

Growing Pains: The Role of Regulation in the Collaborative Economy

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Abstract

The rise of the collaborative economy has breathed new life into old industries. Everyday consumers now use the power of collaborative platforms like online marketplaces and on-demand services to rent, share, and swap their houses, cars, and homemade goods with their peers. As such platforms continue to grow in size and popularity, they will undoubtedly face numerous regulatory challenges, and how they respond to future roadblocks will determine their longevity. This paper examines the regulatory obstacles faced by the collaborative economy by providing three case studies focused on the regulatory experiences of Airbnb, Uber, and Lending Club. The observations from the three case studies indicate that regulation is an inevitable truth for the collaborative economy, and that it will be a key factor behind smoothing the integration of collaborative platforms into mainstream society.

Background

In just the past decade, the old guard of business models has experienced unprecedented disruption. Technology has given people the power to obtain goods and services through their peers instead of relying on established industry players. Industries (such as consumer loans, transportation, and hospitality) have had their traditional business models uprooted and challenged by the rise of the collaborative economy. The collaborative economy is a system composed of multiple distributed networks of people who are connected through online platforms that facilitate the exchange of goods and services. From its beginnings through today, the collaborative economy has continued to reshape society's view of ownership, creating vast networks that empower the individual consumer.

A. Brief History

The beginnings of the collaborative economy's rapid growth can be traced back to companies like eBay, whose successful used goods marketplace redefined the concept of ownership. eBay's popularity demonstrated the viability of buying and selling pre-owned goods on a large scale, growing from a tiny startup founded in 1995 to a company with \$17.9 billion in revenue in 2014 (NASDAQ, 2015). Craigslist, also launched in 1995, found similar success as an online platform for classified advertisements and today serves over 60 million monthly users in the United States alone (Craigslist Inc., 2015). The mainstream acceptance of eBay and Craigslist represents a clear shift in consumer attitude away from the traditional model of buy and dispose towards one of buy and sell.

The mass secondhand good market popularized by eBay and Craigslist offers clear financial incentives for all participants: instead of being thrown away for nothing, a used good can be sold, and rather than paying full price for a brand-new product, consumers can purchase something nearly identical for less. Additionally, consumers realize that the benefit of the secondary marketplace is both financial and environmental in nature, allowing for the full lifetime use of goods and thus reducing the resources needed to produce new goods. For example, the United Nations Environment Programme estimates that the production of a single mobile phone accounts for 60 kg of CO₂e (carbon dioxide equivalent); buying a pre-owned phone eliminates the production of an additional phone (GRID-Arendal, 2008). The same impact extends to pre-owned cars, clothes, and household appliances.

Business models built around shareable goods are a natural progression from secondhand good marketplaces. In some open marketplace models, participants play a hybrid role of consumer and producer, manufacturing and distributing their own products while purchasing those of others within a company-built framework. Likewise, in on-demand models, participants use a company's infrastructure to offer personal services and assets for hire or for rent while also utilizing the

services and assets of their peers. The concept of shareable goods appeared as early as 2004 in Harvard law professor Yochai Benkler's essay, "Sharing Nicely: On Shareable Goods and the Emergence of Sharing as a Modality of Economic Production." In his essay, Benkler recognizes sharing as "an underappreciated modality of production," outlining the potential of shareable goods to establish new economic frameworks that take full advantage of a resources' utility (Benkler, 2004). In 2010, Rachel Botsman's book *What's Mine is Yours: The Rise of Collaborative Consumption* underscored the growing traction of the collaborative economy, detailing a "social revolution" across multiple platforms built on shared trust. Benkler and Botsman both foresaw a burgeoning industry: a World Economic Forum Young Leaders study estimated that the sharing economy generated over \$350 billion in transactional revenues in 2013 and Forbes estimated that people collectively earned \$3.5 billion in income from the sharing economy in the same year (Rinne, 2013; Geron, 2013). Moreover, the sharing economy has generated 17 companies capturing valuations of at least \$1 billion while raising over \$15 billion in funding (VB Profiles, 2015).

B. Definition of Collaborative Economy

An important distinction must be made between collaboration and sharing. The collaborative economy refers to an economic model that focuses on providing access to products and services through renting, trading, or sharing instead of traditional ownership. The sharing economy is a subset of the collaborative economy that focuses solely on the outright sharing of assets. Consider BlaBlaCar and Uber, two collaborative transportation companies. BlaBlaCar is part of the sharing economy because it matches drivers who have empty seats with travelers who share the same destination and vice versa. Uber, wherein passengers book on-demand rides from registered drivers, is not part of the sharing economy but is part of the larger collaborative economy. The difference lies in the intent of each platform: BlaBlaCar drivers and passengers already share a common destination while Uber drivers, who use their personal vehicles, offer their services regardless of destination.

There exist multiple definitions and interpretations of the collaborative economy, but two basic themes hold true:

A collaborative economy company gives everyone the capability to access underutilized or unused assets. The ability to make excess or idling capacity available for use is at the core of the collaborative economy. When transportation, housing, or capital is not utilized, excess capacity is produced and potential productivity is lost. While this phenomenon is present in many economic systems, the collaborative economy offers a means to eliminate this otherwise lost productivity through the redistribution and sharing of unused assets. Another reason why the collaborative economy is so powerful is because anyone can participate. At the same time, people stand to gain something from their participation

in such a platform. Such value may be derived from the exchange of money for a product or a service, even if the company owns the platform that holds pricing power. In the case of free platforms, participation yields the right for an individual to access the products and services of others.

A collaborative economy company offers a distributed network of individuals built upon a foundation of trust. A collaborative platform is merely a means to an end; people are the real drivers of traction and momentum behind a collaborative company. People are important in any company's success, but the prominent role that individuals play in the collaborative economy elevates them to an increased level of significance. Individuals are both the producers and consumers in the collaborative economy, controlling a company's supply chain solely through their participation. A commonly cited phenomenon is the "network effect," a term first popularized by Robert Metcalfe as "Metcalfe's Law," which states that the value of a telecommunications network is proportional to the square of the number of users—large networks are exponentially more valuable than smaller networks, increasing the possibility that the company with the largest network will monopolize the market (Hendler & Golbeck, 2008). In terms of the collaborative economy, the same is true: as a company adds more users, it offers more resources and the value of its services skyrockets. The importance of developing a sense of culture and community within such a user base is also crucial. The distributed nature of users promotes a "we" culture that transcends geographic borders and champions the value of a collaborative community. Furthermore, companies must also work to establish a culture of trust within their networks. People are only able to drive the collaborative economy forward because of trustworthy relationships between suppliers and buyers. The construction and validation of new relationships should be a priority for any company targeting the collaborative space.

Today, the collaborative economy has come to encompass multiple sectors. By expanding into major markets that are integral to the overall economy, collaborative platforms constitute a powerful force that redistributes social and economic power into the hands of the consumer.

C. Regulation

Despite the immense value that the collaborative economy offers society, it still faces substantial growth challenges in the form of industry incumbents and regulation. Unsurprisingly, long-standing companies recognize the threat that such platforms pose to their businesses by giving consumers the means to bypass them. Startups are at risk of more established companies taking decisive action to take back market share or drive them out completely. Furthermore, given the relative novelty and youth of many collaborative business models, policymakers and collaborative startups have had numerous clashes borne out of some startups' disregard for existing laws and out of regulators' attempts to integrate these business models smoothly and safely into society. While

there currently exists no official federal policy addressing the collaborative economy as a whole, startups have and will continue to face regulatory challenges that will define their future growth trajectories.

Case Studies

The following case studies are intended to provide an understanding of the role that regulatory action may play in the development of a collaborative startup. The three startups chosen for case studies are all major well-developed companies within their respective industries and have each experienced regulatory controversy regarding their business practices. Each case will provide a general company background and then examine the regulatory landscape faced by each company as well as the company's regulatory strategy.

A. Airbnb

A.1 Background

Prior to collaborative startups' entry into real estate and travel, travelers usually addressed their lodging needs with a stay at either an expensive hotel or a bare bones hostel. Founded in 2008, Airbnb created a solution that effectively met the needs of travelers while also being mutually beneficial for both landlords and tenants. Airbnb's online housing marketplace allows travelers to book short-term rentals in other Airbnb community members' properties around the world. Members are able to list their properties for rent on the site, charging a certain dollar amount per night from which Airbnb takes a percentage. Airbnb offers value not only by giving travelers access to a huge pool of rental listings but also by giving property owners an additional source of income. By serving as a virtual matchmaker and transaction medium for landlords and tenants, Airbnb's marketplace has become an integral part of the collaborative economy. The market for vacation rentals, one of Airbnb's primary markets, is enormous. Americans spent over \$23 billion on vacation rentals alone in 2012, a figure that accounts for one-fifth of the entire U.S. lodging market and seven percent of the U.S. travel market (Quinby & Rauch, 2013). The simple model of matching travelers with the excess capacity of unused rooms and residences has brought Airbnb much success—the company is valued at over \$25 billion and boasts 1.5 million listings in over 34,000 cities and 190 countries (Demos, 2015; Airbnb, Inc., 2015).

A.2 Regulatory Landscape

The structure of Airbnb's business model naturally invites regulatory scrutiny. In hotly contested housing markets such as those of New York City and San Francisco, the impact of Airbnb's operations raises a multitude of concerns with taxation, local housing laws, and fair use at the forefront. New York, like many states in the U.S., charges a 5.875 percent hotel occupancy tax that makes up one percent of its tax revenue (NY

OMB, 2013). In 2013, however, the New York City's Department of Finance clarified that Airbnb was exempt from the tax on the grounds that it was "neither a hotel operator nor a room remarketer" (Kaplan & Nadler, 2015). While such an exemption represents a small regulatory break for Airbnb, more significant issues lie with housing laws and the fair use of Airbnb.

Airbnb has found it difficult to combat city regulation regarding short-term leases. Housing laws passed in New York in 2010 prohibit the renting out of any permanent residential apartments with more than three units to transient visitors for less than 30 days, directly affecting the bulk of Airbnb's customer base (Majority Press, 2010). According to New York State Senator Liz Krueger, the intent of the law was not to attack casual Airbnb listers but rather to combat the operation of illegal hotels, dwellings purchased expressly to be listed on Airbnb that "exacerbate New York City's affordable housing crisis and are bad for tenants" (Krueger, 2014). Landlords previously took advantage of ambiguities in New York's multiple dwelling law and administrative code to form these illegal hotels, evicting tenants and converting housing units in more than 300 buildings in New York City to transient housing while shrinking the pool of housing available to long-term tenants (Moynihan, 2010). Additionally, Senator Krueger expressed concern with safety standards in transient dwellings, citing that illegal hotels made possible by Airbnb bring in "a regular stream of relatively unvetted strangers coming into and out of residential buildings" with reports of "buildings burglarized and neighbors assaulted by strangers" (Krueger, 2014, p. 1).

In contrast to New York City, San Francisco has taken a comparatively supportive stance with Airbnb. Dubbed the "Airbnb Law," Ordinance No. 218-14 became effective in San Francisco on February 1, 2015, passing with two key provisions. The first allows for rentals of residential units for a maximum of 90 nights per calendar year while the owner is not present, and the second permits rentals of residential units for an unlimited number of nights per calendar year while the owner is present. Further provisions in the ordinance require all Airbnb hosts to register for a permit from the city planning department, pay San Francisco's 14% hotel occupancy tax, and carry liability insurance. Although only 700 out of over 5,000 San Francisco Airbnb properties have registered with the planning department, an upcoming revision to the law will consolidate the registration process and make it easier for authorities to discipline violators. In July 2015, Mayor Ed Lee announced the creation of the Office of Short Term Rental Administration and Enforcement, which will allow businesses to register online with the city and allow authorities to investigate violators more efficiently (Said, 2015). Additionally, in November 2015, Airbnb scored a victory when San Francisco voters struck down Measure F, a measure that would have capped rentals at 75 days a year, regardless of whether the owner is present or not (Romney, Lien, & Hamilton, 2015).

The debate over fair housing in San Francisco has remained contentious despite rulings in Airbnb's favor. While the ordinance makes San Francisco one of the first cities to legalize short-term rentals, it is not without opposition. In an opinion piece in the *San Francisco Chronicle*, Senator Dianne Feinstein openly voiced her displeasure with the "shortsighted" new law, warning that it would "destroy the integrity of zoning throughout San Francisco" and increase already high living costs (Feinstein, 2014, par. 2). Likewise, supporters of Measure F were focused on protecting the "soul and future of the city" from "class warfare," citing the need "to control what's happening" (Romney, Lien, & Hamilton, 2015). Similar pushback in other cities has prompted those cities to take more decisive action against short-term rentals than has San Francisco: Santa Monica, for instance, has unequivocally outlawed rentals of less than 30 days, outlawing an estimated 80% of the city's 1,700 short-term rentals (Logan, 2015).

A.3 Conclusion

Airbnb's regulatory fate remains very much undecided. While cities with a large Airbnb presence scramble to piece together effective legislation, the company would best be served by focusing its community outreach efforts on educating its users about relevant laws regarding Airbnb and by continuing its existing collaboration with regulators. If Airbnb users are aware of what constitutes legal and illegal Airbnb practices, they will be more likely to examine their own behavior and monitor that of others. On the other hand, Airbnb has demonstrated that it understands regulators' chief concerns of illegal hotels; as of September 2014, Airbnb has removed over 2,000 New York listings belonging to property managers who were abusing the site (Pomeranc, 2014). Furthermore, in May 2014, Airbnb and the New York State Attorney General issued a joint statement that confirmed Airbnb's compliance with subpoena requests for user data (Schneiderman, 2014). When Airbnb disagreed with the subpoena terms on the grounds of the data requests being too invasive both parties reached a new agreement in which Airbnb would provide anonymized user data to the Attorney General and reveal specific user identities upon request. This successful exchange is a microcosm of what Airbnb should strive for in dealing with regulatory hurdles. By working together with state and local governments in conjunction with an educated user base, Airbnb can advance its interests without antagonizing legal authorities.

B. Uber

B.1 Background

The taxi industry has long been a stalwart of bustling urban centers. Yellow cabs zooming through the streets are a common sight in metropolises across the world. Despite their apparent ubiquity, taxis are notoriously difficult to hail, relying on visual cues from passengers on the side of the street. Founded in 2009, Uber (originally called UberCab) has

harnessed the power of technological and collaborative platforms to provide quick and easy transportation to everyday commuters and travelers. Using a mobile app, passengers are able to remotely request a ride with the press of a button. An algorithm then matches the passenger to a nearby Uber driver, who then picks the passenger up at their specified GPS location. All payment is processed automatically through the app with a customer's pre-linked credit card, eliminating the cash transactions or manual credit card swipes often needed with traditional taxis. Uber's product line has grown considerably since the company was founded, and today caters to multiple market segments: requesting an "UberX" yields an average sedan, while an "UberBlack" or "UberLUX" promises a ride in a high-end luxury sedan for a premium.

Although Uber has marketed itself as an on-demand car service, its business model fits the mold of a collaborative economy company. Boasting service in 58 countries and 300 cities worldwide, Uber owns few to none of the actual vehicles used to provide its services (Uber, Inc., 2015). Instead, drivers work for Uber as independent contractors, setting their own hours and using their personal vehicles that meet Uber service standards. While many drivers do choose to drive full-time, Uber's operation relies heavily on the everyday drivers who work for the company in their spare time. So far the model has been working: Uber has already raised in excess of \$5 billion in debt and equity at a valuation of nearly \$51 billion, making it the second venture-backed company to reach such financial heights (Macmillan & Demos, 2015).

B.2 Regulatory Landscape

The argument against Uber is, at its heart, a financial one. The logic is simple: more rides with Uber means fewer rides with taxis and less income for cab drivers and fleet owners alike. A major point of Uber's opposition challenges the company's right to operate its on-demand car service without the licenses or permits that taxi companies are legally required to own. Such legal permits, called medallions, give taxi drivers and taxi fleet owners the right to operate their vehicles in the city of issuance, and are effectively the strongest barrier to entry in the taxi industry. In major cities such as New York, capping the number of taxis allowed on the road is a common regulatory tool, and has driven the price of medallions as high as \$1.3 million per unit (Hickman, 2015). Medallion prices, which reflect the value of running a taxi fleet, have felt the impact of Uber: the average price of New York medallions has suffered a 17% decline since a peak in 2013, with Chicago and Boston observing declines of 17% and 20%, respectively (Barro, 2014).

Unsurprisingly, the taxi industry has been a vocal leader in lobbying against Uber, pressuring local governments to enforce regulations that would limit Uber's service. Taxi drivers in Chicago, Atlanta, and New York, have publicly lobbied for bans on Uber, or at the very least the regulation of Uber as a taxi company (Harris, 2012; Wheatley, 2014;

Brustein, 2014). In some cases, taxi lobbyists have seen success: Uber has completely suspended service in Nevada, and faces or has faced lawsuits in cities such as Portland, and Los Angeles, all on the premise of its lack of proper permits (Fitzgerald, 2014; Owens, 2014; Rao, 2012). Looking abroad, the situation has been even tougher: Spain, Thailand, Germany, Vietnam, Amsterdam, and the Netherlands, among many others, have all banned Uber for operating without the necessary licenses (Uber State of Play, 2014). In New York City, however, Uber celebrated a small triumph when city officials decided to put a bill on hold that would have allowed Uber to add only 200 new drivers by the end of 2015, in contrast to the 10,000 it reportedly wants (Badger, 2015). San Francisco also welcomed Uber when the California Public Utilities Commission (CPUC) approved regulations around ridesharing services in September 2012, providing a legal framework for ridesharing operation (Ha, 2013).

Beyond concerns with taxi licenses, Uber has also come under fire regarding safety and insurance policies. In the wake of an alleged sexual assault involving an Uber driver and passenger, New Delhi's transport authority rejected Uber's application for a taxi license, citing Uber's failure to comply with a previous operational ban (Kalra, 2015). Uber's stance on servicing passengers with disabilities is also in question as a series of lawsuits accuse the company of discriminating against disabled passengers and violating the Americans with Disabilities Act (Weiczner, 2015).

B.3 Conclusion

Regulatory opposition to Uber is unique in its strength and size, and Uber's aggressive marketing and public relations tactics have clearly established the company's regulatory strategy. In one instance, when confronted with the eventually frozen NYC bill, Uber added a "DE BLASIO" section to its mobile app that, when selected, displayed no cars in operation, warning users about the potential consequences (Newcomer & Verhage, 2015). Uber has also been proactive in hiring specialized legal counsel, as demonstrated by its legal department growing from nonexistent to 70 employees over three years; some notable hires are David Plouffe, a former top Obama advisor, and Sabrina Ross, a former Apple Inc. privacy lawyer (Ruiz, 2015; Macmillan, Epstein, & Nicholas, 2014; Ruiz, 2015). With its now-vast legal network and its immense user base, Uber has fought vehemently with legislators on all regulatory fronts, experiencing both wins and losses (Weise, 2015). Moving forward, Uber needs to consider whether or not it can sustain such a confrontational approach, which puts it at risk of alienating communities.

C. Lending Club

C.1 Background

Counted among the largest financial technology companies, Lending Club has drastically changed the face of the marketplace for loans. Since 2007,

Lending Club has issued over \$13 billion in loans in the U.S., and has thus established itself as a dominant player in peer-to-peer (P2P) lending (Lending Club, 2015). Traditionally, loans are administered through large institutions such as banks or credit card unions, which often charge borrowers extremely high interest rates. Lending Club presents an opportunity for borrowers to bypass traditional lenders as well as a chance for investors to invest in the loans of their peers.

Initially started in 2006 as a Facebook application, Lending Club took off in popularity after raising its initial Series A round and went on to raise a valuation of \$3.8 billion. As a marketplace for personal loans, Lending Club uses algorithms to assess the risk associated with borrowers based on their provided financial history. Lending Club then assigns borrowers interest rates that can range from 5.99% to 32.99% depending on its risk assessment. Using Lending Club, borrowers can borrow up to \$35,000 from investors, who can fund partial or entire loans and profit from the interest paid. On December 11, 2014, Lending Club completed its initial public offering (IPO), making it one of the few collaborative economy IPOs and the first publicly traded P2P lending platform.

C.2 Regulatory Landscape

Lending Club is classified as a non-bank credit provider and is subject to the same federal statutes as banks, which include but are not limited to the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Gramm-Leach-Bliley Act, the Electronic Fund Transfer Act, the Bank Secrecy Act, and the Fair Debt Collection Practices Act. This set of laws regulates the entire consumer credit lifecycle and is under the jurisdiction of federal and state regulators. In addition, because P2P platforms often strategically partner with banks to originate consumer loans and gain access to more customers, the Consumer Financial Protection Bureau (CFPB) has regulatory authority over Lending Club and its partner banks in cases of unfair, deceptive, or abusive acts and practices (UDAAP) (Eiger & Mandell, 2015).

Aside from standard consumer credit regulations, Lending Club must also comply with Securities and Exchange Commission (SEC) regulations regarding the funding of its loans. While Lending Club and other lending platforms such as Prosper and Loanio initially viewed themselves as simple loan marketplaces free of securities regulation, a SEC analysis based on *Reves v. Ernst & Young* concluded that P2P investor notes were securities and were therefore required to be registered with the SEC (Eiger & Mandell, 2015). In April 2008, Lending Club announced on its blog that it had voluntarily entered a “quiet period” and halted the investment side of its service in order to register its notes with the SEC (Lending Club, 2008). Subsequently, in October 2008, Lending Club announced the successful completion of its \$600 million SEC registration and resumed normal operations (Lending Club, 2008).

C.3 Conclusion

As a publicly traded company, Lending Club can claim, to some degree, to have successfully overcome the regulatory obstacles that once threatened to derail its business. By reaching new heights as a business after complying with government regulation, Lending Club affirmed the value of a cooperative regulatory approach. Moreover, as SEC registration is an expensive, time-consuming process, Lending Club and Prosper, the only two lending platforms to have completed such a process, now enjoy an additional barrier to entry, contributing to the formation of an oligopoly-like lending industry. Nevertheless, Lending Club still faces additional challenges concerning its legality across state borders; differing state laws regarding security investments have limited Lending Club's full investment and trading services to 39 U.S. states, and have limited its borrowing services in every state except Idaho and Iowa (Lending Club, 2014).

Conclusion

The business models employed by collaborative platforms are novel and innovative, yet they clash with existing institutions in society that claim to be threatened by them. In observing the regulatory experiences of Airbnb, Uber, and Lending Club, it is evident that regulation is society's natural response to emerging companies in the collaborative economy and has become an unavoidable component of the collaborative economy's growth. There are two possibilities for the role of future regulation: the establishment of regulatory frameworks that work in tandem with collaborative platforms, or the deregulation of existing institutions.

Airbnb and Lending Club have already shown the possibility of regulatory action that is mutually beneficial. Open dialogues between governments and companies today can begin a positive history of cooperation that future startups can follow.

In cases like Uber, deregulation can serve as a tool to level the playing field. Collaborative platforms that disrupt industries have a technological edge that forces incumbents to play catch up. In addition, incumbents are limited by existing regulations that have not yet adapted to their newer competitors. By easing regulations on incumbents, governments can promote even regulatory circumstances for all parties.

Regardless of future regulatory outcomes, the very existence of these regulatory controversies proves that the collaborative economy has reached a new stage of maturity. Collaborative platforms will continue to flourish, and the inexorable march of technological innovation will continue to provide them the tools to alter societal norms.

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