

# THE SUCCESS OF THE SHARING ECONOMY

Social Capital, Self-Regulatory Mechanisms  
and Crowd Sourced Regulation

by Andrew Klain and Avery Maloney



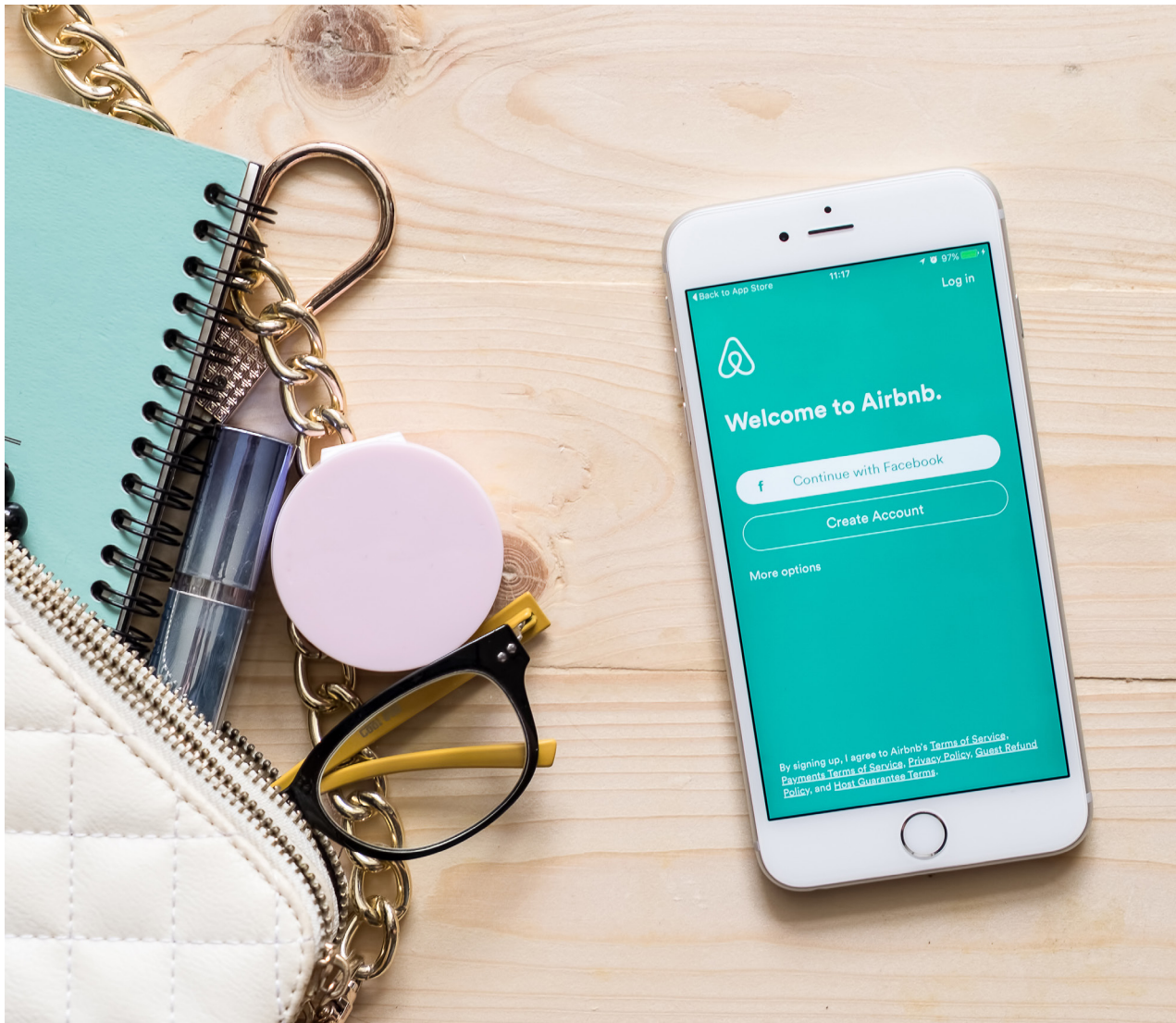
## Introduction

**T**he growth of the sharing economy has prompted all levels of government to begin to contemplate regulatory measures for this emerging market. Those most threatened by the sharing economy, largely incumbent businesses, argue that the lack of regulations for the sharing economy creates an unfair playing field between this emerging sector and the traditional economy. Additionally, many researchers, including Elvira Nica and Ana-Mădălina Potcovaru (2015), argue that the sharing economy leaves consumers unprotected. Many of those who support the idea of the sharing economy base their argument on viewing the sharing economy as a solution to issues of market failure. The sharing economy accounts for market failures by capitalizing on unused, or underused, pools of labour and capital. Mobile apps and networks connect users with excess capacity to those who have excess needs, and facilitate fluid, immediate transactions, much to the delight of the on-demand consumer (Sundararajan, 2016). The sharing economy also aims to protect consumers by eroding the information asymmetry between producers and consumers that characterizes the current traditional economy (Koopman, Mitchell and Thierer, 2015; Dittmann and Kuchinke, 2016). Additionally, advocates argue that the sharing economy has emerged in response to the 2008 financial crisis to address issues within the current

labour market; a market characterized by part-time work and a reduction in job opportunities (Bonciu, 2016).

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Likewise, the sharing economy has always existed on some scale. One example is local farmers' markets. Where the traditional economy cannot meet the demands of the market, alternative peer-to-peer (P2P) markets have always formed. The advancement of technology has changed the dynamics of these unconventional markets. New forms of P2P and networks based on mobile apps and instant communication have fundamentally altered the consumer and producer relationship. Due to this, the sharing economy offers opportunities to consumers and producers that the formal economy cannot: lower price points; a reduction in the information asymmetry between consumer and producer; better market access; and self-regulation through online communities and reputation systems. Consequently, it is these same characteristics that have allowed the sharing economy to inadvertently develop many of the same regulations found in the traditional economy. Moreover, while the traditional economy is regulated by government, the sharing economy's inherent structure allows for self-regulation. A brief analysis of Uber and Airbnb will



demonstrate the sharing economy's perpetual self-regulation and why government intervention infringes upon the sharing economy's growth and efficiency.

### Uber and Airbnb

Uber began in San Francisco in 2009 as a response to a desire for reduced costs for luxury car services and later expanded to the monopolistic taxi industry. Its business model is founded on the

concept of "ridesharing." The Uber App connects Uber drivers and riders. This connection enables Uber to capitalize on underused vehicles and transportation services. It can also offer, on average, cheaper prices than traditional taxi companies (Noulas et al., 2017). This is at least in part because Uber and its drivers have conventionally been exempt from the same licensing and regulatory standards as taxi companies. These licensing standards are also the primary point of contention between

Uber and incumbent taxi companies. Taxi licensees are traditionally limited and heavily sought-after. For example, in 2010 the value of taxi medallions in New York City rose to over \$1 million dollars (Bond, 2015). Additionally, concerns over rider protection and accountability have been raised. Subsequently these issues have given rise to demands for increased government regulation of the ridesharing market.

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Similar to Uber, Airbnb began in 2007 in San Francisco as a response to the saturated hotel marketplace. It turns unused, or underused, properties and rooms into rental properties. It also attempts to address a saturated hotel market by providing lower price points, which it can do because it does not own the rental property. No ownership relieves Airbnb of the cost of business expenses such as the cost of room upkeep, rent costs, property taxes, and overhead. Airbnb facilitates short-term or long-term rentals between renters and consumers. It has become extremely popular for renters, as they can compete in the rental and hotel market at traditionally cheaper prices. Airbnb has experienced backlash from the hotel industry and the real estate

market. The hotel industry has argued that Airbnb hosts are not required to meet the same regulatory standards as hotels for health and food. The real estate industry and homebuyers have criticized Airbnb as responsible for inflating the housing market in many cities, as there has been an increase in purchases of properties for the sole purpose of using them for Airbnb accommodations. For example, Lee's (2016) study finds a correlation between the Los Angeles housing crisis and Airbnb's role in reducing the available living units and increasing rental prices. In seven of the most desired neighbourhoods for tourists, (Venice, Downtown, Miracle Mile, Hollywood, Hollywood Hills, Echo Park, and Silver Lake) he finds that rents rose 20% and increased 33% faster than rents city wide. Additionally, a study done by the city of Los Angeles in 2015 identified that Los Angeles had the highest percentage of renters in the United States and that there were enough Airbnb apartment listings to meet the required amount of affordable housing for the city. The city determined that it needed 5,300 affordable housing units to meet the annual housing demand, while Airbnb had over 7,300 full apartment listings (Samaan, 2015). Some cities have begun to enact policies and legislation regarding the number of days during which property owners can rent their property and where individuals can purchase property for Airbnb rental purposes (Krauss, 2014).

However, Uber and Airbnb offer the ability to not only correct market



imperfections by capitalizing on underused vehicles, transportation services, and rental properties, but to regulate themselves. This is achieved primarily through social capital, which is facilitated by built-in reputation systems and an online community, where riders and renters can share experiences with one another. Social capital is considered a set of resources available to individuals and communities because of social networks (Turcotte, 2015). Social capital creates a flow of information, trust, reciprocity, co-operation, and productivity. Since both companies have reputation systems that allow workers to benefit through collecting social capital, there is incentive for both Uber drivers and Airbnb hosts to provide optimal customer service and protect customers.

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The online communities and reputation systems that both companies use, as do many of the sharing economy's service companies, also reduce the information asymmetry that typically characterizes aspects of the traditional economy. This asymmetrical relationship is typically characterized by producers having a monopoly on information about products and services. Consumers are given limited information on products and

services and must make choices based on this limited information. When this information asymmetry is reduced, consumers in the sharing economy gain more power in the marketplace. Thus, Uber and Airbnb both demonstrate, as microcosms of the system as a whole, the necessary tie between self-preservation and self-regulation in the sharing economy's revolutionary market structure.

## Moving forward

The sharing economy's reduction in information asymmetry between producer and consumer along with its use of reputation systems, online communities, and P2P networks act as informal institutions (Helmke and Levitsky, 2004). These mechanisms act in the absence of state intervention—and have done well so far. In 2014, 21 percent of Americans had used a P2P market to acquire a good or a service, and companies in the sharing economy earned US\$15 billion. There are currently 10 companies in this market segment that are worth over US\$1 billion dollars (Puschmann and Alt, 2016). Furthermore, these mechanisms also address consumer protection regulation issues, customer service, and increasing market transparency. By creating a relationship between one's reputation and economic self-interest, it has become in the best interest of producers to operate in good faith (Sundararajan, 2016). This self-regulation has also allowed for lower price points. Producers in the sharing economy offer consumers

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lower prices due to their lower costs of business (Koopman, Mitchell, and Thierer, 2015). The informal economy operates outside of cumbersome regulatory standards which allows for a cheaper and more efficient business model. Consumers traditionally priced out of some formal markets for certain goods and services find substitutes in the informal economy. Additionally, the availability of information for consumers has affected price points, as consumers can more efficiently compare products and prices. The sharing economy and its use of information technology have “facilitated the creation of countless reputational feedback mechanisms across the online ecosystem—such as product rating and review systems—that give consumers a more powerful voice in economic transactions” (Koopman, Mitchell, and Thierer, 2015: 451). It is important that policymakers consciously not interfere with such open entry into the informal economy, as it is a defining characteristic of the sharing economy itself. It ensures lower price points for consumers and expanded work opportunities for producers. In regulating competition in the informal economy, the government should take a reactive approach, waiting

for issues to arise, especially when existing regulatory frameworks are designed for traditional markets with larger scales of production and fewer total producers (Sassen, 1994).


If government regulation is required anywhere, it is in the area of consumer rights. Because many producers in the informal economy operate using their own capital (their own cars or their own homes), there is potential for issues of agency. For example, it is possible that someone running an Airbnb may choose not to serve an individual based on ethnicity, religion, or gender. Situations of discrimination are bound to occur in the sharing economy, and regulation in the protection of basic human rights should be proactive, rather than responsive. Recalling our case studies, companies like Airbnb and Uber are better positioned to monitor employees and ensure proper business practices in areas such as customer care and tax collection by leveraging their own data networks (Sundararajan, 2016). However, regulations on discrimination should be standard across companies, and as such, should be handled by the government. Companies can use their data systems for monitoring transactions, and governments can create standardized regulation to protect consumers across platforms. Governments may fear that companies will fail to cooperate and regulate themselves properly; however, self-

regulation provides firms with an opportunity to create credibility with consumers and government regulators (Sundararajan, 2016). Additionally, these efforts will intensify as competition between companies causes them to attempt to differentiate themselves from the market based on quality of service. Both of these aspects of the sharing economy depend heavily on social capital and reputation.

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## Conclusion

The sharing economy attempts to correct market imperfections, balance supply and demand, and develop a P2P marketplace. Furthermore, the sharing economy will continue to grow, as it is estimated in the United States alone that there are \$5.35 trillion US dollars of underused or unused assets (Bonciu, 2016). However, it is naïve to think that regulatory frameworks designed for businesses such as Hilton Hotels or the New York cab industry would work efficiently for companies like Airbnb and Uber. A responsive approach should be taken to regulation. In addition, the market is experiencing a change where social

capital is becoming a fundamental component to market place success (Cohen and Sundararajan, 2016). Social capital, attained through online communities and reputation systems, also acts as a regulatory mechanism for businesses. Thus, it is of ethical and economic interest for businesses and employees in the sharing economy to conduct themselves in a professional manner. Furthermore, the sharing economy is here to stay and “we can no longer close Pandora’s box” (Katz, 2015: 1125). 



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