

PLATFORM BUSINESSES: THE DOMINANT BUSINESS MODEL OF THE 21ST CENTURY

Jeremy Schwartz – Global Chief Investment Officer, Kara Marciscano – Associate, Research
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We recently hosted Nick Johnson, principal at Applico and co-author of the Amazon bestseller *Modern Monopolies*, on our Behind the Markets podcast to discuss the latest on platform businesses.

Platform businesses operate in a nonlinear, multi-sided model that creates value by facilitating interactions between two or more interdependent groups. While traditional business models are based on a linear supply chain (e.g., Chipotle’s assembly-line food production, where the customer participates at the end of the supply chain), the platform business model is an asset-light network of connections (e.g., GrubHub’s online-food ordering connects diners with restaurants).

Instead of owning a means of production, platform-based businesses own the means of connection, and this key distinction is apparent in their financial statements:

[Balance Sheet](#) – Lower Inventory, Property, Plant and Equipment; Higher Cash

Platform businesses like GrubHub do not hold a Chipotle burrito as inventory or own the storefronts where they are produced.

Inventory, as well as property, plant and equipment (PP&E), constitutes a significantly lower proportion of a platform business’ total assets; meanwhile, cash as a percentage of total assets is roughly 3x greater for a platform company relative to the [S&P 500 Index](#).

Median as a Percentage of Total Assets						
	Cash		Inventory		Property, Plant and Equipment	
	Platforms	S&P 500	Platforms	S&P 500	Platforms	S&P 500
Last Fiscal Year	15.0%	5.0%	1.0%	6.4%	4.0%	12.3%
3-Year	15.1%	5.6%	1.0%	6.0%	4.0%	12.8%
Since IPO	17.2%	4.9%	1.5%	8.5%	5.2%	19.5%

Sources: WisdomTree, FactSet, as of 9/13/19. Platforms are measured by the WisdomTree Modern Tech Platforms Index. The S&P 500 is measured by the S&P 500 Index. Medians are calculated as the median fiscal year metrics for the last fiscal year, the trailing three full fiscal years and all trailing fiscal years since IPO. Past performance is not indicative of future results. Subject to change. You cannot invest directly in an index.

Income Statement – Lower Production Spend, Greater Investment in Research and Sales

Median as a Percentage of Total Revenue				
	Cost of Goods Sold		Selling, General, and Administrative + Research & Development Expense	
	Platforms	S&P 500	Platforms	S&P 500
Last Fiscal Year	33.4%	63.1%	46.0%	18.2%
3-Year	32.1%	62.9%	42.6%	18.4%
Since IPO	30.4%	64.8%	41.2%	20.4%

Sources: WisdomTree, FactSet, as of 9/13/19. Platforms are measured by the WisdomTree Modern Tech Platforms Index. The S&P 500 is measured by the S&P 500 Index. Medians are calculated as the median fiscal year metrics for the last fiscal year, the trailing three full fiscal years and all trailing fiscal years since IPO. Past performance is not indicative of future results. Subject to change. You cannot invest directly in an index.

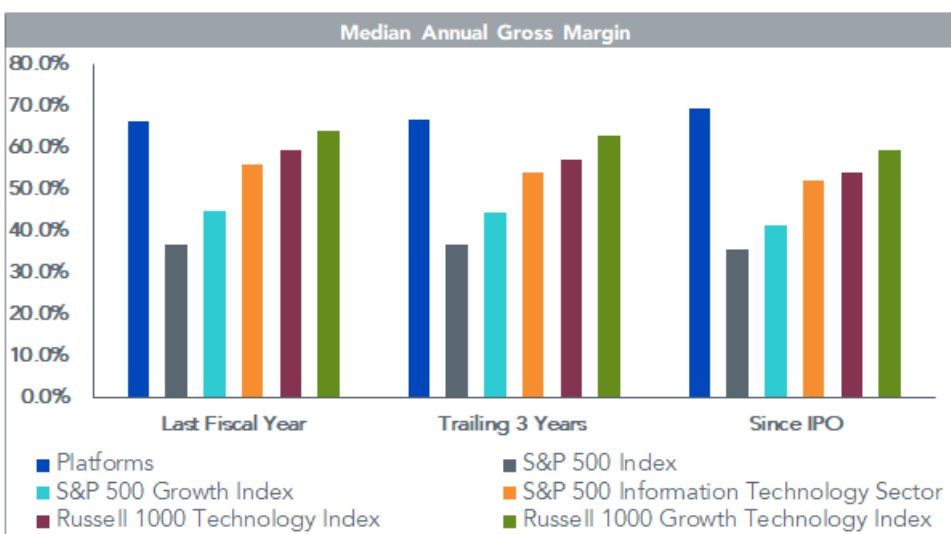
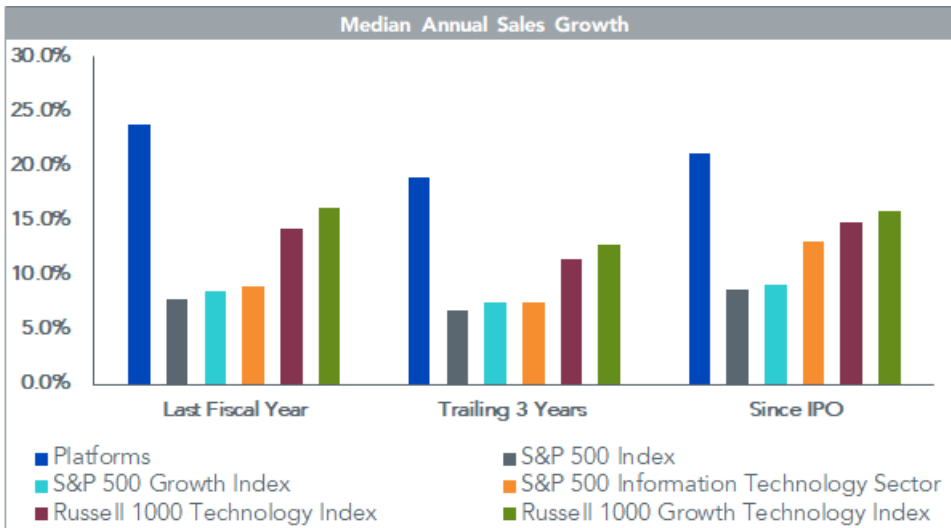
More Marketing Expenses

Platform businesses spend more on user acquisition and less on building up fixed assets or inventory. Expenses are mostly allocated to the technology and human capital necessary to grow and support their networks.

Nick noted platform-based businesses do not face production resource constraints, unlike linear businesses. Platforms scale beyond the capacity of a linear business because they benefit from low [marginal costs](#) and [network effects](#):

- Low to Zero Marginal Cost – Platforms incur little to no expense to facilitate a marginal connection. The cost GrubHub incurs to facilitate an additional food order is lower than the cost Chipotle incurs to prepare an additional burrito, especially if that location needs to order more rice (i.e., resource constraints) to meet demand.
- Network Effects – The value of each additional network user increases over time as the network expands. As more restaurants join GrubHub’s network, the value of the network increases for the consumer because he/she has more choice, and vice versa, as the number of consumers on GrubHub’s network increases, the value to producers increases because they have a greater number of potential customers.

Importantly, the structural advantages that allow platform-based businesses to profitably scale are reflected in stronger [revenue growth](#) and [margins](#).



Sources: WisdomTree, FactSet, as of 9/13/19. Platforms are measured by the WisdomTree Modern Tech Platforms Index. Median growth rates and margins are calculated as the median fiscal year metrics for the last fiscal year, the trailing three full fiscal years and all trailing fiscal years since IPO. Past performance is not indicative of future results. Subject to change. You cannot invest directly in an index.

Dominant Model of 21st Century

Nick views platforms as the dominant business model of the 21st century because of their ability to expand to the total size of a market. He believes we are at the early stages (approximately 15-20 years in) of a long-term, 50-year transition toward this platform model.

Platforms are prevalent within the Communication Services, Consumer Discretionary and Information Technology sectors, but Nick is confident more disruption is coming across industries like third-party logistics, business-to-business distribution, finance and health care.

Platform opportunities have sprung up from: 1) venture capital funded startups with a platform model entering new industries, or 2) through large, existing platform businesses using their core network to enter new markets.

Looking ahead, Nick expects more opportunities in a third way: the adoption of the platform business model by linear incumbents who see disruption on the horizon.

Nick provided great insight into the strength of the platform-based business and made a very compelling case for why he believes it is the dominant business model of today and the future. Thank you to Nick for the great discussion!

Please listen to the podcast below.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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DEFINITIONS

Balance sheet: refers to the cash and cash equivalents part of the Current Assets on a firm's balance sheet and cash available for purchasing new position.

S&P 500 Index: Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Marginal Cost: The cost added by producing one additional unit of a product or service.

Network Effects: When the value of a good or service exchanged in a network increases with the numbers of user.

Revenue: Income that a company receives from its normal business activities, usually from the sale of goods and services to customers.

Margins: Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.