
The power of intermediaries like Google, Amazon, and Blu-ray is rapidly growing. Be prepared.

What's Your Google Strategy?

by Andrei Hagiu and David B. Yoffie

Included with this full-text *Harvard Business Review* article:

1 [Article Summary](#)

The Idea in Brief—*the core idea*

The Idea in Practice—*putting the idea to work*

2 [What's Your Google Strategy?](#)

9 [Further Reading](#)

A list of related materials, with annotations to guide further exploration of the article's ideas and applications

What's Your Google Strategy?

The Idea in Brief

Multisided platforms (think intermediaries like Amazon or eBay that connect interdependent groups of customers) can lower your transaction costs and increase customer reach. But, as Toys "R" Us learned when it teamed up with Amazon, choosing the wrong MSP can lead to stiffer competition and loss of control over customers.

To select the right MSP for your business, consider three crucial decisions:

- Should you use an existing MSP or build your own platform?
- Should your company partner with one MSP or many? For instance, many companies advertise on both Google and Yahoo!
- Which MSP features should you adopt—or reject—to maintain competitive advantage? Target preserved its brand by selectively using Amazon's order-fulfillment services on its own Web site.

The Idea in Practice

A closer look at the three decisions:

USE AN EXISTING MSP—OR BUILD YOUR OWN?

An existing MSP may use its power against you to capture more value for itself. Watch out for these moves:

- **Imposing price increases once the MSP becomes successful.** After the PC market tipped to Windows, Microsoft raised its license price to OEMs.
- **Vertically integrating into players' businesses.** Google has been bundling more applications into its core offerings.
- **Weakening your relationship with your customers.** Retailing giants that joined Amazon had difficulty differentiating themselves from smaller merchants piling onto the site.

Given these risks, you may want to build an MSP (proprietary or open) yourself or with other players. That's expensive. Do so only if:

- You're a strategic player: You wield substantial power in the market relative to established MSPs and other players—so you can influence the MSP's actions.
- You can team up with enough other players to create a new MSP.

PARTNER WITH ONE MSP—OR MANY?

- With MSPs that don't require exclusivity: Consider joining all those that offer you positive net value. For example, advertise on Google *and* Yahoo!
- If an MSP demands exclusivity: That can present an opportunity. An MSP that needs you may offer money in exchange for an exclusive relationship.

► **Example:** Satellite radio provider Sirius paid \$500 million for an exclusive contract with radio personality Howard Stern to gain the upper hand over its rival XM.

ADOPT WHICH MSP FEATURES?

Use MSPs in ways that will enable you to:

- Differentiate yourself from competitors conducting business on the same platform
- Reduce the risk of an MSP using its power against you

► **Example:**

When Google launched a social networking application development platform, OpenSocial, it invited other social networking sites to use OpenSocial applications. Social networking site LinkedIn joined in, but to preserve its distinctiveness compared with other networking sites, it has been selective about which OpenSocial applications it will allow to work with LinkedIn. In addition, LinkedIn continues to offer unique applications; for instance, an events calendar that allows a LinkedIn member to find which members from LinkedIn and other networks are attending events.

The power of intermediaries like Google, Amazon, and Blu-ray is rapidly growing. Be prepared.

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When Toys “R” Us executives signed a 10-year “exclusive” agreement with Amazon in 2000, they saw the deal as the perfect solution to a vexing challenge: how to establish an online retail business that would dominate its category and achieve profitability sooner rather than later. Having struggled to build an online business on their own, they believed they needed Amazon’s internet savvy and order-fulfillment skills. They agreed to pay Amazon a hefty \$50 million annually plus a percentage of the toy retailer’s online sales in exchange for Amazon’s building and running a Toys “R” Us virtual storefront on its e-commerce site. Less than four years later, the deal had turned into a money loser for Toys “R” Us, and the company sued Amazon, seeking \$200 million in damages.

What went wrong? To fuel its own growth and profitability, Amazon had recruited small, third-party merchants to sell toys and games directly through its website. In a two-year court battle, Toys “R” Us argued that Amazon had violated the exclusivity agreement and

that the rising competition had hurt its online sales. Amazon tried to justify its actions by contending that the other merchants were addressing customer needs that Toys “R” Us couldn’t or wouldn’t satisfy. In the end, the court ruled that Amazon had violated the agreement; it allowed the companies to sever their relationship but didn’t award Toys “R” Us damages.

Toys “R” Us’s frustration is not unique. Companies large and small have been wandering in the wilderness, trying to figure out how to play with the rapidly growing number of multisided platforms such as Amazon. MSPs are products, services, or technologies that connect different types of customers to one another. Credit-card companies and eBay link consumers and merchants. Google’s search engine connects advertisers and users of its services. Microsoft’s Windows platform has three sides (application developers, users, and OEMs), as does the Blu-ray standard for high-definition DVDs (content providers, manufacturers of DVD players, and consumers). Once

a relatively obscure strategic problem, multi-sided platforms have become important for all companies today, thanks to the power of the internet and related technologies. As new intermediaries have emerged to facilitate search capabilities and reduce transaction costs, companies find themselves acting either as an MSP or as a player on someone else's MSP.

MSPs are doubled-edged swords for the average company. On the one hand, a platform can make a company more efficient or increase its customer reach. For example, by advertising on Google, a firm can gain access to an audience that otherwise may be impossibly expensive to attract. On the other hand, just because an MSP has a great installed base of customers or offers platform services that can significantly reduce costs does not mean that joining it guarantees success. Before Toys "R" Us struck its deal with Amazon, it should have recognized that the two companies' long-term interests were fundamentally at odds. The success of Amazon's platform depended on covering the "long tail" of consumer demand by offering any product in any category. By contrast, Toys "R" Us's success was driven by the "short tail" of toys: pushing mainly hot products in high demand. Toys "R" Us should have anticipated that as soon as it succeeded in establishing the toys and games category on Amazon's platform, Amazon would have the upper hand and would try to wiggle out of the exclusivity pact. Toys "R" Us probably should not have agreed to put its online store inside Amazon's site. At the very least, it should have extracted more concessions (including tougher restrictions on adding other toy vendors) up front, when its power was the greatest.

Without a clear strategy for dealing with multisided platforms, firms can easily find themselves ceding control over customers or being unwittingly turned into commodities. A few basic steps can help managers set a clear platform strategy:

- First, decide whether to play with an existing MSP, build your own platform, or do both.
- If you conclude that a third-party MSP can benefit your business, determine whether your company should join one or many.
- Once you know which MSPs to play with, figure out how to play—which features

or services you should adopt and which you should reject in order to maintain your competitive advantage.

To Play or Not to Play?

It might seem obvious that all companies should play with platforms that can add value to their business. Indeed, in some industries there is no choice: If you want to write applications for PCs or games, you have to work on MSPs such as Windows, Macintosh, or PlayStation. Your initial bias should be to join an MSP for two reasons: the immediate opportunity to reduce search and transaction costs and the expense and risk of building your own. But before leaping onto an MSP, you should carefully consider one major risk: the potential for the company (or companies) that owns or controls an MSP to hold you up—to use its power against you to capture more value for itself.

The most obvious form of holdup is the price increases that companies can and often do impose once their MSPs become successful. After the PC market tipped to Windows, Microsoft raised the price of its license to OEMs almost every other year for two decades. A company can also hold up players by using the MSP to vertically integrate into their businesses. The more successful a player is, the greater the temptation is for the MSP to try to capture that value for itself. And the MSP has considerable power to do so: The company that controls a successful MSP controls the interface between players and end users and dictates the rules of engagement. This form of holdup has become pervasive in technology-based industries where the dividing line between players and platforms is easily crossed. Microsoft's practice of invading other companies' turf by adding features to Office and Explorer is well known, but it's hardly the only example: eBay expanded into payment systems; Google has been bundling more and more applications into its core offerings; and Facebook has been introducing features previously provided by its third-party vendors.

The third way an MSP can hold you up is by using its power to weaken your relationship with your customers—either by gradually taking control over end customers or by inviting other players to compete in your product category. Obviously, this can greatly reduce a player's ability to extract value. Aside

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from Toys “R” Us, several other retailers, including Borders, Circuit City, Gap, and HMV, rushed to join the Amazon platform between 2000 and 2001, only to realize a few years later that they were having a hard time differentiating their offerings from the increasing numbers of smaller merchants piling onto the site. Eventually, all these big retailers dropped Amazon and went with their own web platforms. But by that time, they had lost valuable years.

Some companies claim that they will never use their MSPs to compete with their players, but you should not take such commitments at face value. The president of one multibillion-dollar online retailer we interviewed had the right attitude. He told us that even though a platform’s initial sales pitch may sound great, “I assume they want to screw us. For example, PayPal and Google want us to take their payment system, but for us, they are a Trojan horse.” In the face of holdup threats, you should seriously consider building a platform on your own or with other players. If you wield substantial power in the market or can team up with enough other players to gain the upper hand, building a platform yourself or with others may be the way to go. The test of whether you have enough power is: Can you influence the MSP’s actions? Those companies that can we call “strategic players.”

Strategic players can choose from two broad do-it-yourself approaches. The first is to build a proprietary platform (by yourself or with partners) in order to create value and capture as much of it as possible. The second do-it-yourself approach is to create an open MSP, which prevents any platform from ever claiming value. Google’s Android operating system (for mobile phones) and OpenSocial application programming interface (for developing applications for social networks) can be viewed as an attempt to do just that. The search giant wants to prevent Symbian, Microsoft, or Apple from becoming the dominant operating system for mobile devices, and it wants to prevent Facebook and MySpace from dominating social networks.

Companies make two common mistakes in deciding whether or not to play with an existing MSP. First, they fail to fully understand the objectives of the MSP’s owner and how those objectives might change over time as the MSP’s growing power creates opportunities to extract more value from its players. For instance, providing technology or order-fulfillment services to third-party sellers makes up only 5% of Amazon’s revenues but accounts for a full 30% of the company’s profits. Some retailers recognized the benefits and dangers of the Amazon platform and played their cards well. Target, for example, decided not to create a storefront within Amazon.com and instead built a 100% Target-branded website that used some of Amazon’s order-fulfillment services.

The second common mistake in deciding whether to build their own proprietary platform is that some companies grossly overestimate their own ability to persuade other players to support it. Nokia fell into this trap.

After introducing smartphones in 1996, Nokia realized that it needed a software platform that would encourage the development of sophisticated applications and mobile services. Rather than rely on Palm OS or Microsoft’s Windows Mobile, the leading software platforms for handheld devices at the time, Nokia persuaded three other handset manufacturers to join it in creating Symbian, a for-profit consortium that would develop a new operating system. Initially, Nokia held the largest stake, around 40%.

Symbian licensed its operating system to its shareholders as well as to any other mobile

Platforms, Market Intermediaries, and Multisided Platforms

Pure Platforms

Platforms are products, services, or technologies that serve as foundations on which other parties can build complementary products, services, or technologies. Pure platforms do not have any contact with players’ customers.

Examples: SAP’s ERP software, E-Ink’s electronic ink technology (used in the Amazon Kindle), Qualcomm’s CDMA technology for mobile devices

Pure Market Intermediaries

Market intermediaries are firms that make a living by reducing search and transactions costs for two or more distinct groups of players. These firms

generally take full possession or control of the goods and services whose sale they facilitate.

Examples: Wal-Mart, 7-Eleven, Whole Foods

Multisided Platforms

An MSP is both a platform and an intermediary. MSPs can insert themselves between you and your customers, though they don’t take ownership of the goods and services whose sale they facilitate. MSPs support players that are interdependent, which creates indirect network effects.

Examples: Nintendo Wii, Amazon.com, Match.com

phone manufacturer that wanted it, and it quickly became the leading smartphone operating system, with a market share of more than 60%. But to differentiate themselves in the fiercely competitive market, licensees then developed customized, incompatible versions of the operating system. The resulting fragmentation prevented the platform from becoming popular with application developers. After more than seven years on the market, only about 5,000 applications had been built. (More than 10,000 applications were built for Apple's iPhone OS in less than a year.)

In addition, Nokia's leading stake in the venture caused other handset manufacturers to fear that Nokia would use its power to gain an advantage over them. They hedged their bets by supporting various versions of Linux and Windows Mobile as well as Symbian. That left a huge opening for existing competitors to catch up and for newcomers such as Google's Android and Apple's iPhone to enter the fray.

In a last-ditch effort to save the Symbian operating system, Nokia bought out its partners and spun off the enterprise in June 2008 as an open source consortium that gave its software away. In essence, Nokia recognized that it had erred in trying to use a proprietary platform to contain or deter competing platforms while also attempting to extract value

for itself. But it may have learned this too late. Companies rarely get a second chance to tip a market.

Which MSP Should We Play With?

If you decide that you should play with one or more MSPs, then you have to figure out which to join. More specifically, should you go with one MSP exclusively or affiliate with several?

Some MSPs may not require exclusivity, in which case you should consider joining all those that offer positive net value. For example, since neither Google nor Yahoo requires exclusive arrangements, there's no reason not to advertise on both.

Other MSPs may demand exclusivity, which can be an opportunity. If an MSP wants and needs you, it may offer money or other forms of compensation in exchange for an exclusive relationship. The most visible example in recent times was the battle between the Toshiba-led HD DVD camp and the Sony-led Blu-ray camp to be the dominant platform for high-definition DVDs. Both sides reportedly offered large sums to Paramount, DreamWorks, Disney, and other studios to persuade them to join on an exclusive basis.

Similarly, hot content producers have been able to rake in enormous sums by getting rival radio and TV broadcasters to bid against each other for exclusive access to their content. Satellite radio provider Sirius paid \$500 million for a five-year exclusive contract with radio personality Howard Stern to gain the upper hand over its rival XM.

In the long run, perhaps the most critical considerations for strategic players are: Would an exclusive relationship with you tip the market to one platform or another? If so, do you want to tip the market and allow one winner to take all? Tipping is desirable when adopting one standard would expand the market for all players and it's still possible to prevent the MSP from holding you up. Otherwise, a strategic player should steer clear of the arrangement and maintain support for two or more competing MSPs. Samsung and Motorola adroitly adopted this approach in mobile phones and played with multiple MSPs: Symbian, Windows Mobile, Linux, and Palm OS. This strategy made sense for them because it was (and still is) very hard to tell which platform might win, and neither was large enough to tip the market to one

To Play or Not to Play?

Questions to ask when deciding whether to play

- What parts of our business are we doing ourselves that would be better handled by using an existing multisided platform?
- What are the things that we rely on MSPs for that we should be doing ourselves?
- Can existing MSPs add value to our business by lowering our costs or increasing our customer reach at a reasonable price?
- What are the risks that an MSP will use its power against us to capture more value for itself?
- What conditions might allow the MSP to raise prices over time?
- Is there a danger that the MSP will try to take control of our customers and reduce our differentiation?
- Should we pursue a "do it yourself" (DIY) strategy and build our own platform?
- What are the feasible DIY options (by ourselves or in a coalition with other players)?
- Would we pursue a DIY strategy to claim value for ourselves or to prevent other MSPs from claiming value?
- If we build a platform, will other players join us? Can we achieve sufficient scale without working through an established MSP?

operating system. The downside of this hedging strategy, of course, is obviously the extra engineering, marketing, and support required to play with several MSPs.

Indecisiveness in choosing where to play can be expensive. Time Warner arguably made this mistake in the high-definition DVD standards war. For more than two years, Time Warner supported both HD DVD and Blu-ray. It initially hoped that HD DVD would win for a number of reasons: Time Warner had a higher market share for content on HD DVD than it did on Blu-ray (50% versus 20%); HD DVD players were cheaper, which meant that the market for machines and content would grow faster if that standard prevailed; and the company was reluctant to throw its weight behind a platform led by Sony, one of its main competitors. But with the overall market evenly split between the two standards, Time Warner was unwilling to gamble and exclusively back HD DVD—especially since Sony, which had lost the VHS-Betamax wars in the 1980s and had bet its PlayStation 3 franchise on Blu-ray, could be expected to fight until the bloody end.

Eventually, Time Warner's fears about helping Sony were supplanted by the concern that the long-term opportunity to sell high-definition DVDs was shrinking. One factor was that the continuing uncertainty about which standard would prevail was slowing consumer purchases of high-definition players. The second was that digital downloads were rapidly eating into the market for DVDs. Time Warner couldn't do much about the

second factor, but it could do something about the first by helping tip the market to one standard. Realizing that its 50% share of HD DVD content gave it more power over HD DVD's fate than its 20% share of Blu-ray content gave it over Blu-ray's, Time Warner decided in early 2008 to abandon the HD DVD camp, which immediately called it quits.

But Time Warner's indecision clearly hurt its long-term profits. It would have been better off making an exclusive commitment earlier—in exchange for a sufficiently large payment to compensate for the risk of guessing wrong about who the ultimate winner would be. Given all the previous occasions when delays in resolving standards wars had opened the gate for new technologies to leapfrog existing ones, Time Warner should have known better.

How to Play

In choosing how to play on a given platform, companies must keep two main questions in mind: How can we differentiate ourselves from competitors that are conducting business on the same platform? And how can we reduce or mitigate the risk of holdup once we have decided to play?

For nonstrategic players that lack the power to influence an MSP's actions, deciding how to play usually boils down to choosing from the menu of contracts offered by an MSP. For example, after a company has decided to place online ads through Google, the only remaining choices are how much to spend and which keywords to bid on. But in some cases, even a nonstrategic player can make choices that will differentiate it from competitors and avoid contract options that could commoditize its business. LinkedIn clearly kept those issues in mind when deciding how to play on Google's OpenSocial platform.

When Google announced in 2007 that it was going to launch OpenSocial, a new platform for developing applications that would work on all social network websites that joined it, LinkedIn had to decide whether it should play with Google and, if so, how. The decision to play was relatively easy. LinkedIn, as the third-largest social network behind MySpace and Facebook, needed to extend its reach and potentially lower its costs in order to compete. The critical question was, how to play?

Google's motive for launching OpenSocial

Where to Play?

Questions to ask when deciding where to play

- Does the multisided platform require exclusivity, or can we play on multiple MSPs?
- How does the increase in customer reach from playing on multiple MSPs compare with the increase in costs from supporting multiple MSPs?
- Can we extract extra compensation from an MSP if we go exclusive? Does the extra compensation outweigh the loss of customer reach and flexibility from playing with multiple MSPs?
- Would we tip the market to one MSP by going exclusive?
- Do we want or need to tip the market, or do we want to prevent it from tipping?
- What are the benefits and costs associated with the market tipping?
- What are the benefits and costs associated with the market not tipping?

was clear: to commoditize the leaders, increase competition among social networks in general, and make it easier for Google to sell advertising. If “gated” communities such as Facebook or MySpace were more open to everyone on the web, there might be huge opportunities to sell advertising.

Recognizing these dangers, LinkedIn crafted a strategy that would exploit the advantages of the platform but mitigate most of the risks. It decided to build its own platform and invite third-party application developers to join. In addition, it decided it would not allow all applications developed for OpenSocial members to work on LinkedIn. It would continue to offer proprietary applications and would use OpenSocial to increase their value. For example, it added to its proprietary calendar application an OpenSocial feature that allows a LinkedIn member to find out who else from LinkedIn and other networks is attending an event. Though it was a nonstrategic player in the space, LinkedIn consciously took steps to avoid becoming trapped in a commodity world, by mixing and matching the advantages of the MSP with its own products.

Strategic players have more options. They can either order from the menu or use their power to obtain a custom deal. A good example is the way Electronic Arts, the world's largest video-game developer and publisher, forced Microsoft's Xbox division to accede to its demands in online gaming.

Microsoft had required that game companies use its proprietary tools in developing their online games, include standardized features such as voice chat and Gamertags (unique user names), and allow Microsoft to handle customer service, billing, and administration. EA feared that those terms would cede too much control of the user relationship to Microsoft and would level the playing field among game developers. It also worried that it would set a bad precedent, encouraging Microsoft to make even more onerous demands in the future. Moreover, EA felt that Microsoft's refusal to share Xbox Live subscription fees with game publishers was unfair. Consequently, it refused to go along. To put pressure on Microsoft, EA included online functionality in the versions of the games it made for the Sony PlayStation 2, but not for the Xbox versions. Recognizing that this put Xbox Live at a severe disadvantage,

Microsoft caved. It allowed EA to maintain control over its own user data, marketing, and billing and reportedly also agreed to give EA financial compensation.

The biggest mistake you can make when deciding how to play is granting preferential terms to an MSP without carefully analyzing how the terms will affect the balance of power, both now and in the future. Failing to keep options open when you don't want the market to tip can put you at a significant disadvantage if the market does tip. This has been a painful lesson for the music studios in their relationship with Apple and iTunes. To contain the mortal threat posed by Napster and other file-sharing services, the studios hastily jumped on the iTunes platform in 2001. As a result, iTunes became the dominant platform for digital music, the studios found themselves dependent on it, and Apple has been able to extract most of the value of the business—mainly by keeping all the proceeds of its highly profitable iPod sales for itself. The studios should have considered the long-term implications of their decision to join iTunes more carefully and tried to negotiate more advantageous terms from the outset.

•••

Playing with multisided platforms soon will be a fact of life for all companies, big and small. MSPs reduce search and transaction costs and give companies vastly broader access to markets than they could achieve on their own. But over the past 10 years, we've also seen powerful owners of MSPs like Microsoft, Google, and Apple extract most of the value from platforms, because companies that played with them didn't adequately understand their motives and operating strategies.

So resist the herd mentality. Think twice before you join a popular platform. And remember that MSPs are moving targets and regularly review your strategy. The Google of tomorrow is unlikely to be the same platform as the Google of today. What's more, today's player can become tomorrow's platform. Until the iPhone was invented, most cell phone companies were players on the platforms of cellular networks. In the last two years, first the iPhone and then a slew of other cell phone manufacturers have rushed to turn themselves into the next-generation platform. Players should be on the lookout

How to Play?

Questions to ask when deciding how to play

- Which services or features of the multisided platform will enhance our differentiation and which will commoditize our business?
- How do the MSP's terms affect our competitive advantage relative to other players on the MSP?
- Do the terms strengthen the MSP's ability to hold us up?
- Should we (and do we have to) choose from the menu of contracts offered by the MSP? Can we negotiate a custom offering to mitigate the risk of holdup or commoditization?

for opportunities to become the tail that wags the dog. If you play really well on an MSP, you may even be able to dictate the rules of the game.

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Further Reading

ARTICLES

[Strategies for Two-Sided Markets](#)

by Thomas Eisenmann, Geoffrey Parker,
and Marshall W. Van Alstyne

Harvard Business Review

October 2006

Product no. R0610F

If you listed the blockbuster products and services that have redefined the global business landscape, you'd find that many of them link two distinct groups of users in a network. Case in point: The most important innovation in financial services since World War II is almost certainly the credit card, which links consumers and merchants. The list would also include newspapers, HMOs, and computer operating systems—all of which serve what economists call two-sided markets, or networks. Newspapers, for instance, bring together readers and advertisers; HMOs link patients to a web of health-care providers; operating systems connect computer users and application developers. Two-sided networks differ from traditional value chains in a fundamental way. Traditionally, value moves from left to right: To the left of the company is cost; to the right is revenue. In two-sided networks, cost and revenue are both to the left and to the right, because the "platform" has a distinct group of users on each side. The platform product or service incurs costs in serving both groups and can collect revenue from each. Because of what economists call "network effects," these platform products enjoy increasing returns to scale, which explains their extraordinary impact. Yet most firms still struggle to establish and sustain their platforms. Their failures are rooted in a common mistake: In creating strategies for two-sided networks, managers typically rely on assumptions that apply to products without network effects. As a result, they make decisions that are wholly inappropriate for the economics of their industries. In this article, the authors draw on recent theoretical work to guide executives who are negotiating the challenges of two-sided networks.

[Shaping Strategy in a World of Constant Disruption](#)

by John Hagel III, John Seely Brown, and
Lang Davison

Harvard Business Review

October 2008

Product no. R0810E

Redefining the terms of competition for a market sector, an industry, or an entire global ecosystem is a tall order. It means attracting thousands of participants, galvanizing their efforts, and keeping them committed for the long haul. Hagel, Brown, and Davison, of the Deloitte Center for Edge Innovation, provide a blueprint for this daunting task of shaping strategy while technology-driven infrastructures constantly change. The authors discuss three elements that are vital in shaping strategy. *A shaping view*, or rallying cry to potential participants, clarifies the market opportunity, makes sense of fundamental forces, identifies rewards, and highlights the shared nature of risk. Bill Gates succeeded with his view of desktop computing; more recently, Salesforce.com's Marc Benioff has held out a new model for delivering enterprise software. *A shaping platform*, like that of Google's AdSense, clearly defines standards and practices that help organize and support the activities of many participants, enabling them to do more with less. Specific *shaping acts and assets* convince participants that the shaper has the muscle to pull off its initiatives, as Facebook has done by showcasing its relationship with Microsoft. The three elements together allow a shaper to quickly mobilize a critical mass of participants and unleash powerful network effects, yielding big rewards during periods of rapid change. Almost any company will benefit from an attempt to shape strategy, say the authors, but they recognize that not every business is a shaper. By participating in other firms' shaping strategies, a company can still find plenty of opportunities to create value.

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