Good to be Bad:
Should we be Worried by the Sharing Economy?

Dominic Chalmers
University of Glasgow
United Kingdom

Russell Matthews
University of Strathclyde
United Kingdom

We develop the notion of a legitimacy tipping point to demonstrate how informal economy practices are being utilised by innovative sharing economy ventures to gain a competitive advantage that is subsequently leveraged to reconfigure formal institutional arrangements. Companies who are able to scale rapidly can afford to contravene regulations, provided they have public support. When they reach a certain size, in terms of investment and customer numbers, regulators are forced into a reactive position where novel business models are legitimised. This raises an important question for regulators and entrepreneurs as to whether subverting business regulation is being viewed as a viable source of competitive advantage by scaling firms.

Introduction

Since the launch of Napster in 1999, new economic models based on peer-to-peer (P2P) exchange have had an increasingly disruptive impact on the economy. Alternately termed the sharing economy (Martin, Upham et al. 2015), the access economy (Belk 2014), the collaborative economy (Stokes, Clarence et al. 2014) and the peer economy (Fraiberger and Sundararajan 2015), variations of these models, which employ digital multisided platforms to connect buyers and sellers (Gandia and Parmentier 2017), underpin many of today's fastest growing entrepreneurial ventures. Notable examples include the peer-based taxi service Uber and AirBnb, a service that allows users to rent out spare accommodation. Despite forming in 2009 and 2008 respectively, Uber has a 2018 valuation of up to $100bn (Ram, Massoudi et al. 2018) and AirBnb is valued at $31bn (Carson 2018). What is remarkable about both companies is that, despite significant market capitalisation, they are or have been considered illegitimate by many formal institutional actors (Hellier 2015), with conflicting attitudes to the these new distributed business models existing even within different levels of the same government. In the UK for example, the national government has been broadly supportive of the 'sharing economy' (Wosskow 2014), yet the conservative former mayor of London, Boris Johnson, struck a more cautious note, observing "law is being systematically broken – or at least circumvented – by the use of the Uber app" (Johnson 2015 1). Such variation in opinion, even within the same political party, characterises the institutional uncertainty surrounding these emerging practices.

In this article we highlight that the historically unprecedented scope for a start-up to scale globally over a short time period (Ramadan, Lochhead et al. 2015), has increased the 'pull' for technology entrepreneurs to seek competitive advantage through informal economy practices that are considered illegitimate by formal institutional actors such as regulators or legislators. By operating partly outside, or at the boundaries of formal institutional arrangements (Gobble 2015), these entrepreneurial ventures gain rapid market share through what competitors consider unfair or potentially illegal methods (e.g. sidestepping labour laws or avoiding taxation). However, once a ‘tipping point’ is reached in terms of user volume, market penetration and external investment, it becomes untenable for existing regulatory frameworks to contain the scale of transgression. Legislators are then pressured into a reactive position whereby they adapt or clarify laws to accommodate the new practices, often at the expense of incumbents, leading to the new business models being integrated into, and hence reconfiguring, the formal economy.

Foundations of the Sharing Economy

The ‘sharing economy” is emerging as the most popular term to capture the broad range of apparently inter-related economic practices that encompass the collaborative economy, the access economy, the gift economy, the gig economy and various other associated terms (Botsman 2013, Stokes, Clarence et al. 2014, Botsman 2015, Acquier, Daudigeos et al. 2017). These emerging models of exchange and consumption are underpinned by falling cost and increasing ubiquity of the digital technologies (Hagel, Brown et al. 2013) that enable direct market interactions between distributed economic actors. Low-cost digital communication networks have spurred the development of powerful new online platforms that link ‘peers’ with other economic actors, including fellow peers and professional businesses. Collaborative platforms enable users to circumvent incumbent industry providers and intermediaries whose operations generally have higher transaction costs and offer less value (Chase 2015). These exchanges constitute a form of collaborative consumption, which (Belk 2014 1597) defines as “people coordinating the acquisition and distribution of a resource for a fee or other compensation. By including other compensation, the definition also encompasses bartering, trading, and swapping, which involve giving and receiving non-monetary compensation.”

Others scholars have conceptualised these more active economic agents as prosumers, a neologism that describes activity where consumption and production are combined (Toffler 1980, Ritzer, Dean et al. 2012).

Although concepts such as the sharing economy have only gained in popularity relatively recently, collaborative consumption (Felson and Spaeth 1978) and other cooperative forms of exchange have existed for some time. From farmers sharing or lending harvesting resources (Gröger 1981, Wenzel 1995), to vacation timeshares (Warnken and Guilding 2009) and Local Exchange Trading Schemes (LETS) (North 1999, Williams, Aldridge et al. 2001), in each case, economic actors have demonstrated the efficacy and often emancipatory benefits of alternative systems of shared, temporary or access-based consumption.

This more recent renaissance in 'sharing' can be attributed to a diverse range of factors. Technological innovations such as digital currencies and the Blockchain (Cohen 2016) have made decentralised consumption easier to coordinate. Meanwhile, high levels of household indebtedness (Barba and Pivetti 2009) and growing disaffection with the current neo-liberal economic paradigm (Streeck 2016), are pushing individuals towards alternative forms of consumerism. Perhaps most critically, information technology has undermined traditional economic models by decoupling the relationship between price and production. As those writing on the topic of informational capitalism have argued, the internet now enables the production and exchange of goods at (next to) zero-marginal cost (Rifkin 2014, Mason 2015). This goes some way to explaining why economic actors are increasingly engaging in the pro-social production and exchange of goods through platforms such as Wikipedia, and open-source software communities such as Linux (Bruns 2008), in doing so, bypassing established commercial providers in the process. Rifkin (2014) argues that this move towards a 'collaborative commons' indicates a paradigm shift away from traditional forms of market capitalism.

The Informal Economy, Sharing Economy and Entrepreneurial Legitimacy

Scholars have recently highlighted links between sharing economy and informal economy practices (Ahsan 2018). The informal economy encompasses "the set of illegal yet legitimate (to some large groups) activities through which actors recognize and exploit opportunities" (Webb, Tihanyi et al. 2009 492). This may involve products or services that are considered legal (such as a new house), yet that may have been produced through illegitimate means (e.g. untaxed and undocumented migrant labourers or the illegal disposal of building waste). While it is acknowledged that informal economy activities can provide entrepreneurial opportunities that lead to desirable products and services (Prahalad 2009), they can also "undermine and potentially ''crowd-out'' regular, productive entrepreneurship" (Mathias, Lux et al. 2014: 253). Established ventures typically avoid engaging in illegal practices as the financial costs imposed by formal institutions and the reputational damage if caught are material to the business. Rules and regulations are thus designed to incentivise firms to avoid engaging in illicit unproductive activity and to eschew socially destructive behaviours (North 1990). As Barnes and Mattsson (2016) note however, the recent emergence of disruptive platform businesses, call into question the delicate relationship between new technologies, entrepreneurship and the efficacy of formal institutions in shaping productive forms of entrepreneurial behaviour.

Incumbent businesses, particularly within low innovation, highly regulated industries, are increasingly finding consumers prepared to accept regulatory transgressions from new entrants if goods or services have been provided more efficiently or at cheaper cost. The increased utilisation of informal economy practices therefore poses a significant challenge to businesses that are 'playing by the rules' and operating firmly within formal institutional boundaries.

In developing this argument, we extend Webb, Bruton et al. (2013) and Webb et al's (2009) theory of the informal economy to explain how illegitimate means are increasingly being used as a growth strategy for achieving market share and venture financing, and how this institutional power is subsequently leveraged by new entrants to construct favourable formal institutional frameworks.

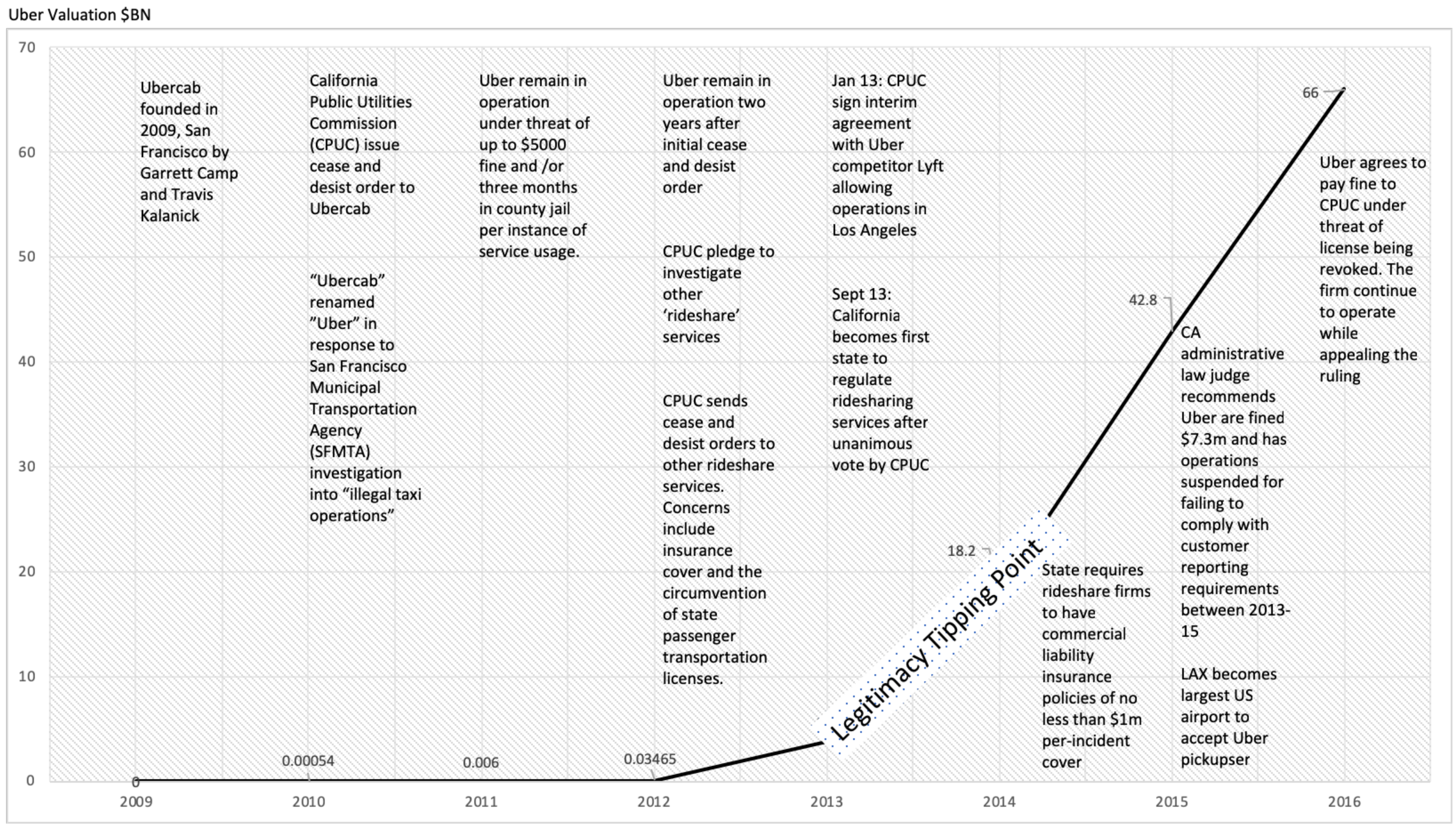
Methodology

To illustrate our arguments, we discuss the case of Uber's initial entry into the Californian market between 2010-2016. Originally formed in San Francisco in late 2009, Uber utilises an innovative app-based platform to connect drivers and passengers in a 'flexibly coordinated taxi service" (Heylighen 2015 77). As of 2017, the firm had grown to operate in over 600 cities within 65 countries (https://www.uber.com/en-GB/newsroom/company-info/). To date, the distributed exchanges facilitated by Uber have contravened an assortment of rules and regulations relating to the private hire industry in various jurisdictions (Uzunca, Rigtering et al. 2018). However, given these rules were not designed to govern P2P technology specifically, digital platforms such as Uber have been interpreting laws in such a way as to legitimise their business model.

By examining the firm's initial beachhead market penetration strategy, we depict the early stage emergence of institutional strategies employed both by the firm and by relevant institutional actors. Mirroring other historical cases of legitimation strategies (e.g. Navis and Glynn 2010) our study builds on a range of archival sources. Our data sources correspond to the actions and responses of three primary stakeholder groups: regulators, the firm (Uber), and incumbents (the taxi industry). For each group, we compiled a body of evidence including regulatory measures, legislative decisions, industry association agreements, company archives and press releases, and financial performance data. All evidence sources were derived from official reporting by relevant bodies, including the California Public Utilities Commission, the San Francisco Municipal Transport Agency, the United States District Courts for Northern and Southern California, the Taxi Worker's Alliance (for various Californian cities), as well as by Uber and rival firm Lyft.

We used our archival data to develop a timeline of critical incidents detailing the exchanges between key stakeholders. Evidence for critical incidents was triangulated through the use of multiple sources, with each providing a different stakeholder perspective on the same event. Analyzing strategic actions, responses, and challenges at each incident, and contextualizing these within Uber's broader market penetration performance, we develop an understanding of how a disruptive new market entrant navigates the regulatory landscape by employing legally ambiguous growth strategies. Figure 1 presents a timeline of key milestones in the development of the Uber service in California. It demonstrates that Uber's legitimacy tipping point occurred in 2013, in parallel with a rapidly increasing market capitalisation and ridership.

Figure 1: A Timeline of Uber's Legitimacy Transformation (source: the authors).

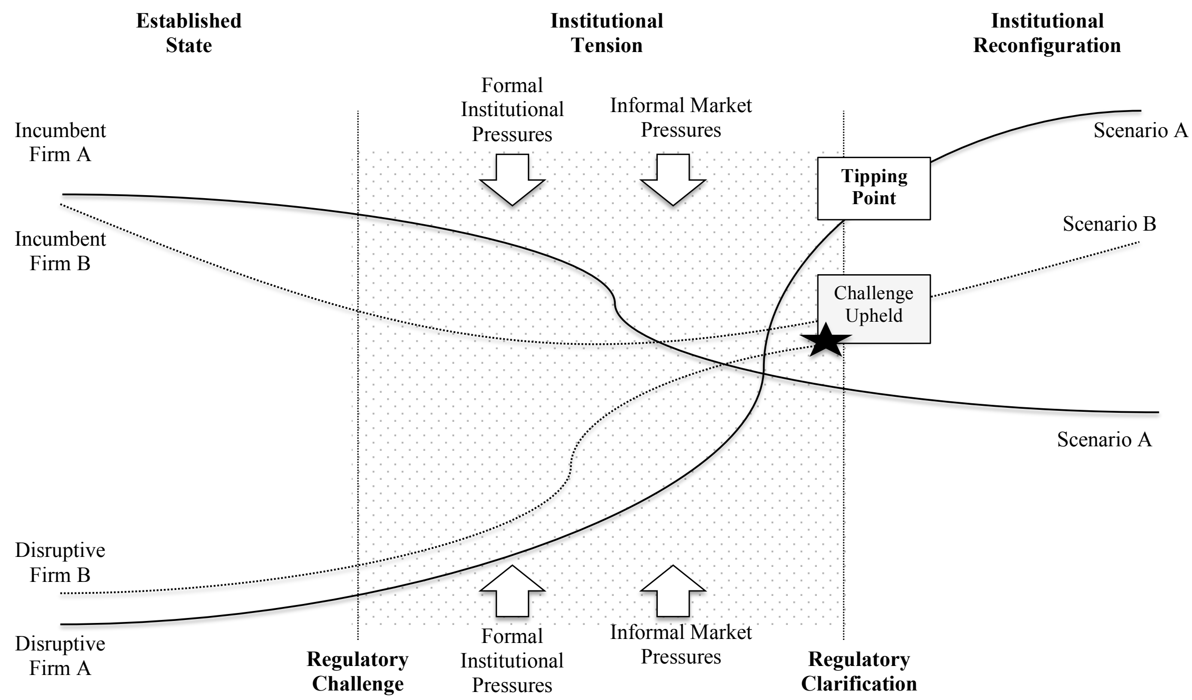


How Rapid Scaling Can Force Formal Legitimisation of Informal Economy Practices

As our chart illustrates, Uber spent much of the time during their formative years operating in violation of various laws. These laws and regulations had been designed for transportation firms who had modest growth potential and limited resources, and were mostly effective for this type of firm. However, by 2012, Uber had generated nearly $62 million in investment, and $5000 potential fines were relatively inconsequential for the firm. In 2014, the company completed 140 million journeys globally, and by this stage, regulators had been forced to adapt to the new technology by sanctioning ridesharing in some cities, based on public pressure. At the same time, Uber began engaging in lobbying activity, attempting to use revenue and investment to favourably reshape laws to accommodate sharing economy practices (Uber's lobbying spend reached $1.36m in 2016, (Centre for Responsive Politics 2017). Additionally, the company used their resources to encourage customers to lobby lawmakers on the companies behalf to enact advantageous regulatory change (Uzunca, Rigtering et al. 2018). The key transformation phase of this legitimation process occurred between 2013 and 2014, where the valuation of the company rose significantly and the company capitalised on network effects to drive user growth on both sides of the platform.

Beyond the case of Uber, a further fast-growing sharing platform, AirBnb, have further demonstrated that speed and scale are key dimensions in forcing institutional change. The P2P service has introduced a range of new options for travellers who can stay in quirky and often cheap accommodation (Guttentag 2015). User satisfaction with both sides of the platform is high and many travellers now substitute a traditional hotel stay for an AirBnb rental. Empirical evidence from Austin, Texas, for example, suggests that AirBnb has shrunk revenue for 'vulnerable hotels' by 8-10 percent over 5 years (Zervas, Proserpio et al. 2014), confirming this P2P model as a threat to the viability of some established hotel operators. Despite scaling from 50,000 listings in 2010 (Caulfield 2010) to 300,000 listings in 2013 (Crook 2013), a report by the New York attorney general claims that 72 percent of the 25,532 listings in New York City are illegal[1] (Schneiderman 2014). A spokesman for New York attorney general Eric T. Schneiderman, confirms that "Airbnb continues to show a blatant disregard for New York laws designed to protect the rights of tenants and prevent the proliferation of illegal hotels" (Bromwich 2016: 1). Yet, as with the case of Uber and Lyft, authorities in cities such as San Francisco have 'legalised' the industry after initially opposing it,

Figure 2: A Tipping Point Theory of Institutional Legitimacy Transformation



Scenario A: Disruptive firm reaches tipping point and forces institutional reconfiguration. Incumbent firms lose notable market share
Scenario B: Disruptive firm fails to reach tipping point. Regulatory barriers persist. Incumbent firms recover market share

[1] AirBnb claimed the figure was nearer 55 percent (Fermino. 2015), and released data to support this, however it was later claimed that the company purged illegal rentals from the site just before the data was opened to the public to present the statistics in a more favourable light (Kasperkevic, 2016)

largely acknowledging that policing the estimated 5249 – 6113 illegal listings (in San Francisco between November 2013 and February 2015) was unrealistic, and that formalising the practice could not only increase tax revenues but also establish some necessary restrictions on how the industry functions (Quinton 2015). A generalized model of legitimacy transformation is illustrated in Figure 2, below.

Thus far, evidence suggests that the entrance of new sharing economy actors does not operate on a zero-sum-game basis. As scenario A proposes, incumbent ventures will likely experience a drop in customers, yet this may not always correspond with the growth of the new entrant. There are suggestions that the novel technology and typically lower transaction costs, bring new consumers into established markets, and hence the overall industry size may increase (Fraiberger and Sundararajan 2015). Evidence of this can be found in London, where the volume of private hire registrations has grew 25.9 percent in 2015 compared to 2013 (Department for Transport 2015), without a commensurate drop in the number of Black Hackney Taxis, suggesting users are switching from other forms of public transport such as bus and rail to Uber and other P2P services.

Good to be bad? Formal Institutional Illegitimacy as an Emerging Strategy for Fast-growing Start-ups

The success of novel P2P business models in challenging formal institutional arrangements, represents a significant expansion of the informal economy research agenda outlined by Webb, Ireland et al. (2014). As further examples emerge of mainstream start-ups achieving market share and institutional power through 'bad behaviour' - only to then reach a tipping point where formal institutional actors are forced to reach a typically asymmetrical compromise - then the institutional effectiveness of broader marketplace regulations, and the speed at which they can adapt to new technologies, is increasingly called into question (North 1990). Further research is required to explore the dynamics of this 'tipping point', and the often hidden decision-making processes that underpin shifts in institutional arrangements, and social process behind technology legitimation more generally (e.g. Hall, Matos et al. 2014).

We suggest a future research agenda could examine the factors that persuade formal institutional actors to accede to pressures exerted by sharing economy entrants at the expense of more entrenched institutions such as trade unions, industry associations and stakeholder groups who seek to preserve and uphold the status quo. For some, such as the former UK Minister of State for Business, Enterprise and Energy, Mathew Hancock MP, it is apparently an issue of innovation, free markets and the process of creative destruction (Wosskow 2014). In other cases, political self-interest likely comes into play; it is understandably challenging, in a system of short-term 4- or 5-year election cycles, to enforce a ban on something that has both significant popular legitimacy and technological sophistication, despite the potential longer-term societal costs (Mathias, Lux et al. 2014) associated with normalising informal practices such as casualised labour (King 2014) and a diminished concern for environmental sustainability (Martin 2016).

Amidst this institutional uncertainty, innovators that can rapidly scale a business model may, for now, consider formal institutional illegitimacy a rational strategy where the benefits of transgression outweigh the financial and reputational costs[2]. As our proposed model demonstrates however, such a strategy is fully contingent on the new entrant developing sufficient informal institutional legitimacy to carry the venture past

[2] Uber's threat of a relatively small $20,000 fine for breaking industry regulations in California (Bishop, 2012) demonstrates how institutional arrangements are not designed to address rapidly scaling tech businesses that have multi-million dollar venture capital investment.

a tipping point where formal institutions cannot contain the new mode of exchange through existing enforcement mechanisms. In sum, from the self-interested perspective of the entrepreneur, it may ultimately be *good to be bad*.

Conclusions

The success of recent 'sharing economy' businesses such as Uber would appear to call into question theoretical claims that "as people come to be better educated, enjoy a higher level of social security and earn more income, they are less inclined to engage in the informal economy (Thai and Turkina 2014 491). Fortune Magazine's Unicorn List (Fortune Magazine 2016) for example, indexes multiple highly capitalised organisations that are engaged in ambiguous and contested practices (such as Uber, AirBnb, Lyft and FanDuel[3]), suggesting that it is precisely those better-educated, technologically sophisticated and wealthier middle class citizens that are increasingly engaging in both entrepreneurship and consumption in the informal economy.

The high-profile cases outlined in this article, serve as a warning to businesses and innovators who 'play by the rules' and for the policymakers who create and enforce the formal institutional arrangements that seek to foster productive entrepreneurship. In this article we propose a tipping point theory of entrepreneurial legitimacy where sufficiently rapid growth of a new venture engaged in illegitimate behaviour, can coerce formal institutions to adapt to these new practices rather than reject them. For some businesses therefore we conclude, yes, it is time to be worried by the rapid diffusion of sharing economy models.

[3] FanDuel is accused of breaking gambling laws in New York State by facilitating a 'fantasy league'

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Biographies

Dominic is a senior lecturer at the Adam Smith Business School at the University of Glasgow. His current research examines emerging collaborative and decentralised business models.

Russell is a lecturer at the University of Strathclyde Business School. He has a research interest in entrepreneurship and selling, high-growth firms and opportunity theory.

Corresponding author, Dominic Chalmers T: 0141 330 7317
Email: dominic.chalmers@glasgow.ac.uk

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