Chapter 5: Marketplace Financial Model

"Intellectual capital drives financial capital and growth."
Andrew Yang, American Entrepreneur

Introduction

Marketplaces operate on a different financial model than traditional first-party eCommerce and retail.

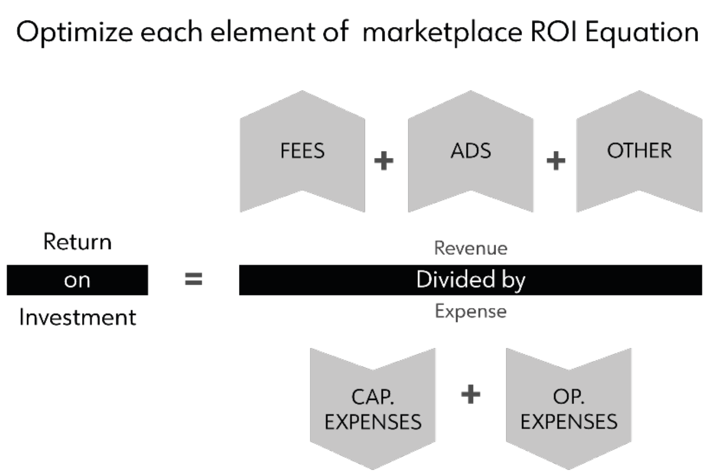
The simplified math of first-party eCommerce and retail is to buy a product for $A, sell it for $B, and earn a gross profit of $B - $A.

The simplified math of most marketplaces is to enable third-party sellers to set their own price at $X, charge the seller a commission of Y%, and earn a gross profit of $X * Y%.

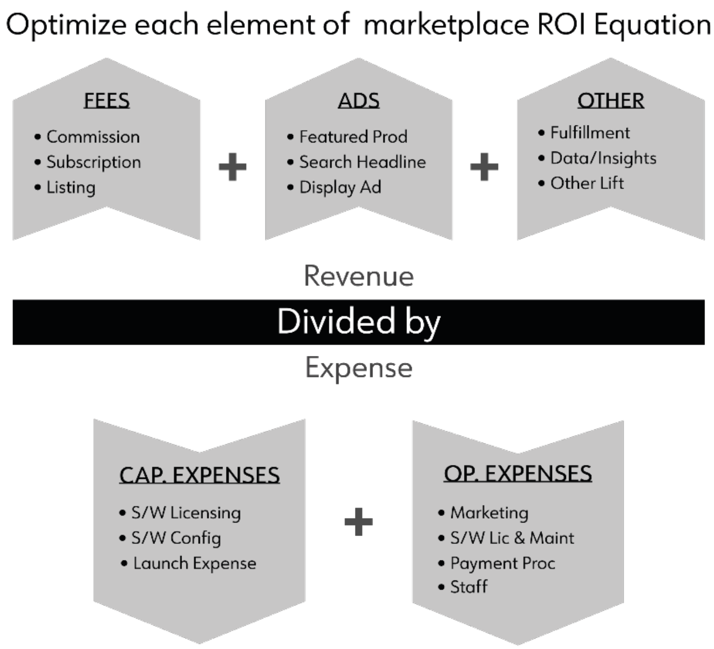
This simplification does not include many other factors that affect net margin. However, the profitable growth of many marketplaces compared to the low (or negative) margins of eCommerce and retail has proven the financial benefits of the marketplace model.

This chapter will start by explaining the types of revenue and the types of expenses in a marketplace. Those elements will then be organized in a sample financial model in the third section followed by a discussion about optimizing the financial return.

The graphic below provides a conceptual equation for marketplace financial ROI. The up arrows show revenue sources (fees, ads, other) that should be maximized, while the down arrows indicate expenses (CapEx and OpEx) that should be minimized.



This is not correct math; for example, one-time CapEx and recurring OpEx costs are not simply added together to calculate ROI. The intent is to indicate which elements should be maximized and which should be minimized. Samples of the types of revenue and expense in each category are shown below.



Although marketplaces want to increase both GMV and revenue, it is important to understand the difference between these terms. Gross Merchandise Value is the total sales price of a third party good to a customer. The revenue to the marketplace is usually calculated as just the commission fee percentage of the sale. For example, a marketplace sale of a $100 item with a 20% commission fee would result in $20 of revenue to the marketplace operator. Other sources of marketplace revenue are explained in the following section.

5.1 Types of Revenue

Marketplace revenue typically comes from three main categories: fees, advertising, or other. The most common types of fees are commission, membership, and listing fees.

- Commission is the most common and often the largest marketplace revenue source. Vendors are charged only when they complete a sale. The commission rate can vary based on category, seller rating, and other factors, and many marketplaces choose to charge lower fees initially to entice new vendors. Commissions are often in the 10%–20% range but can vary greatly.