Digital Economy

Technology and Trust: How the Sharing Economy is Changing Consumer Behavior

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- **The sharing economy has moved mainstream as technology has allowed people to overcome the trust gap**
- **Ride and accommodation sharing are the most mature areas, but other sectors are growing fast**
- **The banking industry should learn from and adapt to changing consumer behaviors**

Introduction

The sharing economy has grown tremendously over the past few years and is no longer just for the early adopters, but is starting to become an everyday feature of modern society. Currently, 44% of U.S. consumers are familiar with the sharing economy and 19% of consumers have engaged in a sharing economy transaction, and these numbers will keep growing.[1] This model is typically characterized by two parties entering a transaction that allows them to share the use of an asset or service in a mutually beneficial way. The difference between the sharing economy and the traditional rental economy is that the rental economy involves a firm owning an asset that is then rented out. In the modern version of the sharing economy, an app or service connects an owner of an asset that is used below capacity with someone who would like to use it. The basics of the sharing economy have always existed, as owners of underutilized assets such as a car, a power tool, or an empty guest room searched for those who desired the temporary use of such assets in their community via bulletin boards or newsletters. What has changed is the emergence of mobile software platforms that allow these two parties to easily come together whenever and wherever they wish. This significant reduction in searching and transactional frictions, as well as the flexibility to conduct a trade anytime and anywhere from a smartphone, has driven the sharing economy into the daily lives of many people, changing patterns of consumer behavior. The modern sharing economy allows the participants to have a unique experience that transcends that of a traditional commercial transaction This model is an apt example of the millennial ideals of breaking with the traditional way of doing things, being flexible, and embracing the advantages of digital and mobile technology. Therefore, it is worthwhile to understand the impact of this new model and its implications for the banking industry.

Sector Overview and Growth

The sharing industry as a whole had an estimated $15 billion in revenues last year, and is expected to continue to grow at an exponential pace.[2] Uber and Airbnb are the two highest profile companies in the sharing economy, and they are representative of the most developed areas of this movement: ride and accommodation sharing. These sectors have grown rapidly and are developed enough that they are now threatening the traditional business models of the taxi and hospitality industries.

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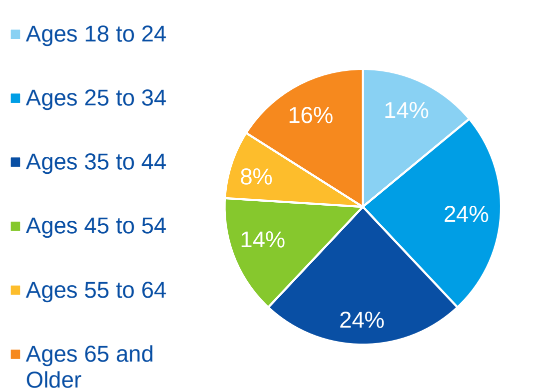
[1] Source: PWC
[2] Source: PWC

For example, seven years after its founding, Airbnb has expanded to over 190 countries and 34,000 cities with a catalog of over 1.5 million listings. This year they are expected to increase bookings to over 80 million by the end of 2015 from 37 million in 2014.[3] Airbnb's impressive performance in this metric is nearing that of industry leader, InterContinental Hotels Group, with 177 million bookings, and that of the website Expedia which had 150 million hotel bookings last year. Similarly, Uber has taken 55% of the paid car ride market away from taxis in the U.S. business travel market.[4] In addition, ride sharing apps have succeeded in not only taking market share away from taxis, but also in increasing overall demand for rides.[5]

However, the sharing economy does not just exist in transportation and accommodation; there are plenty of other areas that show promise, such as home goods sharing apps that set up a local network of users that wish to share their underutilized tools, such as a hammer or a ladder, for a fee. Other platforms connect people who are willing and able to do various household chores with those who lack the time and/or ability to carry out these tasks themselves.

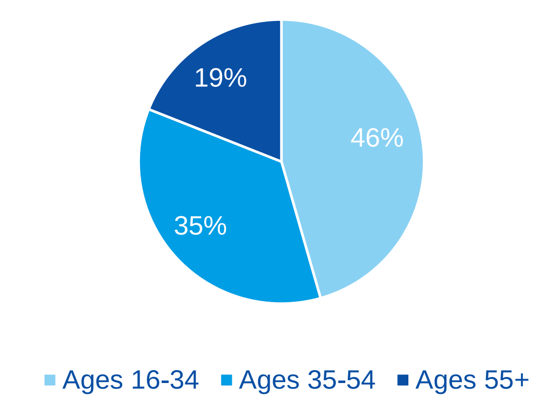
One reason that these companies have been able to grow so rapidly is that their business model, based on the use of specialized software, allows them to scale up, gain recognition, and generate strong network effects without having to invest in costly underlying assets, such as cars or buildings. Moreover, these companies focus on the unique experience of the transaction versus solely focusing on the price. Their principles when it comes to the design of the transactional experience emphasize flexibility, ease of use, and transparency. This has allowed them to continue growing even as the economy has improved and consumers are able to afford more traditional options.

Chart 1
U.S. Providers in the Sharing Economy by Age



Source: PWC

Chart 2
U.S. Users in the Sharing Economy by Age



Source: Havas

Software and mobile technology's ability to make integration of the sharing economy into a person's life seamless has allowed the sector to grow rapidly and gain widespread use. With smartphone and GPS technology, users are able to use an application's software to have a flexible and on demand interaction with

[3] Source: Reuters
[4] Source: Certify
[5] Source: Portland Bureau of Transportation

someone else. What is even more significant is the ability of the modern sharing economy to get users to overcome any trust gap between them and a stranger by establishing trust in the connection process itself. Whereas someone traveling in an unfamiliar city would have once opted to find lodging in a well-known hotel brand, they have now become comfortable in pulling out their smartphone and selecting a stranger's guest room to stay in for the night. From the other side of the transaction, people have become willing to rent out their guest room or even their entire house to strangers for a fee. The increasing amount of trust consumers have in the reviews they read online and in the community-like atmosphere that these sharing apps create is very important to consider when looking at consumer behavior going forward. The impact technology has had is to not only reduce search and transaction frictions, but also to help bridge that trust gap between users.

Economic Impact

Providers: The ability to monetize something that is already owned has fueled the growth of providers in the sharing economy, but providers do not just include those seeking to utilize an underused asset part-time. For example, listings on accommodation-sharing platforms are becoming increasingly populated by full-time commercial landlords and investors who are able to emphasize the uniqueness of their properties and earn multiples of what they could have earned renting their rooms to full-time tenants, while avoiding the regulations and costs that come with being a hotel. In New York City, an investigation by the State Office of the Attorney General showed that commercial operators accepted 36% of bookings and earned 37% of the total revenue on Airbnb, while only making up 6% of the total number of providers.[6] In L.A., a similar investigation showed that while only 6% of providers were classified as being commercial operators, they generated over 35% of the total Airbnb revenue in the city.[7]

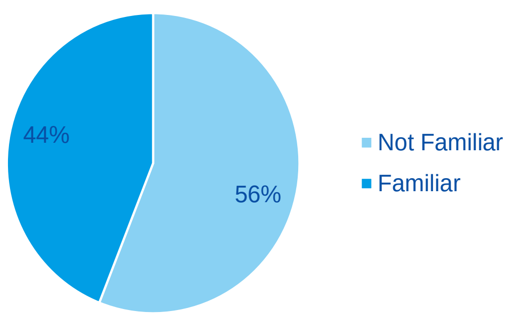
Regulation: This migration of commercial operators to the sharing economy in order to engage in pure regulatory arbitrage has already started to prompt action from regulators and authorities. For example, New York City has stepped up enforcement of a 2010 law that prohibits any apartment from being rented for fewer than 30 days unless the host is present. The city is also considering increasing the maximum fine from $25,000 to $50,000. Regulation looks to be a significant risk to the continued growth of the sharing economy as authorities seek to understand and properly regulate this new model of business. One side effect may be that sharing economy services have to bring their providers on as employees, rather than as third party contractors. This would bring increased costs to the model.

Competition: As the sharing economy has evolved from a cheaper way to take a taxi or rent a room to a unique experience for the user, it has also evolved from a way to make some extra money on the side to a full-time job for some providers. However, as more people provide services in the sharing economy and competition increases, the income they may be able to earn will decline. In Houston, the fare an Uber driver could earn dropped from $2.50 a mile to the current $1.10 a mile, though surge pricing during periods of high demand can take this much higher.[8] The barriers to entry are also low in the sharing economy, and rival firms and services can easily come into a market, undermining profitability. In addition, traditional industry players are not standing still while the sharing economy continues to grow. The hotel booking website Expedia recently bought vacation rental site HomeAway, an Airbnb competitor, for $3.9 billion to establish a foothold in the sharing economy. Marriot International has partnered with office space sharing firm LiquidSpace to offer their unused conference and meeting spaces to those who may need short term or last minute office space for a team meeting or a

[6] Source: New York State Office of the Attorney General
[7] Source: Los Angeles Alliance for a New Economy
[8] Source: Al Jazeera America

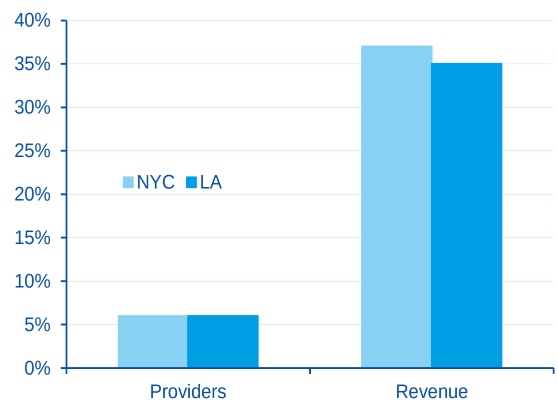
conference. Traditional industries may start to face pricing pressures as a greater number of sharing economy providers enter the market and push prices down during periods of high demand, therefore stifling the ability of the more price-inelastic providers to change prices easily in response to demand.

Chart 3
U.S. Population Familiar with Sharing Economy



Source: PWC

Chart 4
% of Total Airbnb Providers and Revenue from Commercial Operators in LA and NYC



Source: NY Office of the State Attorney General, LAANE

Consumer Behavior: While traditional industries learn from and adapt to compete with the sharing economy, the pattern of consumer behavior itself may be changing as the necessity of purchasing items such as cars, housing, and other consumer goods is reevaluated. If by participating in the sharing economy, consumers can get access on demand at a reasonable price, then purchasing an asset such as a car that wouldn't be used at capacity will start to become less attractive. Like the consumer switch to streaming and purchasing music online has squeezed music labels' revenue, a shift in the way consumers look at buying a car versus using one on demand could hurt future car sales.

On the other hand, the ability to earn income off an asset purchase could entice consumers to buy an asset that they would not have otherwise purchased. The incentive of extra income from renting out a spare room on the weekends could lead to greater number of consumers purchasing a larger house or renting a bigger apartment. The opportunity to share assets such as power tools or home improvement goods could also lead potential providers to shift their purchases towards more quality assets, as the ability to attract users in the sharing economy will in part depend on the quality of the asset to be shared.

How these effects interact will have significant impact on the profitability and growth of industries such as housing, automobiles, and consumer goods. These industries typically require significant capital expenditure and investment on physical assets such as factories and machines. Widespread effects would result if consumers choose to decrease spending on physical assets and utilize the sharing economy instead. This trend could cause a long term decline in consumer spending and the amount of capital investment by businesses, which would put downward pressure on GDP growth and inflation.

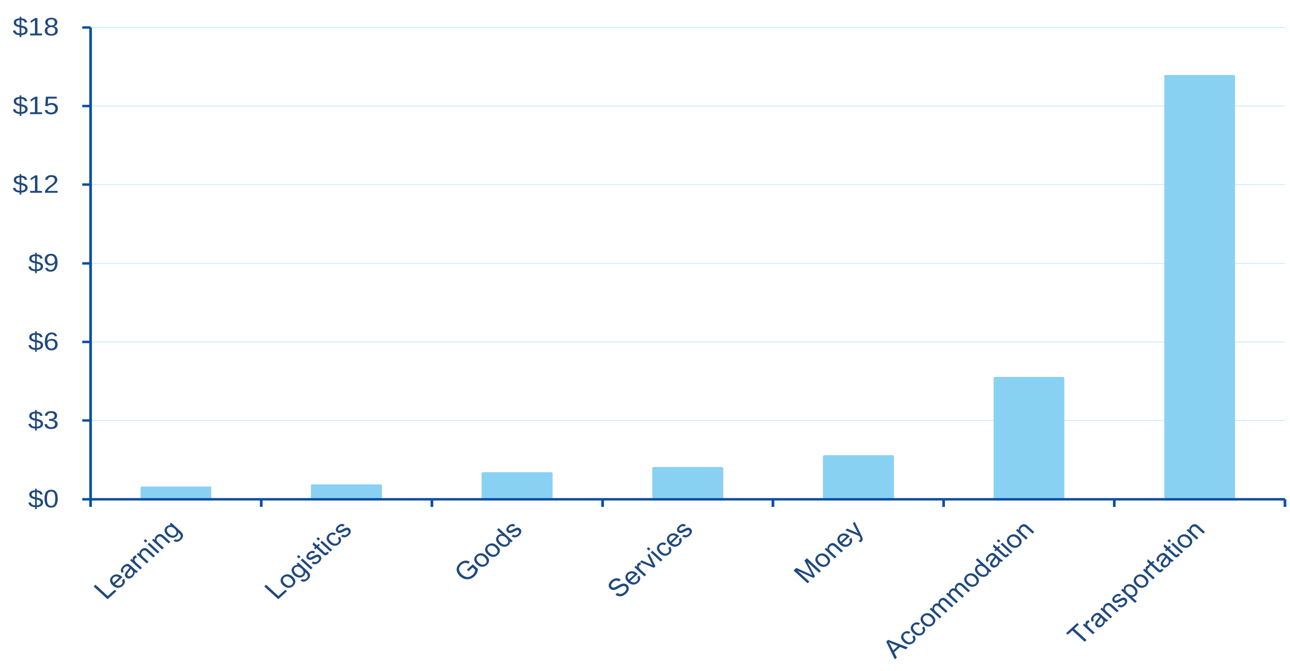
However, in the short-run the sharing economy may result in a transfer of wealth between users and other industries. The ability of consumers to monetize assets they already owned on a flexible schedule could increase their earning power at the expense of workers in the disrupted industries. This explains why there has been fierce opposition from incumbents.

Implications for Banking

There are threads and opportunities for banking in the sharing economy because the traditional pattern of consumer behavior concerning asset purchases and use is changing. A car is no longer just a means of transportation, but can be used as a source of income in an owner's spare time, just as one can rent out an unused room a few nights a month or lend out a power drill. These factors mean that banks should look at adjusting their traditional underwriting models to account for the fact that a consumer applying for an auto loan or a mortgage can earn additional income from the asset. In fact, there are already banks that have underwritten auto loans and leases for those who wish to drive for Uber based on the borrower's additional stream of income. Uber also provides a direct way for banks to receive payments on these loans, as the money can be deducted straight from the driver's weekly earnings in return for special financing terms from the bank.

Threats: A prime example of the way that banks can be threatened by the sharing economy is in peer-to-peer lending. The money related space of the sharing economy has received the 3rd most venture capital funding after transportation and accommodation., By directly connecting borrowers with savers through an online platform, such as Lending Club or Prosper, peer-to-peer lending disrupts the banking industry's main business of transforming an unused asset—savings—into loans by using technology and online data to make quick credit decisions. Borrowers are attracted to this model due to the ease of use of the platform and the ability to quickly gain access to a loan. Investors are attracted to the increased returns they can get, though these investments are not insured like those in a bank account.

Chart 5
Sharing Economy Funding by Sector, billions



Source: Crowd Company Council

Opportunities: An example of how the banking industry can participate in the sharing economy involves using a physical asset that banks have in abundance that is currently underutilized—their branches. Banks could share their space with those who may need room for meetings, collaborations or just a place to work. Much in the same way coffee chains such as Starbucks have become more than just a place to grab a coffee and go, bank branches could become areas of collaboration. Banks could even create spaces that help nurture startups and small businesses, almost like an incubator. Just as many of those who study or work at Starbucks will eventually purchase a coffee or a pastry, banks could win over future business and generate goodwill. This will help banks create an image and atmosphere that is personalized, community-focused, and more in line with consumer's preferences, in contrast to representing a purely impersonal commercial transaction.

Banks could also partner with firms in the sharing economy space in order to connect with customers aged 18-34, who make up the largest proportion of the population in the U.S. that participate in the sharing economy. It is this segment that has increasingly shied away from big national and regional banks. According to a report by Accenture, large national and regional banks lost 16% of their 18-34 year old clients last year.[9] For a bank to grow and be successful, it needs to attract and maintain this generation of savers and borrowers while navigating an emerging field of financial technology startups that do not carry a tarnished reputation from the financial crisis in the minds of many consumers. Furthermore, banks should not just partner with sharing economy firms to reach clients; they should also learn from them in the way that they interact and create a client experience that builds a deep relationship that attracts and retains their customers. The flexibility, transparency, individualization and ease of use that characterize the sharing economy should guide banks as they continue to improve the services they offer their clients.

Bottom Line

The sharing economy has always existed in some form, but a confluence of technologies has significantly reduced traditionally high search and transactional costs and allowed this model to grow rapidly into many industries. Combined with the increasing trust consumers place in online systems such as peer reviews, ratings, and social media verification, the sharing economy has entered the mainstream. The way consumers purchase and use assets will change as they interact with the sharing economy and this will affect their spending habits and needs. This shift can already be seen in the automobile and hospitality industries, but other industries should not be complacent, including the banking industry. Banks can learn and benefit from the sharing economy. Embracing some of its principles such as flexibility, transparency, technology and trust will allow banks to engage with a new generation of clients who have incorporated the sharing economy into their lives.

[9] Source: Accenture

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