Case Study
Online Marketplaces for Freelancers – Faults in the Business Model?

Many electronic marketplaces for freelancers and project work have started on the Web during the last years. The business model seems to be brilliant.
There are freelancers, experts and independent service providers all over the world – and there are companies in search for people who can work on their projects all over the world. Latest technological progress in e-business and IT made it possible to handle nearly every project electronically without the physical presence of the service provider.
Thus, it was an appealing idea to offer a platform where the buyers and suppliers of freelance services can meet, negotiate a price and complete the project. The project exchange serves as the intermediary and takes a fee for providing this platform with related services (normally a percentage of the project price). This revenue should cover the costs of the marketplace. (For details of the business model see our article Internet Marketplaces for Freelancers - The Future of Work?)

For a certain period of time, this model worked that fine that it attracted more and more new exchanges that entered the market. However, if you have a closer look at the long list of Internet-based marketplaces for freelancers and project workers (see our freelancer-section), you will find that not all of them make significant business any more. Some of the exchanges specialized on IT-projects seem to work quite fine. At Ants.com, which was celebrated as a *fascinating concept* by a leading newspaper less than one year ago, there are very few active projects left. You will find more projects that are active at Smarterwork.com; however, not in all categories a new project shows up every day. If you consider furthermore, that a major part of posted projects remains sitting on the projects boards until eternity, i.e. never gets awarded to a freelancer, it becomes questionable how the operators of the exchanges will generate revenues from their fees. Hence, it was no surprise that even Elance.com, which is one of the more busy marketplaces, introduced a monthly fixed fee for registered freelancers earlier this year.

So why doesn't this fascinating concept work? As so often, reasons are multiple.

Too Ambiguous Plans

Most online project marketplaces started while the e-business hype rose and rose. At that time, everybody was convinced that companies that refuse to use the Internet would fail. Hence, the situation was as follows:

Most organizations were desperately looking for experienced professionals at that time. There was a wave of new start-ups and all of them needed a professionally written business plan, a marketing strategy, a website, individually designed databases and much more. Thus, the demand for external expertise was enormous. Project exchanges seemed to be the perfect solution for this problem. Of course, the start-up-project exchanges took this situation as the basis for their own business plans and projected revenues and profits accordingly. Nobody seriously thought that this boom would slow down that quickly.

Start-ups could get Venture Capital virtually everywhere and for every idea in the late nineties. Hence, the slogan was "Think Big"! The favourable market situation in combination with the high expectations of the Venture Capitalists made start-up marketplaces develop ambiguous plans and obtain enormous sums of capital. From the hindsight, it is questionable, how realistic this plans have been. In the end of the day, every investor expects a return of his funds – with an attractive profit, be that from interests, or dividends or IPO profits. A very simplistic

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illustration gives evidence of the dimensions at that time.

According to its press releases, Elance.com received financial investments of US$ 65 Million in total. If we assume this was a normal bank loan with a repayment period of 20 years, they would have to generate revenues of $ 3.25 Million annually only for repayments. Elance's main source of revenue was a 10% fee of the value of all closed (not posted!) projects before introduction of a monthly fixed fee for all registered freelancers. Hence, they would need a transaction volume of at least $ 32.5 Million per annum in order to repay their debts – interests and operational costs like wages etc. not taken into consideration. If we further assume an average project value of $ 1000, they would need 32500 projects closed on this marketplace every year. That is about 2700 projects per month!
According to an Elance.com press release from January 22, 2001, their total transaction volume was $ 32 Million – from their establishment in 1998 up to that date.
Of course, Elance.com did not receive this $ 65 Million as bank loans – but would a venture capitalist or institutional investor expect less? (Source: Elanace.com Press Releases)
Important Notice: This calculation is an assumption. It has nothing to do with the real financing conditions of Elance.com. This calculation is intended to be an illustration for the amounts of money involved in this industry.

The Dot-Com Crisis

Since the dot-com crisis came up, companies started to look more careful at their spendings. They were not willing and not able to spend as much money as before on marketing, web development etc. Moreover, there were less start-ups that needed business plans, websites, marketing plans and all these things. Demand for tasks suitable for online project marketplaces declined remarkably. At the same time, former dot-com employees that had been made redundant tried to make their living as freelancers and offered their services on these marketplaces.
Hence, the demand for projects declined and the supply for freelance services rose. The result was that up to 50 or 100 freelancer placed their bids on one single project, trying to win this job by every means. Mostly, they tried to compete on price, bidding lower and lower. For the online marketplaces that meant that there were fewer projects and those few had lower values. Therefore, their project-based revenues declined. The economic downturn in the industries the marketplaces relied on made their ambiguous plans even more unrealistic.

Intentions of Potential Buyers of Services

The business models of online project marketplaces were designed for a new economy environment. They supposed that developments like the overcoming of physical distances, the blurring of organizational boundaries or the development of virtual networks of organizations would make businesses search for experts on a global level.

Organizations changed their ways of doing business that way, but not at the expected scope and speed. Many managers still prefer to work with partners they know and ideally, with whom they could meet in person. This is the case especially for more complex and critical projects like the development of a business plan. It does not make sense to have an expert from another continent write a business plan, since this person probably does not know very much about the particular business environment of the organization. In most cases, there will be an experienced consultant in the area around, who can do the same job. Moreover, managers can develop a personal relationship to this local expert and he will be able to take into consideration region-specific questions like target market, legal requirements, marketing or financing issues.

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In the result, not all potential buyers of services will post their projects on online marketplaces. Many of them, notably those who are willing to spend a considerable amount of money for an excellent job, still prefer to do it the traditional way. Therefore, many of the people who ask for a logo or business plan on online project exchanges are private individuals or start-ups that still hope for their first round of financing and all of them have a very limited budget. They hope to get a low price when service providers compete for a project globally. Again, the marketplace faces the situation that most projects are price-critical; hence, the average project value, which determines revenue streams from fees, is below expectations.

Trust is Good, Control is Better

Business models of most project exchanges base on a fee as a percentage of the project value. Therefore, the marketplaces revenue depends on the number of projects for which a winner is selected. The number of posted projects in not relevant at all as long as the buyer does not award the project to a service provider.

Normally marketplaces include some regulations in their terms and conditions of use. They state that buyers and providers of services are not allowed to exchange contact details or to close the deal outside the marketplace. Hence, the business models are built on trust in the honesty of their members. Nevertheless, the chance to save a fee of 10% of the project value does provide enough incentive for some buyers and sellers to neglect this rule. We can assume that a significant proportion of all posted projects are closed outside the marketplace in the end of the day. That would explain the high number of open projects sitting on the project boards long after their bidding period has closed.

Despite the fact that the marketplace actually was the intermediary that matched the buyer and the seller of the service, these projects do not provide any revenue for the marketplace. If the marketplaces fail to make their members follow their rules, they help them to avoid their most important source of revenue.

Conclusion

The basic business model of an online marketplace that brings together buyers and sellers of freelance services is promising. There is evidence that there is a need for such matching services. However, most marketplaces made the typical mistakes of over-enthusiastic dot-coms:

- Overestimation of market volume and underestimation of competition
- Poor development of the details of the business models
- Lack of contingency plans for situations of crisis

Now they feel forced to correct these mistakes belated. This is the more difficult the more cautious investors have become. Thus, the whole industry faces a process that is well known from the “Old Economy”: after a boom, there comes a consolidation. Only those who are able to adjust their business models to the new economic situation quickly and in the best way will survive this process. It remains to be seen who will belong to the winners.

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