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Marketplaces and the Chicken and Egg Problem: Supply or Demand First?

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A platform brings at least two sets of users together: consumers and producers. Having one will help reel in the other, and having neither means your marketplace or platform won't succeed. It's the classic chicken-and-egg dilemma, which as we've written before, is solvable in ways that aren't necessarily easy, obvious, or intuitive.

We've said that marketplaces must solve for demand in the early stages by failing fast and faking it until you make it. We've also written about how incumbents building marketplaces should tap into smaller, more fragmented supply rather than partnering with big adjacent-industry retailers in the name of building a complementary marketplace.

You might be asking, as a recent *Winner Take All* viewer did, which is it? Which variable, supply or demand, should be addressed first? The

New Marketplaces Should Solve for Demand First

You need to determine early on whether your marketplace platform idea is attractive to users, and whether the provisional supply is something people will want to consume. That means that in solving the chicken and egg problem for marketplaces, demand usually comes first.

If desire exists in the market for the experience your marketplace facilitates, you'll get an early sense of product-market fit. This lets you build upon this initial core transaction to make the experience sticky enough to draw consumers back, time after time.

This is what we're getting at in the discussion of "manual hacks." Those manual activities, be they individual phone calls to trusted suppliers, buying product wholesale, or contracting out work to individuals and small firms, can quickly test the core transaction's value with consumers before you go ahead and create any custom software. You can hack together or fake the backend of the marketplace with manual labor in the initial stages, until you validate the core transaction and get an understanding of what exactly you should automate with technology.

In this phase, it doesn't matter as much where the supply is coming from. You can fake the supply and source it manually on the back end at first. It's even okay to source supply in linear fashion, meaning you own all the initial products, either by manufacturing or procuring products yourself from other sellers.

market for the kind of thing your platform does? Answering these questions for your nascent marketplace by "faking it 'till you make it" is the first order of business.

Prioritizing demand, however possible, was a crucial part of the origin story of many successful startups:

- Uber met customer demand in the early stages by directly hiring the initial drivers for the ride-hailing service, ensuring availability when a customer hitched a ride through the app.
- com listed merchandise they didn't actually have in inventory, and then went to other retailers like Amazon to fulfill orders…even if it meant buyers would receive the item in an Amazon-branded box.
- The creators of the home services platform Handy took orders through a simple landing page, and then hustled behind the scenes to get the right pro to the customer within the promised 7-day window.

Of course, the typical platform startup has little choice other than to bootstrap some manual hacks, as needed, to prove there's a market for what they want to do. Incumbent retailers embarking on platform innovation, on the other hand, have a huge advantage in this stage. They typically have some pockets of digital demand already, in the form of the customer base they already have or in a currently-underserved segment of their target audience.

Incumbents Should Self-Disrupt to Grow Supply

Let's say you've had a linear eCommerce outlet for a while now, and the demand is there. How do you open up the supply side and build network big-name suppliers in adjacent, noncompeting verticals to offer complementary products. This would turn them into a kind of hybrid marketplace — for example, a home goods retailer that offers groceries, or a big consumer electronics retailer that also sells clothes.

This approach sounds nice all around, as it promises to give customers more options, add more SKUs, and generate buzz. It might feel like a step towards building a big-name eCommerce outlet with mass appeal, something like a Walmart or Amazon. But it's not a great way to get there.

The way they typically play out, complementary marketplaces are a sham. Why? They never move the needle in a significant way for your business or for customers. And, they delay your business's ability to grapple with the important question of how it will respond to a world dominated by true marketplaces.

Will it embrace the disruption, will it try to partner with a fast-growing marketplace in your vertical, or will it go it alone and hope for the best? The longer you put off this decision, the worse your outcome is likely to be. Adding a few complementary products doesn't change the need to answer this question, and quickly.

If you're really going to embrace the marketplace model, your business should instead be looking at how to open up the core business to third-party sellers, including your potential competitors. Allow them to become your third-party suppliers and list their products for sale besides

Letting competitors in this deep may seem like you're playing with fire, but it is one of the best moves to scale up supply. It's key to sidestepping the faux marketplace trap, and it comes with numerous benefits. It lays the foundation of a liquid two-sided marketplace by allowing you to tap into your existing digital demand to achieve scale quickly. You have the leverage to exact a healthy take rate on the third-party supply transactions, since your platform is a reliable (maybe even exclusive) source of digital demand for the very things you're allowing competing suppliers to sell.

As we've noted many times before, this marketplace strategy is a key part of what's driven Walmart's eCommerce success. Following the $3.3 billion Jet.com acquisition, Walmart's rise to the number-two generalized marketplace hinges on their letting third-party sellers compete with internal inventory. This is how it managed to add tens of millions of new products within 12 months after the Jet acquisition.

Going the complementary marketplace route, might only result in a few hundred thousand SKUs with stagnant demand and less leverage over the supplier economics to boot. The unwillingness to take the "risk" of self-disruption simply takes your platform venture out of the running, whether you're a B2C retailer or a B2B distributor.

Given Amazon's decades-long head start in marketplaces, it's too late for retailers and distributors to be experimenting with complementary

Solving the Marketplace Chicken and Egg Problem

Building a platform with winner-take-all potential takes looking at the viability of your efforts from new angles, and being willing to do the uncomfortable. There's more and more data to suggest platform innovation is the wave of the future and the smart move for today's incumbents.

So, what user group to build and when? While there's a variety of ways to solve the chicken and egg problem, it usually makes sense for early marketplaces still in pre-MVP or MVP stage to first prove there's a market, and that the core transaction is a desirable one. That means solving for demand first.

However, if you already have strong digital demand from your core business, the best route to marketplace success is to open up the supply side to compete directly with your core business. Too often, large incumbents engage in innovation theater with complementary marketplaces, rather than addressing the hard questions about the future of their business.

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