Network Externalities

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Abstract / Definition
Network externalities are defined as the increasing utility that a user derives from consumption of a product as the number of other users who consume the same product increases. Network externalities are the new drivers of the network economy. The exponential adoption of a network service, driven by network externalities, is evident in the rapid rise of peer-to-peer networks in three main categories: social networks, e-marketplaces, and information services, such as Facebook, eBay, and Wikipedia. Network market shares tend to ‘tip’ consumer expectations towards one player and away from its rival. The valuation of a product increases the more that others consume the product leading to a winner-takes-all scenario. The exception to this phenomenon would be a regulated network market with strong interconnections between competing platforms. The mobile telephone industry is a classic example, where market shares tend to be equitable among competitors. With the advent of technology disruptors, network industries tend to shift from monopoly to oligopoly. Similar trends are evident in other IT-intensive industries. Thus, the focus of interest in network economics has shifted from the analysis of natural monopoly towards issues of interconnection, compatibility, interoperability and co-ordination of quality.

Keywords
Network externalities, network effects, competitive market theory, networks, network industry strategies, critical mass

Link to publication