Why do the biggest financial platforms charge less but earn more?

The Platform Paradox:

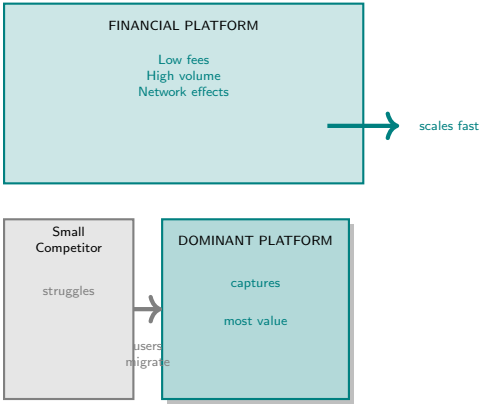
- Traditional banks charge high fees for basic services
- Financial platforms often offer free accounts and low transaction fees
- Yet platforms grow faster and reach higher valuations
- The secret lies in network effects and marginal cost economics

How Platforms Achieve This:

- Zero marginal cost to add one more user
- No physical branches or legacy infrastructure
- Automated operations reduce per-user servicing cost
- Data advantage: see both sides of every transaction
- Cross-sell higher-margin products once scale is reached

The Winner-Take-Most Dynamic:

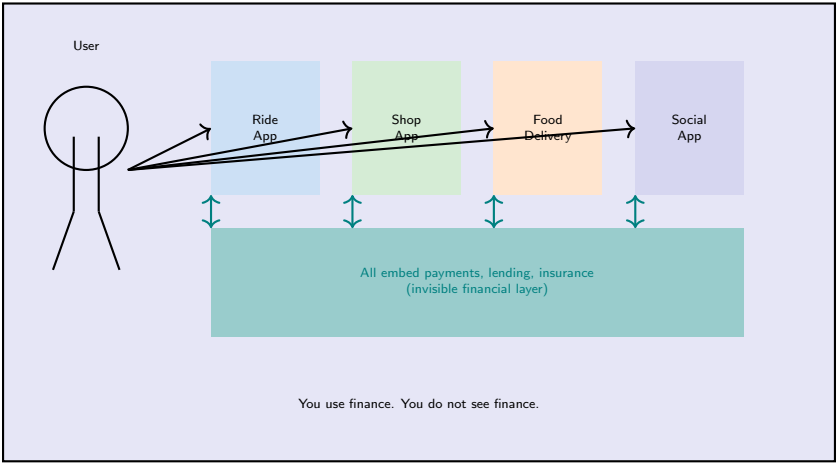
- Early users attract more users through network effects
- Leading platform becomes default choice for new entrants
- Smaller competitors struggle to reach critical mass
- Market consolidates around one or two dominant players



The shadow effect: Small competitors cannot match the scale economies and network effects of dominant platforms.

Key Insight

Which financial platforms do you use daily without thinking of them as 'finance'?



Why This Matters

Financial services are most successful when invisible – embedded into daily workflows rather than standalone destinations.

Embedded finance turns banking from a place you visit into a feature inside the apps you already use.

What distinguishes a platform from a traditional financial firm?

Platform Characteristics:

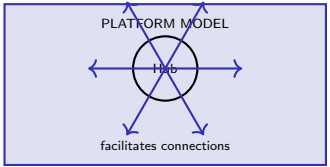
- **Facilitates interactions:** Connects producers and consumers without owning the product
- **Asset-light:** No physical inventory or balance sheet lending required
- **Network effects:** Value grows as more participants join
- **Data advantage:** Observes both sides of every transaction
- **Scalable:** Marginal cost of adding one user approaches zero

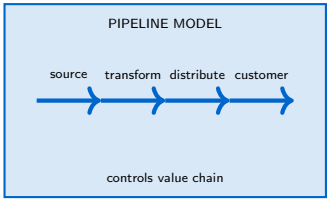
Traditional Financial Firm (Pipeline):

- **Creates products:** Manufactures financial services internally
- **Asset-heavy:** Holds deposits, loans, or securities on balance sheet
- **Linear value chain:** Source, transform, distribute in sequence
- **Regulatory moat:** Banking license creates barrier to entry
- **Limited scalability:** Each customer requires marginal capital and servicing cost

Hybrid Models Emerging:

- Many platforms add pipeline features (banking licenses, balance sheet lending)
- Many banks build platform capabilities (marketplaces, API access)





Key difference: Platforms scale interactions; pipelines scale production.

How does a financial platform reach the tipping point where growth becomes self-reinforcing?

Phase 1: Cold Start (Painful)

- Platform has few users and few merchants
- Chicken-and-egg problem: users join only if merchants accept; merchants accept only if users demand it
- Must subsidize one or both sides to bootstrap
- High customer acquisition cost, minimal revenue

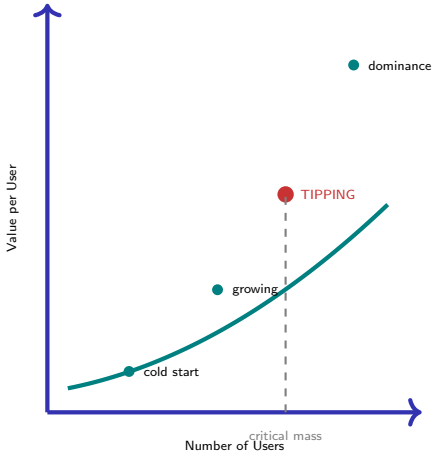
Phase 2: Approaching Critical Mass

- Enough users that merchants see value in joining
- Enough merchants that users find the platform useful
- Organic growth begins but still fragile
- Early users evangelize to their networks

Phase 3: Tipping Point Reached

- Network effects kick in: each new user makes platform more valuable for everyone
- Growth becomes exponential rather than linear
- Competitors struggle to match scale
- Platform can reduce subsidies and begin monetizing

Phase 4: Dominance (Self-Reinforcing)



The tipping point: Once reached, growth accelerates without additional subsidy because users recruit other users.

How are platform and pipeline business models structured differently?

Pipeline Structure (Traditional Bank):

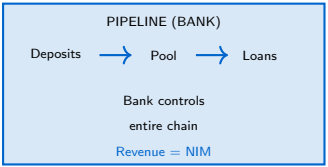
- **Inputs:** Gather deposits from savers
- **Transformation:** Pool capital, assess credit risk, create loan products
- **Distribution:** Deliver through branches, advisors, online channels
- **Revenue:** Net interest margin (spread between deposit and lending rates)
- **Constraint:** Each loan requires capital; scale limited by balance sheet

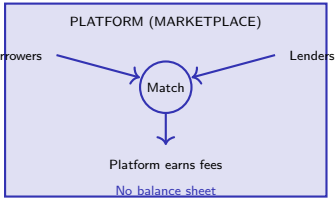
Platform Structure (Fintech Marketplace):

- **Infrastructure:** Build technology to connect borrowers and lenders
- **Matching:** Use algorithms to pair supply with demand
- **Trust layer:** Provide verification, ratings, dispute resolution
- **Revenue:** Transaction fees, subscription, data monetization
- **Constraint:** Must reach critical mass on both sides simultaneously

Structural Trade-offs:

- Pipeline: high control, high capital requirements
- Platform: low capital, high coordination complexity
- Pipeline: linear scaling; Platform: exponential potential





Pipelines own assets and control production; platforms facilitate transactions without owning inventory.

What happens when a dominant platform starts raising prices after locking in users?

The Lock-In Trap:

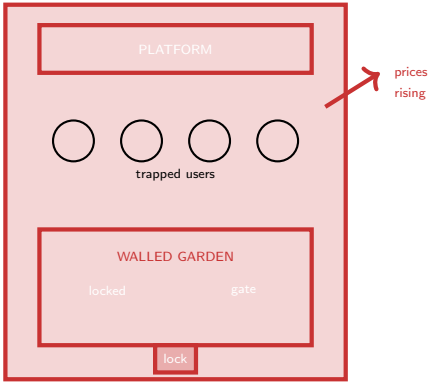
- Users invested time learning the platform interface
- Payment history and integrations create switching costs
- Network effects mean contacts are on the same platform
- Data portability limited or nonexistent
- Users feel trapped despite dissatisfaction

Price Extraction Begins:

- Platform raises transaction fees incrementally
- Introduces mandatory premium tiers for features previously free
- Reduces service quality while maintaining pricing
- Exploits the fact that users cannot easily leave
- Merchant fees rise because they need access to the user base

Consequences for Ecosystem:

- Small merchants squeezed by rising fees
- Innovation stifled as platform captures all value
- Users resentful but unable to coordinate migration
- Regulators intervene too late, after dominance is entrenched



The pattern: Subsidize to build the network, then extract once users are locked in and alternatives are foreclosed.

Where do platform economics create the largest concentration of market power?

Segments with Strong Concentration:

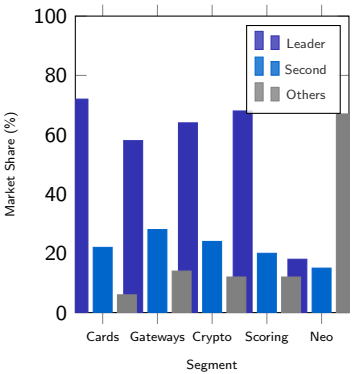
- **Payment networks:** Two players dominate global card processing
- **Online payment gateways:** Top three capture majority of e-commerce volume
- **Cryptocurrency exchanges:** Winner-take-most by liquidity
- **Credit scoring:** Oligopoly controls access to consumer data

Segments with Fragmentation:

- **Neobanks:** Users multi-home across multiple accounts
- **Robo-advisors:** Low switching costs allow competition
- **Insurance:** Regulatory fragmentation by region
- **Lending marketplaces:** Capital providers diversify across platforms

Why Concentration Varies:

- Single-homing users amplify network effects
- High switching costs lock users into one platform
- Strong same-side or cross-side network effects
- Regulatory barriers limit new entrants



Payment networks and credit scoring show extreme concentration; neobanks remain fragmented due to multi-homing.

Key Insight

Platform concentration is highest where users single-home and network effects are strongest.

Who thrives and who gets squeezed in a platform-dominated financial system?

Winners:

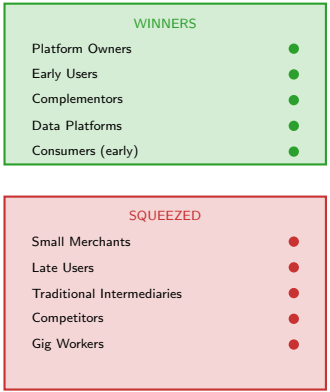
- **Platform owners:** Capture disproportionate share of value created
- **Early users:** Benefit from subsidies during growth phase
- **Complementors:** Third-party developers building on platform APIs
- **Consumers (initially):** Lower prices and better convenience during subsidy phase
- **Data-rich platforms:** Monetize insights from transaction flows

Squeezed Participants:

- **Small merchants:** Pay rising fees but cannot afford to leave
- **Late-stage users:** Arrive after subsidies end, face higher prices
- **Traditional intermediaries:** Banks and brokers lose market share
- **Competitors:** Cannot match incumbent scale and network effects
- **Workers on gig platforms:** Wages compressed as platform extracts more

Ambiguous Outcomes:

- **Regulators:** Gain oversight challenges but lose control over fragmented innovation
- **Society:** Gains efficiency but loses competition and resilience



Value redistribution: Platforms shift value from intermediaries and late users to platform owners and early adopters.

Three questions to evaluate whether a financial platform is healthy for its ecosystem

Question 1: Can users switch to a competitor easily?

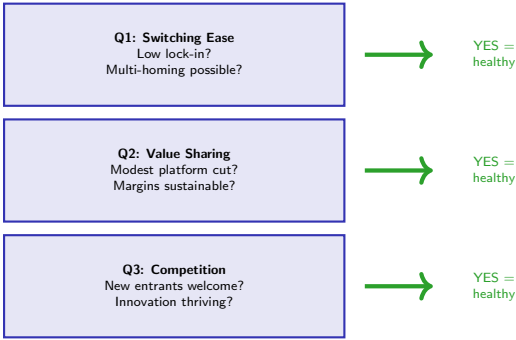
- **Test for lock-in:** Are there data portability tools? Can users export history?
- **Switching cost:** How much time and effort to migrate to an alternative?
- **Multi-homing:** Can users participate on multiple platforms simultaneously?
- **Healthy sign:** Low switching costs preserve competitive pressure
- **Warning sign:** Proprietary formats, no export tools, punitive exit fees

Question 2: Does the platform share value or extract it?

- **Revenue split:** What percentage of transaction value goes to participants vs platform?
- **Fee trajectory:** Are fees stable or rising over time?
- **Merchant/seller margins:** Can participants earn sustainable income?
- **Healthy sign:** Platform takes modest cut, participants prosper
- **Warning sign:** Platform captures increasing share while squeezing margins

Question 3: Is the market more or less competitive because of the platform?

- **Entry barriers:** Can new platforms launch and compete?



How to use: Apply these three tests to any platform you participate in or invest in.

Your Challenge

Task: Pick a financial platform you use. Map its network effects (who are the sides?). Assess whether it passes the three health-test questions from slide 9.

Step 1: Choose Your Platform

- Example options: payment app, investment platform, lending marketplace, insurance aggregator
- Identify the platform and briefly describe what it does

Step 2: Map the Network Effects

1. Who are the participants? (e.g., consumers, merchants, investors, borrowers)
2. What type of network effect exists? (direct, indirect, cross-side)
3. Draw a simple diagram showing who connects to whom through the platform
4. Identify which side was subsidized during growth and which side is monetized now

Step 3: Apply the Health Test (Slide 9)

- Question 1: Can you switch easily? Export your data? Use alternatives simultaneously?
- Question 2: Does the platform share value fairly? Are fees rising or stable?
- Question 3: Is the market more competitive because of this platform, or less?

Step 4: Verdict

- Score the platform: How many of the three health tests does it pass?
- Would you classify it as a healthy ecosystem or an extractive monopoly?