

A MCFADYEN DIGITAL EBOOK

BUILDING THE BUSINESS CASE FOR AN ONLINE MARKETPLACE

Understanding the Marketplace Business Model and Critical Elements to Consider While Building a Business Case



ABOUT THE EBOOK

A Marketplace business case is required to request internal funding for your company's Marketplace initiative or raise capital from professional investors. This ebook delves into the considerations to make while building a business case for a marketplace.

MCFADYEN

DIGITAL

THE MARKETPLACE EXPERTS

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1. Marketplaces are growing - Stats tell the story

The digital transformation wave that accelerated during the pandemic continues as evidenced by companies accelerating their aggressive push to leverage technology to fuel innovation and transform business operations in 2022. Overall digital spend is projected to be 55% of the total IT spend by 2023, up by around 10% from 2021, according to analysts.

The Top 100 online marketplaces in the world collectively grew gross merchandise value (GMV) 29.0% to \$2.68 trillion in 2020. Source: DigitalCommerce360 Apr '21	DIGITAL 360 COMMERCE
Global marketplace sales reached USD \$3.5tr in 2020. This figure is forecast to hit USD \$8.8 trillion by 2025, at a 20% CAGR. Source: Finextra Apr '21	Be SHAPING THE FUTURE
63% of US ecommerce is performed via marketplaces. Source: Forrester Aug '20	FORRESTER
Amazon sold 56% of its units via third party marketplace seller, collecting \$90 billion in marketplace fees over 12 months. Source: Amazon Oct '21	amazon
Amazon adds a new seller to their marketplace every minute. Source: MarketplacePulse Nov '21	Marketplace Pulse
Platform companies were 2X as profitable, were growing 2X as fast, and were than 2X as valuable as their conventional counterparts. Source: MIT Sloan Feb '20	MIT Sloan Management Review
Ecommerce aggregators have raised over \$12 billion in the past few years to acquire marketplace sellers. Source: MarketplacePulse Dec '21	Marketplace Pulse
By 2023, organizations operating enterprise marketplaces for more than a year will see at least a 10% increase in digital revenue. Source: Gartner Oct '20	Gartner

Fig 1.1 - Eight Interesting Marketplace Stats

While ecommerce revenues continue to grow, marketplaces are growing even faster...a trend that's impossible to ignore. 46% of consumers surveyed made purchases on a marketplace beyond Amazon, eBay and Walmart in the past year. 23% of consumers surveyed tried a new marketplace in the past year. The impact is visible in the eight stats in Fig 1.1 above.

2. Online marketplace growth far outpaces offline sales

For Marketplace operators, their stakeholders and investors, the story is even more impressive. Revenues of platform businesses and their corresponding valuations have skyrocketed past the traditional industry incumbents. Within the context of B2C Marketplaces, within 5 years general merchandise Marketplaces grew revenues by 800% while department stores were flat. Refer to Fig 1.2.

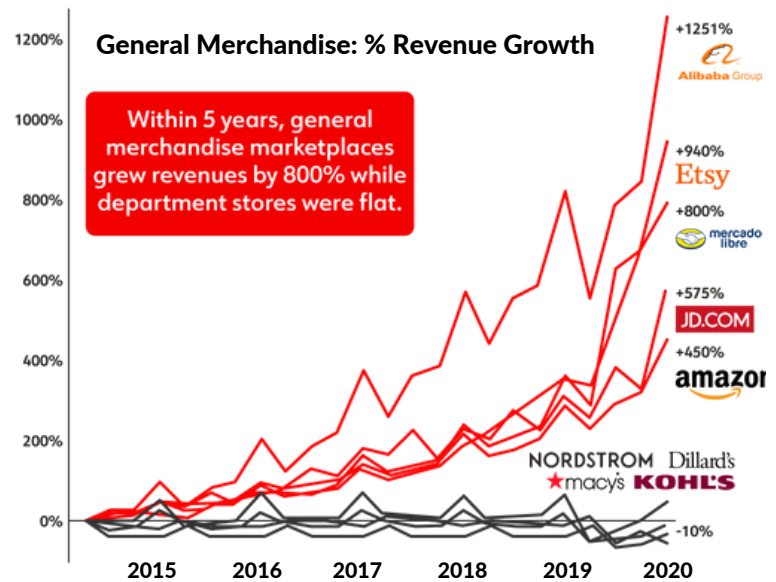


Fig 1.2- Growth of General Merchandise Marketplaces

At the same time Amazon Business which is a B2B Marketplace for manufacturers and distributors to sell their products and services grew over 2400% while others averaged a paltry 3%. Refer to Fig 1.3

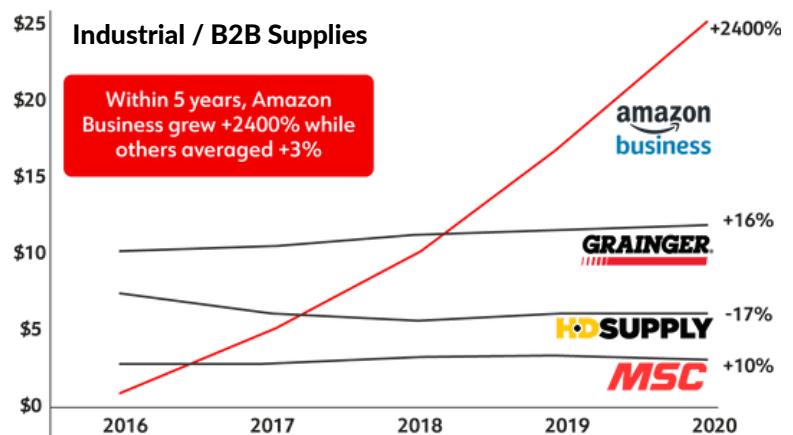


Fig 1.3- Growth of Amazon B2B

3. Marketplaces are in demand, so where's the issue?

In Gartner's Predicts 2022: Buyers Dictate Your Selling Strategy report, they reflect on their predictions made in 2018 where they stated: "By 2022, 10% of organizations doing digital commerce will build that into a platform business to transform into digital businesses, and 60% of those will employ an open ecosystem to scale up the growth. This trend has continued to accelerate, with major retailers such as Target and Walmart becoming material retail marketplaces, along with many major airlines and B2B businesses such as Siemens also connecting buyers with third-party sellers.

You might ask "So what is behind all of this?" The answer is twofold. First, innovative companies are seeing the benefits of a Marketplace business model whereby the cost do not scale linearly with revenue, as in traditional ecommerce business models (1P), thereby creating the ability to scale a highly profitable business faster. They realize there is a first-mover advantage for those who act quickly. For these companies they see opportunity. For other's they realize the world is changing under their feet and customers now do in fact dictate their selling strategy as the Gartner report suggests. For these companies they see a threat. In addition, they also fear the power of Amazon Business which soared from \$1 billion in revenue in 2016, to over \$25 billion last year. The challenge in this model for manufacturers and distributors is that 1) Amazon Business's fees are significant and 2) Amazon Business is disintermediating them from their customers. In response we are seeing unprecedented growth in B2B Marketplaces as manufacturers and distributors are racing to take back control of their sales channel.

As a result of these dynamics, we are seeing tremendous demand from the market from both well-established multi-billion dollar incumbents to literally 2 guys in a garage racing to find a way to build, launch and operate a Marketplace. The challenge in both cases is that this requires funding. In the case of the large incumbents, it means building a business case and getting your project into the corporate budgeting cycle in order to get it approved. For the start-up in means putting together a compelling business plan and companion investor deck in order to raise money from professional investors. So, what's the issue?

4. Understanding The Marketplace Business Model

There still exists a good bit of confusion in the market when the term "marketplace" is discussed. A frequent occurrence is that our experts at McFadyen are approached to have a "marketplace discussion", when the reality is often more of a general digital commerce or drop-ship related discussion. Even long-time industry veterans can struggle with the distinction between first-party (1P) eCommerce and a third-party (3P) marketplace.

What's interesting is that while we all shop on Amazon and know it is a marketplace (B2C), often times when we are in the B2B world where manufacturers and distributors are exploring the idea of becoming a Marketplace operator as a strategic option for their business (vs just selling on some other Marketplace), there is confusion regarding how this differs from traditional 1P eCommerce. Herein lies the challenge for what is oftentimes one or two internal evangelists who are promoting the idea of a Marketplace within the ranks of the senior leadership team – and that challenge is that they have difficulty answering the first and most important question – “Why do we need a Marketplace?”

The answer to this question lies in that person's ability to quantify the business case for their Marketplace initiative. Given that no two marketplaces are the same for a variety of reasons, not the least of which are market segment they will serve, competition, geography, value proposition, and the technology stack, just for starters. Beyond that there are significant differences in the Marketplace model when compared to eCommerce such as the revenue model, the organizational design, the lack of experience associated with recruiting, onboarding and managing third-party sellers, and as we like to call it the “virtuous cycle” meaning how exactly will a Marketplace achieve critical mass. Last but not least there is the issue of how to define success for a Marketplace, develop the appropriate Key Performance Indicators (KPIs) and instill a process for ongoing performance management of your Marketplace. All of these items need to be taken into account when developing a Marketplace business case, otherwise the Marketplace initiative has a good chance of being shot down and never make it into the annual corporate budgeting process in the first place.

5. Approach to Marketplace Business Case

As previously stated, the Marketplace business case is what is required to request internal funding for your company's Marketplace initiative or to raise capital from outside investors. There are three basic questions that a business case must help answer:

- Is there strategic value to the company with this initiative?
- On a relative basis, where does this initiative rank in terms of value to the company, vis-à-vis other investment alternatives?
- Does the business case justify the investment and meet our hurdle rates?

The business case is the financial representation of the proposed business initiative, including an overview of the opportunity, pro forma financials including revenue and expense projections, break even analysis, as well as, assumptions and risk, and preferably a high-level execution plan and timeline.

The business case must take into consideration all of the critical elements needed to build a successful business. At its highest level the business case should be developed through the lenses of three key dimensions; they are the Business dimension, the People dimension and the Technology dimension. Each of these three lenses have critical elements within them that will be required to assess, develop and fully understand the financial opportunity and impact on the company for the proposed Marketplace initiative.

6. Eight Important Considerations When Building a Marketplace Business Case

For those embarking on the first phase of their Marketplace initiative, the planning phase when the business case is being built, there are eight important considerations to bear in mind:

#1 Becoming familiar with your internal budgeting process

First and most importantly, before jumping in and building your business case, be sure to understand your internal budgeting process, timing, requirements for submission and thresholds that will need to be met in order for the budget committee, executive team, or in some cases the Board of Directors, to be able to evaluate your Marketplace business case relative to other potential investment they are considering. Is the primary investment criteria based on Return-On-Investment (ROI), or perhaps the Internal Rate of Return (IRR) of the investment? Both ROI and IRR are performance measurements for investments in projects.

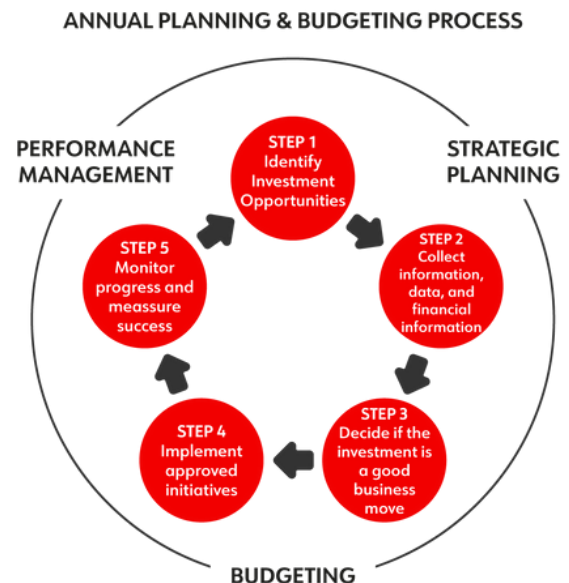


Fig 1.4- Annual Budgeting Process

ROI is more common than IRR, indicates total growth, start to finish, of an investment, while IRR identifies the annual growth rate. While the two numbers will be similar at the end of the first year, they will diverge when developing multi-year projections. In addition to the financial hurdle, there could be other considerations that may include qualitative criteria such as environmental impact or social benefit, just to name a few. Again, make every attempt to 'know your audience' before presenting your business case to improve your probability of success. What follows is a simple example of a typical annual Planning and Budgeting process that begins with Strategic Planning, which then leads into the Annual Budgeting Process followed by the Performance Management process by which your company will measure the ultimate success or failure of your initiative. Marketplace Performance Management is discussed in more detail later.

#2 A business case is not a business plan

A business case addresses the fundamental question regarding the attractiveness of a potential investment opportunity. It details the business value of the initiative such that the budget committee can make a Go/No-Go decision based on business value as well as the risks. A business plan is a comprehensive presentation of the overall Vision, Strategy, Business Objectives that a company plans to execute over the next one to three years. In today's rapidly changing environment, accelerated in large part by technology, it is now less and less common to see a time horizon of five years for business plans as it too difficult to project with any degree of certainty what the future holds that many years out.

The comprehensive business case can actually be constructed using many elements that go into developing a business plan including customer analysis, market analysis, products / market analysis, technology roadmap, organizational roadmap, as well as financial forecasts.

#3 Start from the outside in

Critical to any defensible business case – meaning when the questions start coming your way you are able to successfully hold your ground and explain the rational of your case – is to start with a good understand of the business environment. This means you need to be sure you know your market, your current and potential future competition and most importantly your customers. Why this understanding is so important is because this will form the basis for being able to answer the single most important question associated with your business case, and that is being able to confidently answer the question “Why will customers come to your marketplace and buy from you, and why will they continue to buy from you?” The basis for your answer to this question is in what is referred to as your Value Proposition. If you don't get the Value Proposition right, at best you may end up getting your business case approved but then be met with failure once you launch your Marketplace. At worst, those to whom you are attempting to sell your business case to, will see that you have not done your homework and ask you to go back and do the proper due diligence on your market, your competition, your customers, or perhaps all of the above.

#4 Marketplace Vs relative attractiveness of other investments

Your business case is never going to be evaluated in a vacuum. Every company (or investor in a Marketplace start-up) applies some form of portfolio theory when placing bets and deciding where to “put its money around the table”. At the end of the day a smart investor (Board, VC, etc.) is going to evaluate its portfolio of opportunities within a Risk/Value framework.

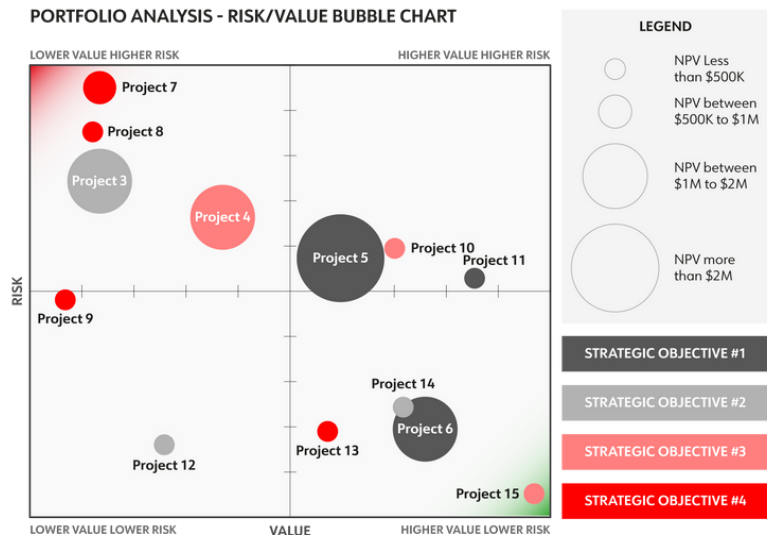


Fig 1.5- Portfolio Analysis

Their framework will plot the individual investment opportunities in four quadrants as depicted in the diagram above. Ref to fig 1.5.

This evaluation is occurring in a dynamic environment, meaning both internal and external conditions can change and even though your business case has not changed, other factors can impact the attractiveness of your initiative. That said, and independent of other forces impacting your ability to secure funding, the best you can do is understand and try to control as many of the variables within your business case. There are three areas where I see companies most often make mistakes by not investing the proper amount of time required to ensure their variables are defensible.

Gross Merchandise Value (GMV): These projections (which are a proxy for revenue in a Marketplace) are not built based on a bottom-up analysis backed by research

The Shiny Object: Too often companies start chasing the technology required to build the Marketplace and consequently only plan for the near-term, which in their mind unfortunately means only the Build Phase.

#5 Work on your assumptions

Let's talk more about assumptions. First, know that all business plans, business cases and business strategies are always built on some set of assumptions so know that it's expected. Second, given you will always have to deal with some set of assumptions simply because we do not know what the world has in store for any market due to a variety of factors ranging from geo-political instability, new competitors, disruptive technologies and business models, etc., etc.. None the less, the goal obviously is to reduce your set of key assumptions to a minimum. The least expensive and time consuming way this can be accomplished is by benchmarking competitors, understanding industry trends, or sourcing secondary research i.e. research that already exists, just to name a few methods that are available to you. In addition, where sufficient secondary research does not exist, you may elect to conduct primary research which can actually be more compelling as it could be the first of its kind that may reveal new insights never before seen. This of course will typically be more expensive and can take longer.

Finally, there are methodologies that can be used that are specifically designed to help companies reduce the risk associated with their assumptions. One such methodology is called Critical Assumption Planning (CAP) which is a methodology for maximizing learning about new markets at the lowest cost. Major uncertainties in the business proposition are isolated as critical planning assumptions. Critical assumptions in the plan are then tested. The test sequence is determined by the potential reduction of uncertainty per dollar of test cost.

Whether a methodology such as CAP is necessary for your company is really a function of your own ability to reduce your assumptions to a manageable and defensible level juxtaposed against your company's tolerance for ambiguity.

#6 Become good at presenting a Financial Model

Given below is an example of a summary Marketplace financial model that you will need to be able to build, present and defend. Be sure you can master this topic!

In the end however, remember that even if you are able to successfully 'sell' this opportunity to the Board, you may be the one that will undoubtedly be measured on its ultimate success or failure. So, the one who can ultimately benefit the most from the assessment and reduction of assumptions could be you.

Fig 1..6 Sample Marketplace Financial Model

Sample Marketplace Financial Model						
REVENUE	Launch Year	Year 2	Year 3	Year 4	Year 5	Subtotal
Customers (MAU)	20,000	50,000	200,000	500,000	1,000,000	
Conversion Rate	3.0%	3.3%	3.6%	4.0%	4.3%	
Avg orders per month	1.5	1.7	1.9	2.2	2.5	
Monthly orders	900	2,805	13,680	44,000	107,500	
Annual orders	10,800	33,660	164,160	528,000	1,290,000	2,026,620
Average Order Value	\$125	\$150	\$175	\$195	\$225	
Annual GMV	\$1,350,000	\$5,049,000	\$28,728,000	\$102,960,000	\$290,250,000	\$428,337,000
Commission Rate	15%	17%	20%	20%	20%	
Annual commission Revenue	\$202,500	\$858,330	\$5,745,600	\$20,592,000	\$58,050,000	\$85,448,430
Sellers	50	200	500	1,000	2,000	
Seller annual membership fee	\$250	\$300	\$400	\$450	\$500	
Annual membership Revenue	\$12,500	\$60,000	\$200,000	\$450,000	\$1,000,000	\$1,722,500
Ads bought per seller per year (avg)	2,000	5,000	10,000	12,000	15,000	
Ads served (clicked) per year	100,000	1,000,000	5,000,000	12,000,000	30,000,000	\$48,100,000
Cost per ad (CPC)	\$0.40	\$0.50	\$0.60	\$0.65	\$0.65	
CPC or impression ad revenue	\$40,000	\$500,000	\$3,000,000	\$7,800,000	\$19,500,000	\$30,840,000
Other ad revenue	\$0	\$20,000	\$1,000,000	\$4,000,000	\$8,000,000	\$13,020,000
Advertising revenue	\$40,000	\$520,000	\$4,000,000	\$11,800,000	\$27,500,000	\$43,860,000
Total Revenue (Comsn, Subscr, Ads)	\$255,000	\$1,438,330	\$9,945,600	\$32,842,000	\$86,550,000	\$131,030,930
EXPENSES	Launch Year	Year 2	Year 3	Year 4	Year 5	Subtotal
Marketplace Software	\$200,000	\$0	\$0	\$0	\$0	
Marketplace	\$300,000	\$100,000	\$100,000	\$100,000	\$100,000	
Marketplace Software Subscr / Maint		\$50,000	\$50,000	\$50,000	\$50,000	
Subtotal Platform Costs	\$500,000	\$150,000	\$150,000	\$150,000	\$150,000	\$1,100,000
Marketplace Staff	3	5	8	10	14	
Cost per staff member	\$75,000	\$77,000	\$79,000	\$81,000	\$83,000	
Subtotal Staff costs	\$225,000	\$385,000	\$632,000	\$810,000	\$1,162,000	\$3,214,000
Marketing: SEM & Other Ads	\$360,000	\$400,000	\$500,000	\$500,000	\$500,000	
Marketings: Social, email, other	\$360,000	\$400,000	\$500,000	\$750,000	\$1,000,000	
Subtotal Marketing	\$720,000	\$800,000	\$1,000,000	\$1,250,000	\$1,500,000	\$5,270,000
Payment Processing Fee (2% of GMV)	\$27,000	\$100,980	\$574,560	\$2,059,200	\$5,805,000	\$8,566,740
Total Expenses	\$1,472,000	\$1,435,980	\$2,356,560	\$4,269,200	\$8,617,000	\$18,150,740
PROFIT	Launch Year	Year 2	Year 3	Year 4	Year 5	Subtotal
Annual Profit	-\$1,217,000	\$2,350	\$7,589,040	\$28,572,800	\$77,933,000	
Cumulative Profit	-\$1,217,000	-\$1,214,650	\$6,374,390	\$34,947,190	\$112,880,190	
Cumulative ROI	-83%	-42%	121%	367%	622%	

#7 Marketplace Performance Management

Let us understand why it is critically important to define what success looks like in your business case. And while defining success is important – being able to measure and achieve success is more important. At McFadyen Digital we coined the term **Marketplace Performance Management** (or **MPM** for short) to describe the concept of instituting a strategic management process that equips you to effectively and efficiently monitor, measure and act upon the KPIs that are critical to your Marketplace business.

Implementing this capability is unique for a Marketplace because the Marketplace business model is unique. This process does not begin once you have launched your Marketplace. As mentioned, this process begins when you first set out to build your business case. Defining what success is and developing those essential KPIs is critical to convincing your potential investor, be they internal or external, that you can not only build your Marketplace, but you know exactly how you will manage and grow your Marketplace.

At McFadyen Digital we are passionate about this topic because of our commitment to help our clients succeed. All too often we have seen Marketplace operator ‘flying blind’ which results in them not being able to proactively manage their business. Please visit our [Strategy Solutions](#) page to understand on how we deliver value to marketplace operators.

We also have [Marketplace Performance Management Dashboard](#), an industry first best-practices packed intelligence tool created for marketplace operators by marketplace experts. This system of powerful dashboards and reports helps ensure your marketplace operations team is measuring the right metrics to drive actionable intelligence that reliably translates into profit and scale.

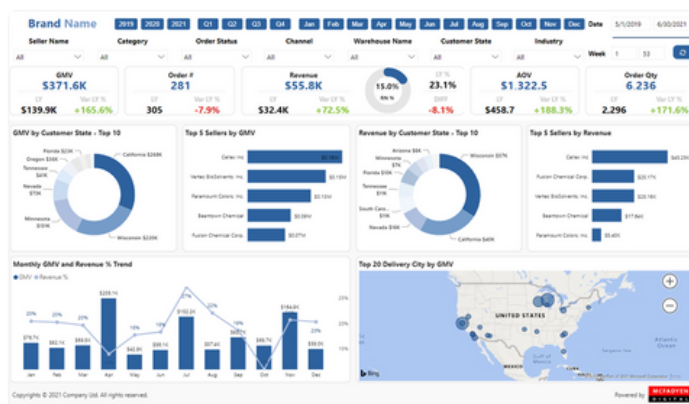


Fig 1.7 - MPM Dashboard - Operator Summary

#8 Get out of "Build it and they will come" mentality

Any discussion about building a winning business case would not be complete without talking about this topic. Popularized by the movie Field of Dreams, the saying "Build it and they will come" has somehow infiltrated the minds of many companies we speak with. Perhaps because anyone who has built an online 1P eCommerce business has seen this occur. Be warned that this is not typically the case for a Marketplace if you do not properly plan for the cost to promote your Marketplace. As mentioned previously, if you do not plan for and allocate sufficient capital to promote and scale your Marketplace you can build it and they won't come...at least not to the degree you expected.

Marketing costs are often overlooked and under budgeted. Based on our experience this is one of the leading causes of suboptimal financial results of newly minted Marketplaces. Be certain to focus on this line item in your business case as it could be one of the most important keys to your success.

7. Summary

It is quite apparent now that Marketplaces are not simply a trend, but rather they are here to stay and are a force that will disrupt traditional industry structures.

The question is “What is your Marketplace strategy?” Operator? Seller? Buyer? When answering this question, if you believe there is an opportunity for you to be a Marketplace operator, be certain to understand the nuances of the Marketplace model so that you factor these into your business case. When building your business case be mindful of your key assumptions and spend the necessary time conducting research in order to reduce the uncertainty of your key assumptions.

Start with the end in mind and define what success looks like early in the process and define the KPIs you will need to focus on in order to proactively and successfully scale your Marketplace into a highly profitable business. Embed these KPIs into your business case presentation to demonstrate your knowledge of how to operate and scale this business so that you are able to secure the funding needed to kick off your Marketplace initiative.

Finally, and most importantly, know your customers and your target market. Your domain expertise may end up being the single biggest competitive advantage, especially if you end up serving markets currently served by Amazon.

About McFadyen Digital

McFadyen Digital's clients are top brands and B2B organizations looking to take the next step in their digital commerce journey. We provide strategic, technical, tactical and operational expertise to evolve their online buying experience in a meaningful and scalable way. The result – McFadyen supports its clients throughout their entire journey from the development of their Marketplace strategy and business case, to the selection and implementation of their Marketplace platform, to the ongoing operations and performance management of their Marketplace business.

Learn more at mcfadyen.com or contact us at info@mcfadyen.com.

Additional Marketplace Content

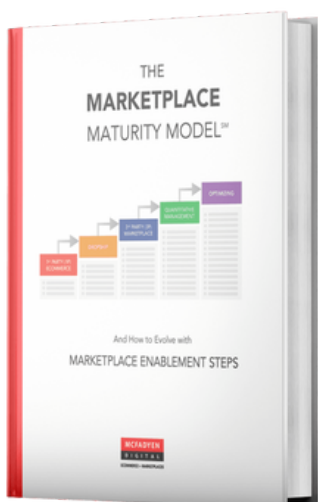


Marketplace Best Practices

Transforming commerce in the platform economy with the online marketplace model

Marketplace Best Practices is an Amazon Best Seller book that explores the online marketplace model as a means of platforming an ecommerce business. Written by Tom McFadyen and the online marketplace experts at McFadyen Digital, this text covers the what, who, and how of online marketplaces from those who have been creating both retail and business-focused marketplaces for over 15-years.

Get your print or digital copy at [Amazon](https://www.amazon.com/dp/1615627000)



The Marketplace Maturity Model with Marketplace Enablement Steps

The Marketplace Maturity Model (MMM) is an industry-first model for ecommerce operators, providing a reliable guide for implementing or iterating an online marketplace. The MMM is comprised of 5 major stages, within each stage are actionable steps across advisory, technology, and business considerations. This guide contains valuable foundational marketplace knowledge and is a must-read for all current and future marketplace operators.

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