemium approach works best for companies that serve a huge market. Even if just a small percentage of suppliers pay for additional seller services, the base is so big that they can build a large business (e.g. Yelp). However, if you are tackling a niche market, you'll never reach the scale necessary for a freemium model to work as the core source of revenue.

Etsy is a perfect case study for enhanced services. Its revenue is diversified, generated from a mix of marketplace activities and other optional seller services. If we analyze their 2019 Annual Report, we see that over one quarter of Etsy's revenue in 2019 came from seller services.

In the following chart, Etsy's Marketplace Revenue is comprised of the fees a seller pays for marketplace activities (listing an item for sale, completing transactions between a buyer and a seller, and using Etsy's payments platforms). Services revenue is comprised of the fees a seller pays for optional services — primarily advertising services and Etsy Shipping Labels.

Etsy's Annual Revenue Breakdown:
Seller services represented more than 25% of revenue in 2019



Source: Etsy, 2019 Annual Report. Data from Notes to the Consolidated Financial Statements, Note 2: Revenue

WHAT TO DO WHEN SERVICES ARE DELIVERED OFFLINE?

A business model based on transaction fees seems like the simplest and most effective approach for any marketplace. However, it's hard to pull off when the service is delivered offline.

For example, Thumbtack is a platform that helps people find service professionals (photographers, painters, home contractors, movers, etc.). They started with a transaction fee model. But when a plumber goes to a customer's house to fix a leaky faucet, it's hard for Thumbtack to know when the service was performed and for how much. That makes charging by transaction fees tricky.

Furthermore, when a marketplace connects the buyer and seller before facilitating the transaction, it weakens the marketplace's ability to capture value.

Thumbtack pivoted to a lead-based model where they charge suppliers to contact customers. Vendors can see all the details for a particular job (what, when, where) and if they feel they are a good fit, they pay Thumbtack to be introduced to compete for the job.

Keep in mind that the lead-based model only works with new connections (i.e. discovery). It's ineffective in those cases where there's a lot of repeat purchases from the same vendor.

In addition to a lead generation revenue model, there are some other strategies for service marketplaces. One approach is to stay as close to the transaction as possible. Elance offers hourly/project tracking and billing solutions that encourage both the provider (freelancer) and the customer to stay on the platform throughout the transaction.

The other approach is to productize the service as much as possible, with boxed offerings that include pre-defined scope, duration, pricing, deliverables, etc. This simplifies the end user experience, enabling them to complete a transaction in just a few clicks. The less back and forth between provider and customer, the more likely they are to complete the transaction on platform.

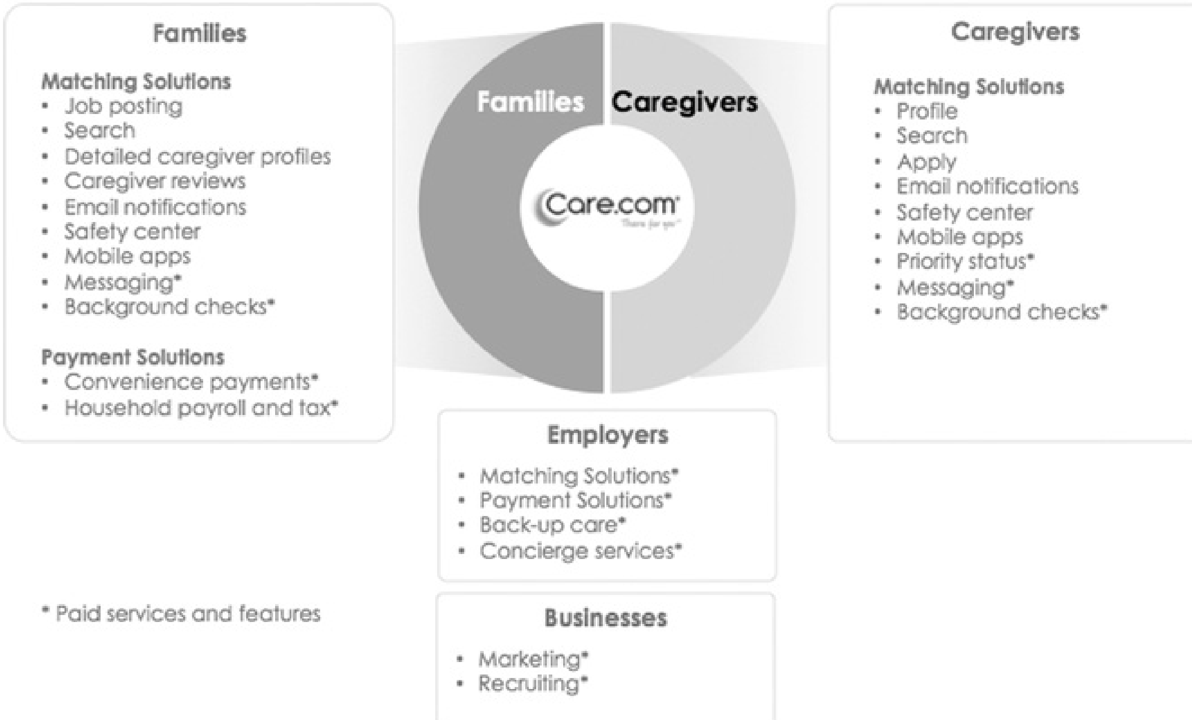
SUBSCRIPTION FEES

While most marketplaces extract a fee from their sellers, a few charge subscription fees to their buyers. Angie's List and Care.com are the most notable examples.

Angie's List charges buyers a membership fee in order to search the directory and view ratings. They also charge advertising fees to the seller.

Care.com has a freemium model, with value-added services on both sides of the marketplace. Families (buyers) need to pay a subscription fee to message a caregiver through the platform. Until you pay, identities are masked. Paying caregivers can move up in the search results, provide a preliminary background check, and get priority notification of opportunities.

Care.com's IPO prospectus offered a detailed look at their free and premium services. Starred features represent paid/premium services.



Care.com: Breakdown of free and paid/premium services,
Source: Care.com IPO Prospectus

There are a few risks with the subscription model:

- Charging buyers can limit the number of potential customers who join your site. Your value proposition needs to be very strong to entice consumers to pay a subscription in order to buy a product or service.

- There's also the question of how long any buyer will remain a paying subscriber. Unlike a SaaS app which can be continually useful, the lifespan of a marketplace's utility can be rather limited. Once a subscriber finds a provider they like (whether it's a doctor or babysitter), they may not look for another provider for years.

Care.com expressed this challenge in their prospectus:

> "Currently, most of our paid memberships are monthly memberships, and the average paid membership length for our consumer matching solutions is approximately seven months. As a result, we must regularly replace paying members who allow their membership to lapse with new paying members either by converting existing non-paying members or by attracting new members to our service."

FINDING THE RIGHT PRICING STRATEGY

Bill Gurley's article "A Rake Too Far: Optimal Platform Pricing Strategy" is recommended reading for any startup trying to determine their pricing strategy. He begins by saying:

> "It may seem tautological that a higher rake is always better – that charging more would be better than charging less. But in fact, the opposite may often be true. The most dangerous strategy for any platform company is to price too high – to charge a greedy and overzealous rake that could serve to undermine the whole point of having a platform in the first place."

What's the problem with levying too high a fee? First, as Gurley explains, if you charge an excessive rate, that cost ultimately gets passed along to the consumer and the "pricing of items in your marketplace are now unnaturally high." Second, high rakes give suppliers a reason to look elsewhere and you become vulnerable to competitors from below.

Here's a telling example: in the late 1990s companies like Expedia and Travelocity were the online travel leaders in Europe, and they took a rake over 30% with certain packages. This left an opening for Booking.com (part of Priceline Group) to come in with a lower 10% rake and sign up nearly every small hotel in Europe. This resulted in greater supply and selection for consumers. And Booking.com is the undisputed leader today.

What's even more interesting is that the average rake at Booking.com is higher today since merchants bid up their rake for better placement, similar to the Google Ads model.

Just like with Etsy's services revenue model, this approach offers the best of both worlds: low starting fees that encourage broad supplier adoption and supply liquidity along with added revenue from those suppliers who want more exposure, or whatever other enhanced services you offer. You won't turn anyone away due to high fees, but can still boost your take as suppliers compete with one another.

4

NEW MARKETPLACE TYPES

At their core, every marketplace is similar. On one side, there's a seller (supply), on the other side a buyer (demand). The marketplace acts as an intermediary to bring these two sides together. But there can be a lot of innovation in how a marketplace handles these transactions, takes care of its seller and buyer communities, and approaches monetization.

As the industry matures, we're seeing new marketplace models emerge, including on-demand, managed, community-driven, SaaS-enabled, decentralized, and business-to-business (B2B). Here's a quick look at each.

ON-DEMAND MARKETPLACES

The widespread use of smartphones has helped create a consumer culture that's conditioned to expect anything and everything on demand. With the "uberfication" of many different markets and services, the smartphone has turned into a remote control that can summon anything from cookies to legal services.

These on-demand marketplaces match jobs with independent contractors on the fly, supplying labor service or products on demand. For example, there's Instacart to buy and deliver groceries, TaskRabbit for odd jobs, and the list continues.

In many ways, today's on-demand economy is a continuation of the sharing economy, or collaborative consumption exemplified by Airbnb, where people turn their underused assets (home, bed, car, etc.) into a source of revenue. Now, with on-demand services, people aren't renting out their assets, but their spare time instead.

While entrepreneurs and investors were once excited by the massive opportunity, it's important to realize that the on-demand service model that lifted Uber's valuation to a high of $70B (pre-IPO) won't work for every vertical. In many cases, the hype driving on-demand marketplaces has come and gone.

The service marketplaces that have broken through and continue to scale follow three key principles:

1. Underlying commoditized services

When it comes to hiring a ride, most of us are happy as long as a driver brings us from point A to point B in a clean car without getting lost. This makes us pretty flexible in terms of who delivers the service. For more complex services — haircuts, babysitting, legal or medical advice — it's harder for customers to accept the idea that somebody at random will show up each time. We develop preferences and like to stick with one provider once they earn our trust.

2. High purchase frequency

The best marketplaces have high purchase frequency and regular usage. For city dwellers and frequent travelers, taxis are used on a daily, or at least weekly, basis. Few other services have such a high purchase frequency. On top of this, Uber also enjoys significant spillover effects as travelers move from one location to another.

With high frequency use cases, customers fall into the habit of using the same service as long as they're satisfied. This makes it easy for a startup to become the "home screen app" for that particular use case. By contrast, it is much harder to retain customer mindshare with lower purchase frequencies. If customers need a yard cleanup just two times a year, they're more likely to begin the research process over again each time.

3. True on-demand use case

Many of the services that fall into the on-demand mobile services category aren't actually "on-demand." In most cases you don't need a cleaning service or house painter to show up within minutes, or even the same day. But, taxis are a different story.

A true on-demand marketplace requires sufficient liquidity on the supply side. Without enough available drivers in a car service marketplace, customers will be left waiting on the curb. This creates a large barrier to entry, since a new competitor needs to launch with hundreds of providers, not just a handful.

By contrast, when services can be delivered with more flexible timing, it's easier for competitors to enter a vertical or new location and there's less of a winner-takes-all dynamic. As such, we can expect just one or two major players for a true on-demand service, while less time-sensitive markets will be crowded with smaller companies.

Sarah Tavel offers another key observation about successful on-demand marketplaces: they not only offer 10x the convenience of traditional alternatives, but also do so at a cheaper price:

> "The magic of Uber is that it used mobile to create a 10x better product than the incumbent (taxis), and did so at a lower price. The 'and' is everything."

PASSION ECONOMY MARKETPLACES

In contrast to on-demand or gig economy marketplaces that prioritize one-off transactions and undifferentiated supply, we're also seeing the emergence of new passion economy marketplaces that encourage the exact opposite: highly unique content creators with niche audiences.

Kevin Kelly was one of the first people to remark on this trend in his seminal 2008 essay 1000 True Fans. The basic idea is that the free distribution and peer to peer nature of the Internet allows people with niche interests to find their small, but passionate tribes regardless of geography — and monetize them. In a pre-Internet world, the only option for most artists or content creators was to aim at becoming a commercial megahit so that they could be promoted by the institutional gatekeepers (large labels, Hollywood studios, etc). But by going direct to their fans, they only need 1000 true fans willing to pay $100 a year to provide a reasonable living.

Li Jin, who coined the term passion economy, takes this argument a step further noting that creators can now make that same reasonable living by finding only 100 mega fans willing to spend $1000 a year. And with the rise of new software tools and marketplaces that help them find these fans and handle business activities (payments, accounting, etc.), we now see this trend taking off in a number of different verticals:

- Platforms like Udemy and Outschool for online courses
- Twitch for video game streamers
- Substack for writers and journalists
- Patreon for any and all of the above

It seems like we're just hitting an inflection point for the passion economy and we expect to see a variety of new tools — marketplaces, SaaS tools, and combos of the two — thrive in these verticals, as well as in new areas like podcast/audio creation, tutoring/coaching, and virtual world experiences. We're also seeing some interesting overlap with cryptocurrency communities where companies like Roll are allowing content creators to create a limited supply of Non-fungible Tokens (NFTs) which grant community members special privileges like access to private Telegram groups and future income sharing.

MANAGED MARKETPLACES

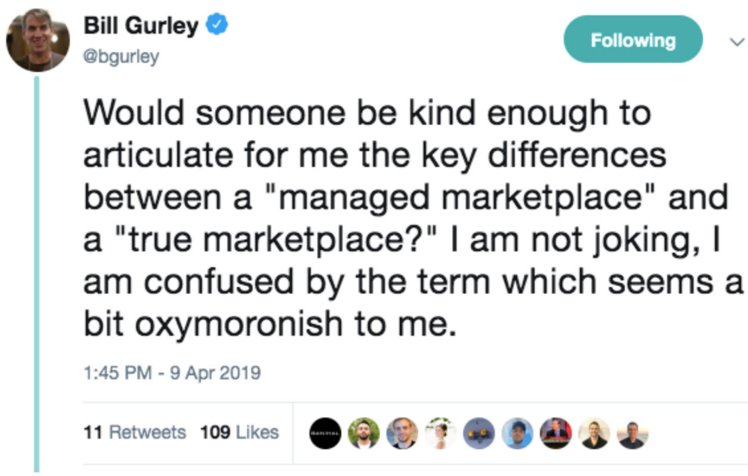
Over the past few years, we've seen the emergence of managed marketplaces. These are marketplaces that don't just connect buyers and sellers, but take on additional parts of the value chain to deliver a better overall experience.

Borrowing from Ezra Galston's "Anatomy of a Managed Marketplace" and Anand Iyer's "The Evolution of Managed Marketplaces," we believe that managed marketplaces share three key characteristics:

- The managed marketplace takes on additional parts of the value chain beyond just connecting buyers and sellers to provide a superior experience versus more traditional peer-to-peer marketplaces. In many cases, the end user experience is a core differentiator, where end users can be buyers, sellers, or both. For example, by adding concierge and logistics support, a marketplace can entice sellers of luxury items who may not have been inclined to take the time and go through the trouble to list their items on a marketplace previously.
- A managed marketplace can involve considerable risk, for example, should you guarantee the sale and take on sellers' inventory. If economic conditions worsen rapidly, such as in 2020, you'll end up sitting on inventory that's impossible to move.
- Lastly, a managed marketplace can have a higher take rate than a pure marketplace that just connects buyers and sellers. This can offset the premium service offerings and added risk.

Since we published the second edition of this guide, more and more marketplaces have taken on pieces of these managed characteristics. One prevalent example is in cases with traditionally licensed or regulated supply. As Li Jin details in this post, managed marketplaces can help alleviate artificial scarcity by listing high quality, but unlicensed providers alongside their licensed counterparts. The managed marketplace can help users build trust in these providers via vetting, reviews, and certifications tied to the platform. This doesn't work for heavily regulated areas like medical care, but for industries like appliance repair (e.g. Nana) and education (e.g. Outschool), this model can prove successful.

We're also seeing the lines between traditional marketplace and managed marketplace continue to blur more generally, so much so that Bill Gurley from Benchmark tweeted that the difference between a "managed marketplace" and a "true marketplace" is no longer clear.



Here's our initial model for answering this question. First, we see a few key areas where marketplaces are indeed becoming managed:

- Standardizing prices for customers: This is often cited as the reason why Uber and Lyft succeeded over Sidecar. Sidecar was a "true" original marketplace where sellers could set their own prices. This would force Sidecar customers to compare different offers from different suppliers — far from the ideal customer experience for somebody who just wants to get from point A to point B.

- Market making: The marketplace creates enough liquidity in certain areas by either subsidizing seller activity (e.g. guaranteed earnings for Uber drivers) or even adding owned and operated supply to the marketplace to fill short-term gaps.

- Quality guarantees: Marketplaces add and pay for inspection services in order to guarantee the quality of a high-value item (e.g. second-hand car).

- Logistics services: Marketplaces take on supply in consignment and manage the entire logistics for the owner of the products (e.g. The RealReal).

In every single one of these areas, the marketplace has to trade off the effect of a better buyer experience with the downside of additional costs and complexity. This is usually not a straightforward decision.

At the same time, the buzzword "managed marketplace" has expanded into business models that are clearly NOT marketplaces. The moment you take on "inventory" like Opendoor (homes) or WeWork (long-term office leases) you are not a marketplace anymore. There is just one seller, yourself. If you own the inventory yourself or employ 100% of the people providing services, you are a retailer or services company, not a marketplace. Great business can be built with such an approach, but the risk profile and potentially the profitability profile are very different than that of a marketplace.

There are "true" marketplaces, managed marketplaces, and then tech-enabled services or commerce companies. Each has a very different take on where the most value can be created for consumers. And every underlying use case and vertical might require a different approach. We should all be mindful about how we use the term "managed marketplace."

COMMUNITY-DRIVEN MARKETPLACES

Marketplaces can leverage the power of community to create a unique differentiator.

Many community-driven marketplaces bring together a community of buyers and sellers who have similar interests, whether it's makers and crafters (Etsy) or sneaker evangelists (GOAT). Here, buyers and sellers visit the marketplace not just to complete a transaction, but also for a sense of identity and belonging. We think of these types of marketplaces as "for enthusiasts, by enthusiasts."

To foster this sense of community, Etsy added team functionality, letting sellers and buyers create and join teams around shared interests. They also host official craft nights in Brooklyn and other local meetups.

There are numerous examples where marketplaces develop community tools to help capture supplier loyalty. For a long time, Lyft was able to hold its own by building a strong culture and sense of identity around its drivers (although this is less true today as drivers are increasingly working for both Uber and Lyft). Historically, Lyft built a community vibe through driver meetups, community rallies, and a private Facebook group (the Driver Lounge) where Lyft drivers could meet other local drivers, share stories, connect over common interests, and organize local events. Such efforts pay off in the form of better brand loyalty for the drivers, and a more unique culture for riders.

At Boris' old company, AbeBooks, the seller community was incredibly active and the marketplace gave them a place to come together as booklovers. To help foster this sense of community, AbeBooks created online community forums, which evolved into book clubs, science fiction groups, collector groups, help with forgotten titles, etc.

While community identification within a marketplace is quite powerful, an interesting next step will be allowing the community, which creates the value of the marketplace, to actually own a piece of the business and share in the value capture as well.

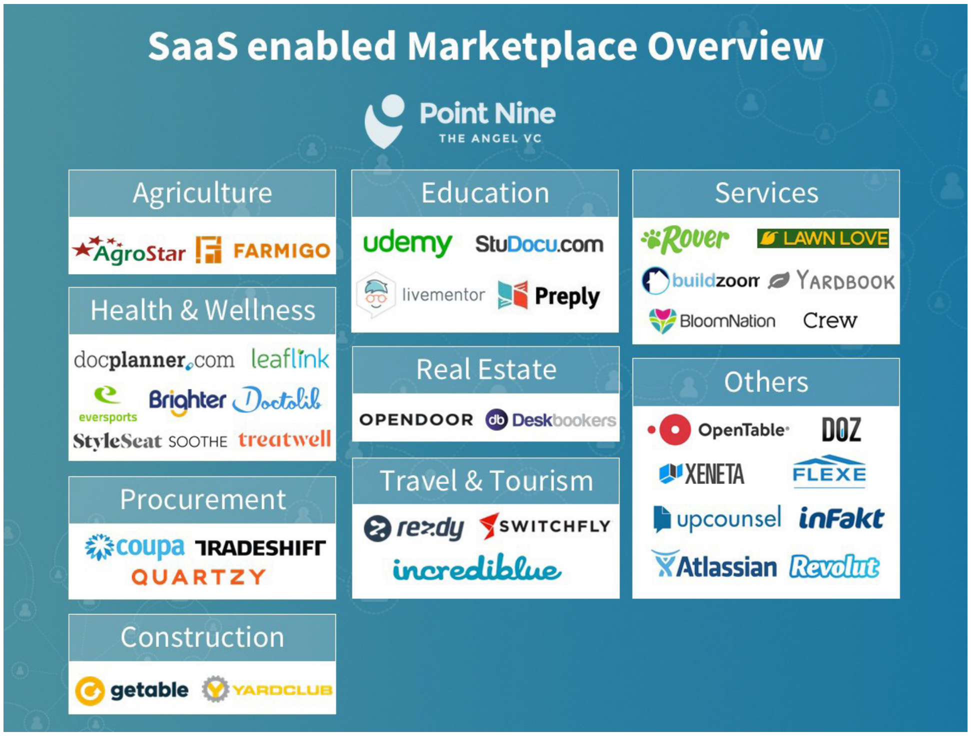
Cryptocurrency/blockchain-based solutions offer an interesting way to track community ownership without any reliance on a third party. You could argue that both Bitcoin and Ethereum are themselves community-owned marketplaces for value storage and access to compute.

Jesse Walden does a fantastic job of exploring the co-op models that crypto enables. We'll explore this idea in more depth in the following section on decentralized marketplaces. And even without a blockchain-based solution, we're still seeing an increasing number of startups like Fairmint that aim to gives communities ownership in the products and services that they love.

SAAS-ENABLED MARKETPLACES

There's a new segment of companies that offer SaaS tools with the ultimate plan of building a marketplace. Such companies attract users, either customers or sellers, with a useful and typically free tool, then encourage them to participate in the marketplace. Chris Dixon described this approach as "come for the tool, stay for the network."

SaaS-enabled marketplaces can be either B2B, B2C or C2C and the SaaS component can be offered to the demand or supply side. Point Nine Capital mapped out a high-level overview of the SaaS-enabled marketplace ecosystem.



Source: Point Nine Capital

OpenTable is a prime example. They offer various front-of-house software tools for restaurants, like seating management. These kinds of business tools attracted restaurants and gave them an easy way to list and manage their incoming reservations (thus helping OpenTable build liquidity and become a leader in online reservations today).

Free software can be a strong go-to-market strategy, as Tomasz Tunguz describes:

> "Free good software spreads quickly, enabling rapid customer acquisition. In competitive markets or when pursuing customers that have been expensive to acquire, free software creates a clear, and often defensible, competitive distribution advantage."

However, developing a SaaS-enabled marketplace requires certain factors to be aligned. First, you need to make sure that the consumers or businesses that sign up for your tool will be just as willing to join and use your marketplace. This strategy will only work if the marketplace is complementary to the tool. Second, you may have to contend with some sellers who want to use your tool, but aren't too eager to join a marketplace that puts them in competition with others. And third, market dynamics require ongoing use of the marketplace. OpenTable has succeeded because people are always looking for a new restaurant to try, so the marketplace provides continuous value. This approach won't work in cases like doctors where consumers prefer a monogamous relationship.

B2B MARKETPLACES

Twenty years ago, in the midst of the Web 1.0 boom, expectations were high for B2B marketplaces. The assumption was that online platforms would completely automate all supplier-customer transactions including retailing, wholesaling, and procurement.

Yet here we are today and the world of B2B marketplaces still lags far behind B2C.

Alibaba is an exception. By reducing the friction for North American companies to find suppliers in China, they've been the most successful B2B marketplace to date. As are a handful of vertical marketplaces that have emerged over the past few years. For example, Knowde is building a marketplace for the chemicals industry and Metalshub for trading ferroalloys and metals.

Bessemer Venture Partners put together a map of the B2B Marketplace Explosion. But despite this increased early activity, we've yet to see the large-scale success of B2B marketplaces across the full spectrum of verticals.

As we consider B2B opportunities, we should think about the challenges in today's customer-supplier relationships, particularly discovery, lack of price transparency, lack of automation, lack of trust in terms of finding new suppliers, and siloed services. As such, successful B2B marketplaces will do the following well:

1. Aggregate suppliers and provide price transparency: A marketplace needs to bring product catalogs from multiple suppliers and aggregate them in one convenient spot for customers. Often, B2B marketplaces are creating their industry's first category data model and product catalog — finally bringing access to choices to the industry.

B2B marketplaces will be particularly useful in heavily fragmented verticals where companies can source from a myriad of suppliers. In this case, a marketplace can help companies identify, research, compare prices, and contact the right suppliers. One successful technique for on-boarding supply that we've seen at marketplaces like Faire is choosing not to charge suppliers for any transactions that occur with their existing customers. At that point, joining the marketplace only provides an upside.

2. Automate processes: B2B marketplaces should create buyer-driven workflows, tailored to the specific needs of a given vertical. While large companies can afford to implement EDI (Electronic Data Interchange) or other automated procurement systems, many small businesses still email, or even fax, purchase orders and quotes. There's an enormous opportunity to streamline the procurement process via automation, rather than having a purchasing manager call around asking suppliers to fax or email quotes.

3. Increase trust and social proof: New B2B suppliers have to contend with a considerable amount of risk-aversion among purchasing managers and company employees, hence the phrase "Nobody gets fired for buying IBM." It's easy to go with the safe bet, rather than risk the repercussions of issues with a new supplier.

An online marketplace can help buying agents evaluate potential partners by adding company profiles, operational performance data as well as customer ratings and reviews. This data can help buyers make the right decision, while also helping create a healthy opportunity for new suppliers. Because without a strong pool of suppliers, there's no incentive for a buyer to use the marketplace.

4. Tie in with the rest of the ecosystem: There's an opportunity beyond just sourcing and procurement. A B2B marketplace can become a platform, integrating other key services, from KYC (Know Your Customer) to logistics, credit and insurance services.

If you're building a B2B marketplace, we recommend reading 24 Ways B2B Marketplaces Win by James Currier at NFX.

How to monetize a B2B marketplace

When it comes to monetizing a B2B marketplace, we see four opportunities:

1. Subscription fees: First, a marketplace can create subscription fees for sellers. Suppliers can pay a listing fee to include their product(s) in the catalog or directory. The marketplace can also charge sellers a fee to use the platform's software that streamlines buyer interactions.

2. Transaction fees: Marketplaces can charge a transaction fee if a) buyers are using the marketplace to find new suppliers and b) the transaction can be completed online, ideally with the payment processed online as well. As with other marketplaces, the risk here is that buyers and suppliers might take future transactions offline and avoid the fee.

3. Referral fees: The marketplace can monetize its platform and charge referral fees for bringing customers to any of its partners (banking, insurance, etc.).

4. Value Added Services: Finally, many marketplaces are monetizing usage and purchase data to upsell additional fintech or insurance services. Some notable examples include Amazon offering financing to their sellers or Uber offering loans for drivers to buy cars.

What's next for B2B marketplaces?

One of the biggest questions we get around B2B marketplaces is "why now?" After decades of waiting, why are B2B marketplaces finally ready to have their moment? We believe there are three major reasons:

- **Transition to millennial leaders:** Millennials are entering positions of power in larger enterprises in traditionally stagnant industries. They are accustomed to slick apps and easy to use marketplaces in their personal lives and expect the same in the workplace. Leaders who are most frustrated will leave to build their own businesses that solve problems around liquidity, transparency, and UI/UX.

- **Easy flow of data:** As every traditional business becomes digitized, it becomes easier to collect and share data via APIs, which in turn makes it easier for marketplaces to programmatically aggregate supply and demand.

- **Payment integrations:** The new wave of financial infrastructure like Stripe makes it increasingly easy for marketplaces to institute payment features and take-rates into their business models.

Moving forward, we see two major trends in this sector: payments and verticalization. As Internet payments become increasingly easy and normalized, we expect to see new experiments around how entrepreneurs can monetize B2B marketplaces, both directly and indirectly with ancillary services like lending, account factoring, etc.

The other major trend is verticialization. As Julia Morrongiello explains, the complex workflows, large average order values (AOV), and high degree of trust required in each specific industry means that these marketplaces may "end up looking more like verticalized SaaS businesses than traditional consumer marketplaces."

API AS A MARKETPLACE

Just like a traditional marketplace, an API-as-a-marketplace has two sides: suppliers and buyers. What makes it different is the interface.

In a traditional marketplace, discovery and purchase are done on the application layer. The transaction process is visible to the end user and is essentially a part of the platform's identity and brand. In an API-as-a-marketplace, the API is the UX for the transaction; that is, the transaction occurs on the infrastructure layer and is abstracted away from the end user.

Here are two examples from e-commerce use cases (both are V1 portfolio companies):

- Shippo: developers can use this API to connect businesses to shipping carriers
- Patch: developers can use this API to connect businesses to carbon removal projects and offset their emissions

Note that we aren't talking about API marketplaces here. API marketplaces (like RapidAPI) are traditional marketplaces that allow API providers to publish their APIs for developers to discover. An API-as-a-marketplace is more of a dev tool that connects pools of suppliers and buyers and uses an API to connect the two sides.

What makes the opportunity interesting? Choice, defensibility and simplicity

APIs are the building blocks of today's digital world: developers use them to quickly integrate features, data, services and functions into their own apps, removing the need to build and scale all those elements from scratch themselves. Given its DNA as a dev tool, an API-as-a-marketplace is a building block just like Stripe (payments), Twilio (communication), and Postmates (on-demand delivery).

But unlike Stripe, Twilio, and Postmates, the supply of an API-as-a-marketplace is not necessarily a commodity. That is, should they choose to, developers and businesses (or even their end users) can pick their suppliers based on whatever requirements they have.

For example, on Shippo, businesses may want to optimize the carrier (supplier) based on price, visibility on tracking, etc. — after all, as CEO Laura Behrens Wu says "shipping is not one size fits all." On Patch, businesses can choose a carbon offset provider based on the type of project (e.g. biochar, mineralization) that most aligns with their business ethos.

In an API-as-a-marketplace, defensibility can result from two paths. First, you can aggregate the supply, especially in antiquated industries where a lot of infrastructure needs to be built for the API-as-a-marketplace. For example, you need to build integrations for the supply side and make it accessible in one API call by the demand side. This direct integration is sticky: there's instantaneous payment to the supplier whenever the API is called.

Next, network effects are a key driver of defensibility just as in traditional marketplace dynamics. When a new supplier or user joins, the value of the service or product that the marketplace is providing to users increases. In Shippo's case, more carriers mean more options for platform users (better prices, faster delivery times, etc.). And when more businesses use Shippo for their shipping needs, there's more revenue for carriers and more incentive for news ones to sign on.

And just like a regular API, the business model is simple. The API-as-a-marketplace can take a rake of each API call.

API-as-a-marketplace vs. data marketplaces

A data marketplace, which is an online store where people can buy data, is not necessarily an API-as-a-marketplace. This is because many of these platforms don't broker data via API (but in the form of .csv for instance). They simply aggregate and resell data and don't always give you a choice of data sources.

However, the trend is most likely such that more and more data marketplaces will move to API delivery for the efficiencies and economies of scale in connecting supply and demand. One example we've seen in healthcare is Segmed, which helps clinics/hospitals monetize their medical image data by selling to healthcare AI startups that need data to train their models.

DECENTRALIZED MARKETPLACES

Over the past few years, we have been closely following the evolution of cryptocurrencies/blockchain technology and the potential impact they will have on the marketplace landscape. Ultimately, we believe that a new wave of protocols will serve as what Placeholder has dubbed "minimally extractive coordinators." That is to say that distributed ledgers capable of storing state should be able to coordinate buyers and sellers with little rent extracted. Given the efficiency gains, it seems plausible that every marketplace could eventually become a crypto-network.

OpenBazaar is still the only game in town for the decentralized buying/selling of physical products. It's an open source project to create a peer-to-peer commerce network using Bitcoin. With OpenBazaar, there's no middle man: the platform connects buyers and sellers directly. And since there's no one in the middle of a transaction, there are no fees and no restrictions on what goods can be listed and sold. While OpenBazaar remains popular with a small subset of ideologically minded users, they've had trouble breaking into the mainstream.

This makes sense as it's much more difficult for a decentralized marketplace to offer a slick user experience for "real world" goods. There are some key questions to ask: Can a decentralized platform offer the same kind of UX, conflict resolution tools, and customer service? And how much do these things matter? Are customers willing to pay a fee for a smoother, sleeker, more trustworthy experience?

The other question is whether or not decentralized marketplaces are being pushed to the fringe and just attract buyers and sellers for illicit goods. If so, how scalable are these use cases?

We do believe that the efficiency gains of a decentralized marketplace will eventually trump all else. This could even happen for labor marketplaces like Uber or Rappi. But that could take decades and some serious breakthroughs (e.g. the rise of DAOs and insurance risk funds).

In the meantime, decentralized marketplaces seem best suited to thrive in the digital world of bits, where we've already seen tremendous traction. One could even argue that Bitcoin and Ethereum themselves, the two dominant cryptocurrencies by security and liquidity with a combined market cap of about $250B as of writing, are themselves decentralized marketplaces for programmable value.

We've also seen widespread adoption of community ownership in Decentralized Finance (DeFi), which exploded in the summer of 2020. Existing industry leaders like Compound, a lending protocol, and Uniswap, a decentralized exchange, made waves when they distributed governance tokens to their users who provided value to the network (via adding liquidity or trading). Other projects like Yearn Finance, an aggregation protocol for DeFi investing, launched as a community owned project from day one. With market caps in the billions, these token distributions marked a huge milestone for the cryptocurrency community.

And that's just the tip of the iceberg. Here are a few of the promising areas for community owned digital marketplaces:

- Decentralized cryptocurrency exchanges (Uniswap, Øx) that allow for trading the ever-rising amount of tokens and currencies supporting the buying and selling of this new asset class. The efficiency of these native protocols is not lost on users as Uniswap recently eclipsed Coinbase in 24h trading volume!
- Decentralized options and derivatives platforms (Opyn)
- Decentralized insurance/cover marketplaces (Nexus Mutual)
- Prediction markets like Augur that enable betting on potentially any event in the world
- Decentralized storage (Filecoin, Sia, dStor) and computing markets (Golem) that can leverage underused computing power and replicate the Airbnb model for digital assets

- Data marketplaces (Ocean Protocol, OpenMined) that are decentralized marketplaces around the collection and distribution of data
- Non-Fungible Token (NFT) and unique digital art/collectible marketplaces. Note that today many of these marketplaces themselves are centralized (e.g. SuperRare, OpenSea), but we see a future where these trade via embedded smart contracts, decentralized exchanges, or liquidity pools like Uniswap.

While decentralizing existing marketplace structures is certainly interesting, we're particularly excited by new cryptonative marketplace structures that were not possible in a pre-blockchain world. Uniswap's liquidity pools are a great example of a cryptonative construct. As this space continues to develop rapidly, we're certain that many new marketplace structures will continue to emerge. We'll be watching closely.

5

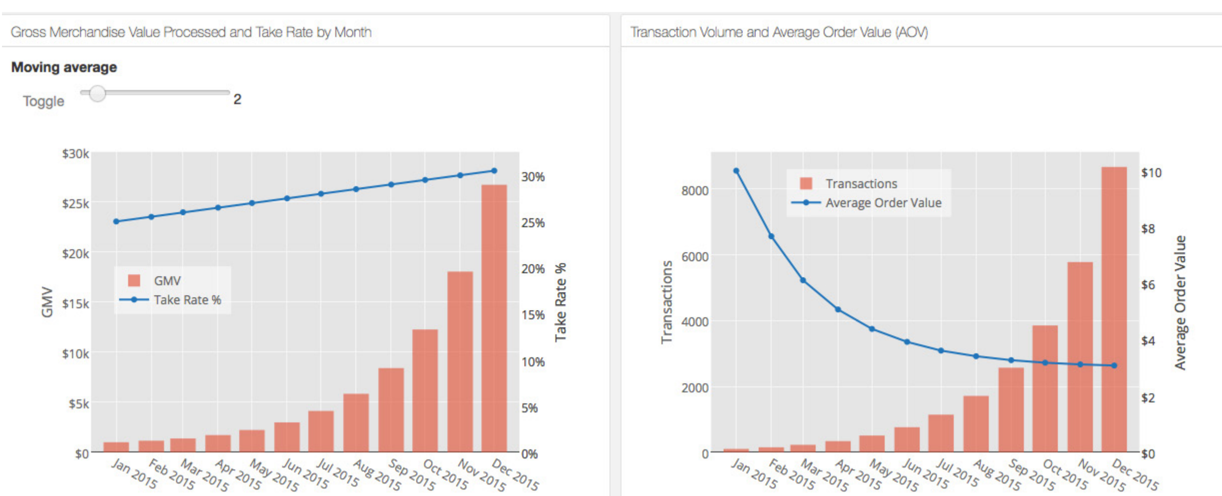
MARKETPLACE METRICS

As you grow, it's important to understand how the business is performing: if your model is financially viable, what's working well, and what needs to be changed. But traditional business metrics and KPI dashboards don't necessarily capture the key factors that drive marketplace performance and health.

Christoph Janz at Point Nine Capital created a KPI dashboard for early-stage SaaS. Inspired by this, we have put together a KPI template for marketplaces.

You can access the Marketplace KPI Template via the Google doc here (make a copy of it and then you can edit away).

Special thanks to Vijay Nagappan of MHS Capital for bringing the KPI template to life and visualizing these KPIs using Plot.ly and Keen.io dashboards. Vijay created four starter dashboards for summary, supplier side, demand side, and then a mashup of supplier side and demand side data to see if there are any interesting trends. If you're interested in creating your own visualizations and dashboards, check out Vijay's post — which includes links to Keen.io's templates, Plot.ly's Web GUI, Plot.ly's Python APIs and much more.



Samples of KPI dashboards created by Vijay Nagappan, MHS Capital, using Plot.ly and Keen.io https://docs.google.com/spreadsheets/d/1K5E1Nzjq4KEvGVv6EysGswTuQm5u21Sa2ugSZewrZqE/edit#gid=1569059121

	A	B	C	D	E
1		Jan-15	Feb-15	Mar-15	Apr-15
2	**Overall Marketplace Metrics**				
3	Gross Merchandise Volume (GMV) ($)				
4	# of Transactions				
5	Average Order Value (AOV) ($)				
6	GMV Growth Rate, M-o-M (%)				
7	GMV Growth Rate, Y-o-Y (%)				
8	Take Rate (%)				
9	Revenue ($)				
10	Revenue from transaction fees ($)				
11	Revenue from listing fees ($)				
12	Revenue from supplier or seller services ($)				
13	Buyer-to-Seller Ratio				
14	Total CAC as a percentage of Revenue (%)				
15					
16					
17	**Seller / Supplier Metrics**				
18	Total # of Sellers or Suppliers				
19	# of New Sellers or Suppliers				
20	Seller or Supplier Growth Rate, M-o-M (%)				
21	Seller or Supplier Growth Rate, Y-o-Y (%)				
22	Percentage of Sellers or Suppliers still active after 1 month (%)				
23	Percentage of Sellers or Suppliers still active after 1 year (%)				
24	Average revenue generated per Seller or Supplier ($)				
25	Average percentage of Month 1 GMV generated by Sellers or Suppliers in Month 12 (%)				
26	Percentage of revenue generated by Top 20% Sellers or Suppliers (%)				
27	Seller or Supplier NPS				

Marketplace KPIs

Our Marketplace KPI Dashboard, available for download here

The dashboard is separated into three dimensions of business efficacy: 1) overall marketplace metrics, 2) seller/supplier metrics, and 3) buyer metrics.

1. Overall Marketplace Metrics

Gross merchandise volume (GMV) is the total sales dollar value for goods sold or services purchased through the marketplace over a certain time. Given that GMV is one of the most important marketplace KPIs, founders should track its growth rate on a monthly and yearly basis, and understand its makeup by customer acquisition channel. With GMV and the total number of transactions, we can compute the average order value (AOV) since:

GMV = # of transactions * AOV

Revenue is the income that the company receives from facilitating connections in the marketplace. It comes in the form of direct GMV revenue (transaction fees, listing fees) or indirect revenue (premium seller/supplier services, etc.). With revenue and GMV, we can calculate take rate via:

Revenue = GMV * take rate

In addition to take rate, we can evaluate business efficacy by calculating the total customer acquisition cost (CAC) of buyers and sellers/suppliers as a percentage of revenue.

2. Seller/Supplier Metrics

Supplier metrics are categorized into general and engagement KPIs, for example:

General KPIs

- Number of suppliers: Consider measuring new, existing, and churned suppliers, to be aware of the longevity of your supply. For instance, if the ratio of new to existing is higher than 10%, then your supply pool is changing 10% every week.
- Supplier growth rate
- Number of listings: In a services marketplace, this is not applicable so perhaps consider the number of active suppliers at a specific time instead.
- Listings growth rate
- Average listing price
- CAC

Engagement KPIs on the supplier side

Engagement KPIs are most important to the supplier side, so make sure you track these at the very least:

- Cohort analysis: percentage of suppliers still active 1 month and/or 1 year after signing up
- GMV retention: average percentage of Month 1 GMV generated by suppliers in Month 12

- Concentration: percentage of revenue generated by the top 20% suppliers or percentage of demand served by supply (i.e. if 90% of unique demand is served by <5% of supply, then you have lower concentration)
- Net promoter score (NPS)

3. Buyer Metrics

Similar to supplier metrics, we can categorize these into general and engagement:

General KPIs

- Number of buyers
- Buyer growth rate
- Average dollar amount purchased per buyer
- Average number of orders per buyer
- Average order growth per buyer
- CAC

Engagement KPIs on the buyer side

- Repeat buyer contribution: percentage of buyers who have purchased more than once, and percentage of GMV generated from buyers in previous months (note: in terms of measuring network effects, it can also be valuable to track the time between first-time purchase and second-time purchase)
- GMV retention: average percentage of Month 1 GMV generated by buyers in Month 12
- Concentration: percentage of revenue generated by top 20% buyers
- Cross pollination (if applicable): percentage of buyers whose second purchase is in a different category
- NPS

4. Measuring Liquidity

The first marketplace in a category to reach liquidity wins. It's winner takes all: we'll discuss this further in Chapter 7, ***Working with Investors***. Marketplaces strengthen with scale and scale comes from liquidity. Until you reach liquidity, you're vulnerable. After, you have the opportunity for dominance.

Liquidity is the reasonable expectation of selling something you list or finding what you're looking for. Liquidity indicates how successful the marketplace is for sellers and buyers. How long does it take to make a transaction? What percentage of goods or services are purchased daily?

Julia Morrongiello described marketplace liquidity this way:

> "Liquidity is the lifeblood of marketplaces. It is the efficiency with which a marketplace matches buyers and sellers on its platform. One could say that a marketplace without liquidity has no real product because the ability to transact on the platform IS the product."

So how do you measure liquidity? Consider two numbers: supply liquidity and buyer liquidity.

- **Supply liquidity** (measured as a percentage): Sangeet Paul Choudary defines supply liquidity as "the percentage of listings that lead to transactions within a certain time period." Sharetribe's Marketplace Academy outlined some examples for how supply liquidity can be calculated. On Etsy, it is the proportion of total stock sold in a given time period (say, in one month). On Airbnb, it's measured daily: how large a proportion of rooms are booked each night. And on Uber, you might need to measure it hourly: how big a percentage of drivers that are on duty are driving a customer at any given hour (in other words, how many logged-on drivers in a given time period get rides).

  The percentage of listings that lead to transactions within a certain time period serves as a proxy for the efficiency of the marketplace. Merely increasing the number of buyer and seller sign-ups doesn't serve a purpose unless this metric starts rising.

- **Customer liquidity**: This is the probability of a visit leading to a transaction. Morrongiello calls this the search to fill rate. What's the likelihood that a request or search leads to a transaction? For Uber, it could be the percentage of requests per week that result in rides. For Amazon, it might be the percentage of search sessions over a month that result in purchases.

  Simon Rothman believes that a conversion range of 30-60% is a reasonable expectation (not counting people who bounce). You can calculate how many visits you get in a given period and how many transactions you get in the same period, i.e. percentage of visiting customers who buy something. Keep in mind that the higher the average selling price of products on your marketplace, the lower the conversion rate may be.

Alternate approaches

Jonathan Hsu looks at marketplaces as two separate product-market-fit (PMF) problems and analyzes PMF within his "8-ball framework." It consists of 1) growth accounting, 2) cohort behavior and 3) distribution of product-market fit all measured for the core unit of value for the business. According to Jonathan, one side of the marketplace typically has stronger PMF than the other and the 8-ball metrics give them a way to understand that in detail. You can read more about the 8-ball framework and his quantitative approach to measuring PMF.

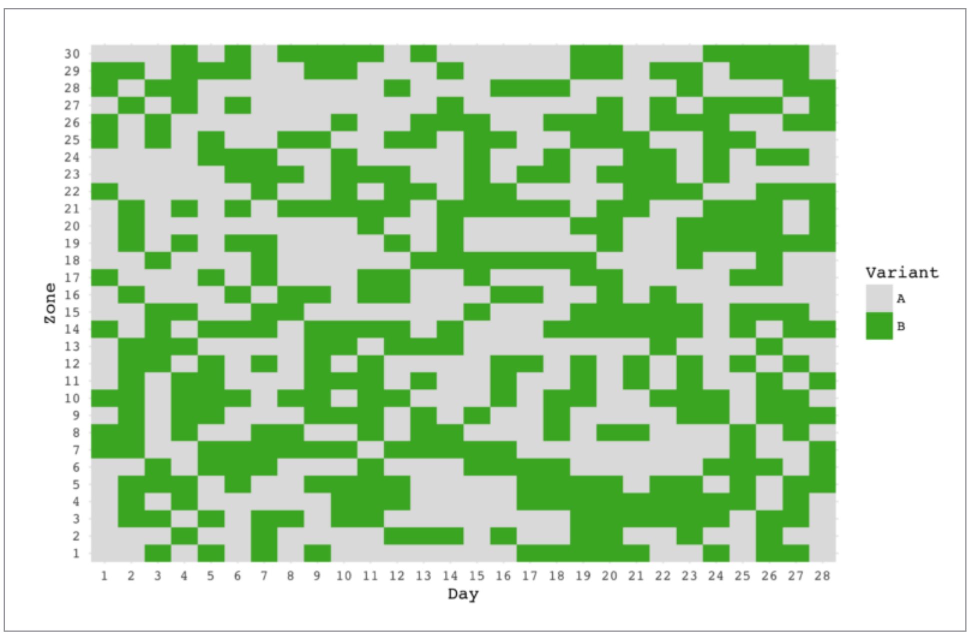
RUNNING CONTROLLED EXPERIMENTS IN MARKETPLACES

Running traditional A/B experiments is inherently challenging with marketplace products, since there's no way to cleanly split samples by demand or supply. They're all interdependent. Yet it can be done, as explained by Bala Subramaniam (formerly Head of Fulfillment at Instacart).

In Instacart's case, grocery deliveries from the control and treatment variant might be dispatched to the same shopper. And, the orders that one shopper fulfills could affect the assignment of other shoppers.

As Bala explained in a guest post on the Version One blog, the key is to identify the correct level of granularity you want to experiment with and more importantly, guarantee some form of independence among the experiment units (EUs).

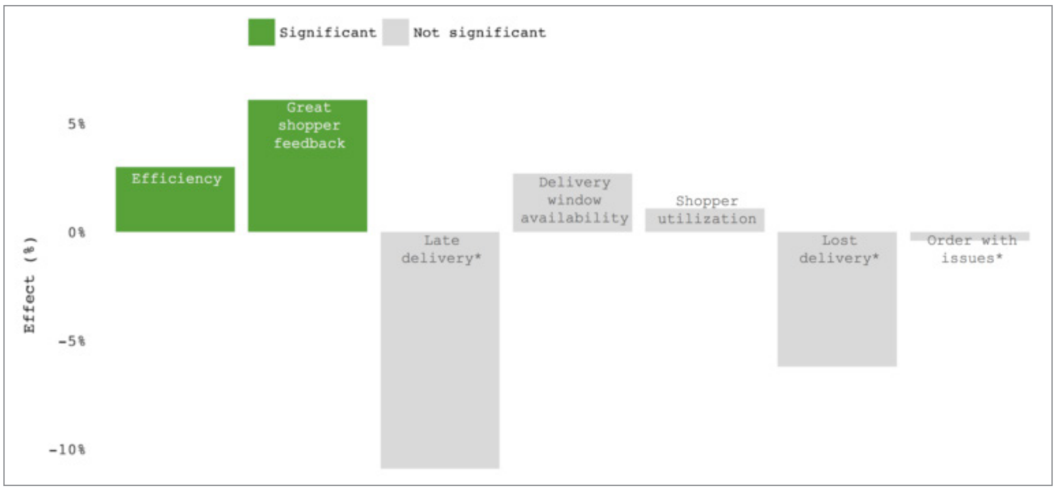
> "In the case of Instacart marketplace models, we chose to start with (Zone, Day) as the EU, where "zone" is a segment that operates independently in geographic areas.
>
> For example, it doesn't make sense to combine an order in San Francisco and an order in Austin into one trip or send a shopper in Austin to deliver in SF. So, by definition, San Francisco and Austin are different zones. In addition, the fulfillment system "clears" overnight as the orders are same-day. Thus, any two days of the same zone are also independent.
>
> This implies that we can split samples by zone and day, and randomly decide which algorithm variant — A for the existing version or B for the new version — to apply based on a schedule.
>
> Here is an example of an experiment scheduled for 28 days and 30 zones (total of 840 sample points between control and variant).



Source: Bala Subramaniam, Version One Blog

> Once the EUs and the experiment schedule is determined (and ensuring no other changes are running across the variants), it is time to start the experimentation for the entire length of the test."

After the experiment is complete, you can measure the differences between the variants to conclude the tests. Below is a sample result of one such experiment.



Source: Bala Subramaniam, [Version One Blog]

6

MARKETPLACE TOOLS

With help from the Marketplaces Facebook Group and the Everything Marketplaces Community, we have curated a list of recommended B2B tools by marketplace founders.

As you're building and scaling your marketplace, consider which tools and technology to leverage. There's no reason to reinvent the wheel as new infrastructure solutions are emerging to help facilitate transactions on your platform, including payment software, background checks, shipping and fulfillment solutions, and data privacy. We're seeing more mid- to later-stage marketplace companies turning toward no- and low-code tools to help automate CX, internal processes, and more.

Many of the tools listed can be relevant to any software startup, and not just marketplace companies. However, a marketplace is unique in that it deals with distributed supply and demand and there aren't many marketplace-specific tools out there yet to help with this.

You can check out a comprehensive directory of marketplaces that were built using no-code tools and platforms like Sharetribe, Bubble, and Webflow. Everything Marketplaces has a toolkit directory that lists tools like ID verification, service providers like insurance, and more. And, there's the helpful Guide to No Code Marketplaces from Mike Williams.

7

WORKING WITH INVESTORS

Two of the most frequently asked questions at any startup event or investor panel are "What do investors look for in a marketplace startup?" and "How do investors value a startup?" While answering these questions is often more art than science, we'll shed some light on how we evaluate companies at Version One.

WHAT DO INVESTORS LOOK FOR IN A MARKETPLACE?

One of the first things to consider is: Does this need to be a marketplace? No doubt, customers are already finding a way to purchase the products or services. Will a marketplace make it a 10x better solution? The answer should be "yes."

Then, we dig into the details. As mentioned earlier, Bill Gurley outlined a list of 10 factors to consider when evaluating marketplaces. If you haven't read his post already, we strongly encourage you to do so.

And, as we mentioned in Chapter 1, the six most important factors for us are:

- High fragmentation
- Regular frequency of use/purchase
- Discovery/new buyer-seller relationships (vs. monogamy)
- Total Available Market
- Transactional (being part of the payment flow)
- Ability to expand the overall market

These aren't the only factors that lead to success. For instance, other VCs feel that a marketplace with less frequency of purchase can be offset by a high AOV. However, for us, these six points create the foundation of our thesis and we're more likely to dive into a startup's data if we're aligned at this higher level.

What type of traction do we want to see in order to invest?

The answer is, "it depends." Every startup is different and we conduct our due diligence on a case-by-case basis. Yet, with that said, there is a general set of questions we use to evaluate the dynamics of a marketplace and assess a startup's product-market fit.

Using our portfolio company Headout as an example, here's a sampling of questions we may ask a potential marketplace startup. You'll see that many of these questions are inspired by the metrics/KPI data we discussed in Chapter 5.

While some of the specific details may vary based on the market (Headout is a travel/experience-oriented marketplace), any founder can use this as a primer for building out his or her own metrics. As you can imagine, there are many more questions to ask but these serve as a good conversation starter between Version One and the entrepreneurs we meet, helping us develop a stronger thesis faster.

Wherever applicable, we ask for average values (e.g. spend, price, buyers, suppliers, time) and absolute numbers and distributions.

On buyers:

- How do you define engagement? What does your engagement pyramid or conversion funnel look like (e.g. % of users who download app, browse your app, purchase based on overall signups or relative to previous activity)?
- How do you identify your most engaged users? Have you been able to identify common traits of power users (e.g. perhaps a demographic breakdown)?
- What is the average time spent on the app on the whole, and on a per-activity basis?
- Do you have a weekly or monthly cohort analysis that you can share? What is your DAU and/or MAU?
- What is the average spend per user? Are users sensitive to price?
- What is the average time to conversion? For some companies, this is the number one KPI. A company like Uber will focus on converting within a minute of the app opening, while a company like Airbnb wants a visitor to convert over multiple visits (but within a few days). The target conversion time for most marketplaces will probably fall somewhere in the middle. Hopefully, your time to conversion improves over time as you identify ways to reduce friction in the process.

- How many users have purchased more than once? What is the time between the first and second time of purchase? Have users purchased in more than one city?
- What is the average time between booking and experiencing the purchase?

On suppliers:

- What percentage of vendors' total inventory is made available on your marketplace?
- How often do suppliers list new inventory?
- What percentage of listings are purchased?
- How long is something posted before it is purchased?
- What is the average price point? What is the most popular price for purchases?
- What is the average discount offered by vendors (if any)?
- What are the common characteristics of the most successful vendors?
- What percentage of vendors do you need to sign up (in a particular area) for critical mass or starting liquidity?

In general:

- To get a greater sense of product-market fit: what is the total number of downloads to date, number of users (suppliers and buyers), etc.?
- Are there any overlaps between suppliers and buyers? If so, what percent? Note: this question won't be applicable to every marketplace.
- What is your GMV? What is your take rate?
- What are your sources of traffic for users?
- What is your CAC by channel?
- What is your growth efficiency? (How much does your run-rate net revenue, or run-rate variable margin, increase for every dollar you spend on sales and marketing?)

Evaluating B2B marketplaces

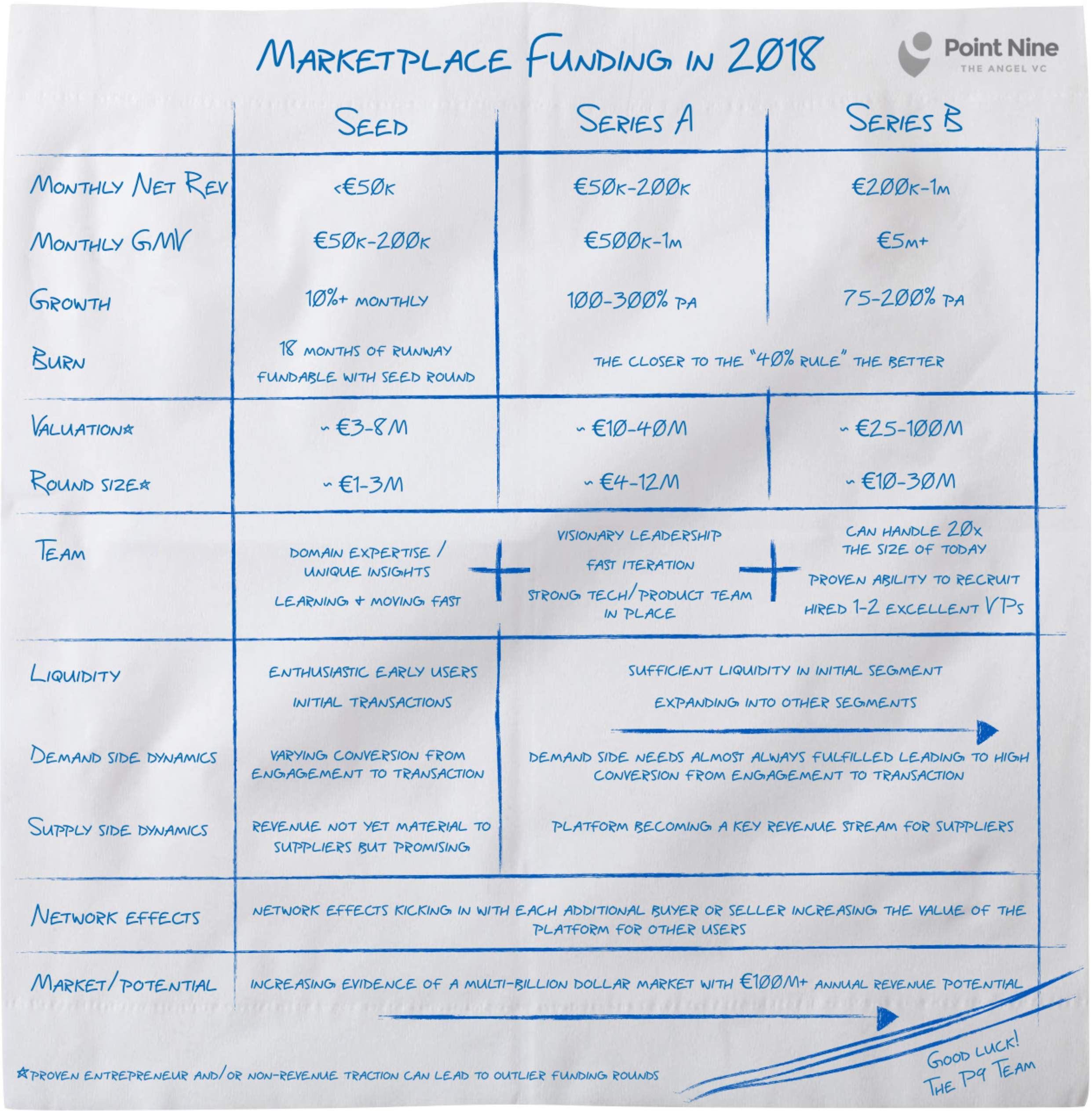
The way we evaluate B2B marketplaces is not much different than B2C. We look at GMV, TAM, and the go-to-market strategy among other factors. For more information about what's considered good, better, best for these three dimensions, we recommend Bessemer's post, Roadmap: B2B Marketplaces.

MARKETPLACE FUNDING NAPKIN

Back in 2016 we collaborated with Point Nine Capital to create a framework that links milestones with fundraising stages for marketplace companies. Since then, the ecosystem has evolved, the amount of capital has increased and round sizes and valuations have been getting larger. We're happy to report that Point Nine updated the Marketplace Napkin in 2018 (note that the values are in Euro).

As always, there are exceptions to every rule. Some startups can raise a big round early on (for example, when the founding team already has large exits under their belts), while other startups feel the frustration of struggling to raise money even though they're hitting every milestone on the chart. But we hope this chart can be a useful framework for founders to understand what benchmarks we as marketplace investors look for, and when we look for them.

Ultimately, we invest in smart founders — ones who are incredibly passionate, ambitious, and talented. But these founders are also data-driven, no matter how early the company is. We want to know that an entrepreneur has a good hold on all KPIs, and understands the knobs and levers that he or she can turn and pull in order to engage users and scale the business. In fact, the most impressive founders are able to present their data quickly and communicate insights clearly.



Marketplace Funding in 2018

Point Nine
The Angel VC

	Seed	Series A	Series B
Monthly Net Rev	<€50K	€50K-200K	€200K-1M
Monthly GMV	€50K-200K	€500K-1M	€5M+
Growth	10%+ monthly	100-300% PA	75-200% PA
Burn	18 months of runway fundable with seed round	The closer to the "40% rule" the better	
Valuation*	~€3-8M	~€10-40M	~€25-100M
Round size*	~€1-3M	~€4-12M	~€10-30M
Team	Domain expertise / unique insights; Learning + moving fast	+ Visionary leadership; Fast iteration; Strong tech/product team in place	+ Can handle 20x the size of today; Proven ability to recruit; Hired 1-2 excellent VPs
Liquidity	Enthusiastic early users; Initial transactions	Sufficient liquidity in initial segment; Expanding into other segments	
Demand side dynamics	Varying conversion from engagement to transaction	Demand side needs almost always fulfilled leading to high conversion from engagement to transaction	
Supply side dynamics	Revenue not yet material to suppliers but promising	Platform becoming a key revenue stream for suppliers	
Network effects	Network effects kicking in with each additional buyer or seller increasing the value of the platform for other users		
Market/potential	Increasing evidence of a multi-billion dollar market with €100M+ annual revenue potential		

*Proven entrepreneur and/or non-revenue traction can lead to outlier funding rounds

Good luck!
The P9 Team

Source: Point Nine Capital

HOW DO INVESTORS DETERMINE VALUATION MULTIPLES FOR MARKETPLACES?

The main multiple we like to use for marketplace businesses is GMV. Our rule of thumb is that marketplaces at scale are valued at roughly 1x annualized GMV, typically about 6-8x annual revenue. These are for marketplaces that are growing fast and are category leaders. Note that this section is not relevant for early marketplaces still refining monetization (that will be covered in the next section).

Our assumptions for this valuation:

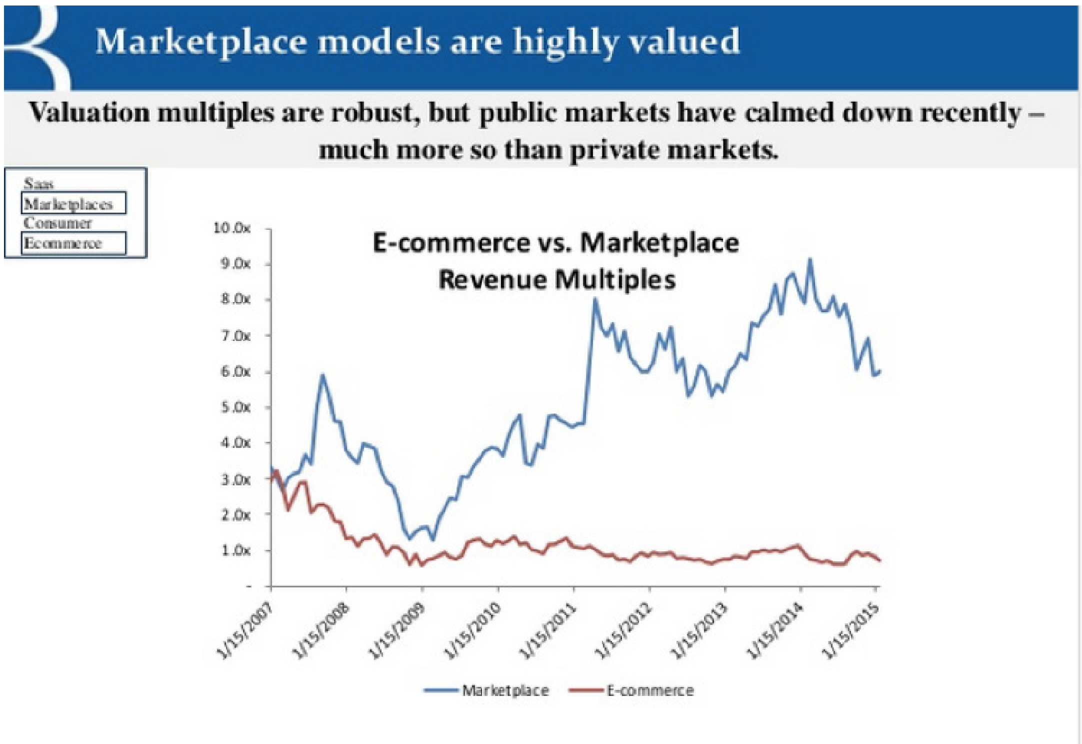
- Scale: > $1b GMV
- YoY growth of at least 30%
- Take rate of about 10-15%

Taking Etsy as an example, after it went public:

- Consensus estimate of approximately $270M for 2015 revenue
- $2.4B for 2015 GMV
- Take rate of about 11%
- YoY growth for most recent quarter (ending Q1 2015): 45%

Etsy had a market cap of about $1.86B as of July 13, 2015 with a revenue multiple of 6.8 and a GMV multiple of 0.76. But note that its GMV multiple was as high as 1.7 immediately following its IPO.

Bessemer offers a good overview of current valuations for different business models: SaaS, marketplaces, consumer, and e-commerce.



Source: Bessemer Venture Partners, SlideShare
"Valuations: What is happening and does it matter?"

You can see in their chart above that marketplaces get some of the highest revenue multiples because of their operational leverage and high defensibility at scale.

While there's certainly a lot of enthusiasm surrounding marketplace valuations, it's important to realize that there's a large (and potentially sobering) disconnect between the valuations for public and private consumer marketplaces. This fact was recently pointed out by Mahesh Vellanki of Redpoint Ventures, after he took a deep look into six metrics for marketplaces, including enterprise value, revenue multiples, and revenue growth. His conclusion:

> "What I see are large scale, profitable and fast growing marketplace businesses in exciting markets that are worth shockingly little relative to private comps. I'm both excited and scared to see how things will shake out."

What about early-stage marketplaces?

These valuations apply to marketplaces that have already solved the chicken-and-egg problem, reached liquidity, and have become a category leader. But you might be wondering how to value your early-stage marketplace startup.

Early-stage companies are valued very differently. In this case, metrics don't count. We're evaluating the team, idea, and vision. Then as the marketplace starts to scale fast, the multiples are often very high because growth is high as well. But you need to understand that your marketplace will ultimately be valued at 1x GMV.

If you're a founder of an early-stage marketplace, you should focus on two things:

1. Growing GMV
2. Proving out take-rate

Sometimes we see entrepreneurs who pitch impressive GMV numbers, but haven't proven that they can ultimately get to a significant take rate. For example, a marketplace that generates leads instead of being part of the transaction might have a take rate as low as 2-3%. In this case, the GMV needs to be 5x bigger than a comparable marketplace with a 10-15% take rate.

The bottom line: don't wait too long to prove out your monetization.

8

MARKETPLACE EXITS

It’s typically a binary outcome for marketplace startups at the beginning: either you figure out the chicken-and-egg problem or you don’t. And, marketplaces usually face a binary outcome at the other end too: either you scale your marketplace into a large, stand-alone company that can go public, or you find yourself with few other exit options.

SaaS companies typically have more exit opportunities. It’s common for SaaS start-ups to be bought by large enterprises for the technology/product. The acquiring company can just plug that product into their existing distribution channel to help round out their current product suite and grab more market share.

However, in the case of marketplaces, it’s much harder to leverage existing distribution or find synergies between the acquirer and acquired company. A marketplace’s technology/product is often custom and proprietary, making it tough to replace with existing technology and save costs.

It’s also hard to transition buyers and sellers over to the acquirer’s marketplace, as Boris has seen first hand. When Amazon acquired Bibliofind (a competitor to his company AbeBooks) in 1999, they expected to switch all of the Bibliofind sellers over to Amazon. Instead, most of the sellers left the platform and signed up with AbeBooks, giving AbeBooks a huge boost.

If an acquiring company cannot fundamentally change the economics of the marketplace they acquire and if it’s tough to switch over the new buyers and sellers, there’s little incentive to acquire a marketplace.

In fact, the only reason you’d ever acquire a marketplace is if it were a large, standalone unit that could grow on its own. eBay was relatively successful when it acquired marketplaces like Rent.com (2005) and StubHub (2007). But, the universe of eBay-like buyers is limited, as is the number of marketplaces that build platforms with several billions of GMV.

This means that an IPO is the exit option for the most successful marketplaces. Over the past few years, we've seen this with Alibaba, Etsy, Lending Club, Lyft and Uber. And, we will most likely see this with Airbnb, DoorDash and Instacart.

In short, it's a binary outcome for most marketplace start-ups at both the beginning and end. Be sure to set your expectations and business model accordingly.

CONCLUSION

Marketplaces are tough to build. But once they reach liquidity, they can be even tougher to kill.

Some of the most truly revolutionary companies born over the past decades have been marketplace companies, and we believe there's a lot of room for new entrants. Some of the world's next billion dollar unicorns will be marketplace startups.

Buying and selling is an integral part of daily life, and there's still great opportunity for innovation in new verticals, models, and monetization strategies.

We also see how online marketplaces are changing participants' lives. For example, Airbnb created a whole new consumer behavior and way of travel: 72% of hosts in NYC depend on their Airbnb earnings to pay their rent or mortgage. Etsy enables crafters and hobbyists to make money doing what they love: 35% of Etsy sellers started their business without much capital investment (compared with 21% for small business owners in general).

One-third of Version One portfolio companies are marketplace companies, and with each company, we're learning more about marketplace success strategies and how to overcome the challenges associated with liquidity and scaling. We're excited to be active investors in this space and are looking forward to the journey ahead.

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